IMMEDIATE ATTENTION

SM/06/193

June 13, 2006

To: Members of the Executive Board

From: The Secretary

Subject: **Spain—Publication of Financial Sector Assessment Program—Detailed Assessment of Observance of the IAIS Insurance Core Principles**

Attached for the **information** of the Executive Directors is the detailed assessment of the observance of the IAIS insurance core principles for Spain in connection with the Financial Sector Assessment Program. The FSAP detailed assessment provides more detail and background to the Financial System Stability Assessment for Spain, which was circulated as SM/06/175 (5/23/06).

It is intended that this detailed assessment be published on the Fund's external website as requested by the authorities of Spain and approved by management.

Questions may be referred to Mr. Baliño (ext. 38551) and Ms. P. Brenner (ext. 38500) in MFD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

SPAIN

DETAILED ASSESSMENT OF OBSERVANCE OF THE IAIS INSURANCE CORE PRINCIPLES

MAY 2006

INTERNATIONAL MONETARY FUND
Monetary and Financial Systems Department

Contents

GLOSSARY

AGROSEGUROS	Spanish Association of Insurers for Combined Crop Insurance
AML	Anti-Money Laundering
BE	Bank of Spain
CCS	Insurance Compensation Consortium
CEIOPS	Committee of European Insurance and Occupational Fund Supervisors
CFT	Combating the Financing of Terrorism
CGCMST	General Council of Insurance Intermediaries
CNMV	Securities Market National Commission
DGSFP	General Directorate of Insurance and Pension Funds
EEA	European Economic Area
EMU	European Monetary Union
EU	European Union
FAFT	Financial Action Task Force
FIU	Financial Intelligence Unit (*Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales*)
FSAP	Financial Sector Assessment Program
IAE	Spanish Institute of Actuaries
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICAC	Accounting and Auditing Institute
ICEA	Insurance Entities Cooperative Research
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
CAC	Actuaries Association of Cataluña
LCS	Insurance Contract Law
LMSP	Private Insurance Intermediation Law
LOSSP	Private Insurance Organization and Supervision Law
ME	Ministry of Economy and Finance
MFD	Monetary and Financial Systems Department of the IMF
ML	Money Laundering
MoU	Memorandum of Understanding
OFESAUTO	Spanish Office of Automobile Insurers
ROSSP	Private Insurance Organization and Supervision Code
SEE	State Secretary of Economy
TIREA	Information Technologies and Networks for Insurers
UNESPA	Insurance and Reinsurance Spanish Entities Union

I. OBSERVANCE OF THE IAIS INSURANCE CORE PRINCIPLES

A. General

1. This is an assessment of the observance of the Insurance Core Principles (ICP) of the International Association of Insurance Supervisors (IAIS) in Spain[1]. The assessment was based on the Insurance Core Principles and Methodology of the IAIS, dated October 2003.

B. Information and Methodology Used for the Assessment

2. The assessment of observance of the ICP took into account the review of the following aspects: (a) self-assessment prepared by the *Dirección General de Seguros y Fondos de Pensiones* (General Directorate of Insurance and Pension Funds, DGSFP) based on the new version of the IAIS Insurance Core Principles and Methodology; (b) the *Comentarios a la Autovaloración de la Dirección General de Seguros y Fondos de Pensiones sobre los "Insurance Core Principles" de la IAIS* (Comments to the Self Assessment of the General Directorate of Insurance and Pension Funds on the IAIS Insurance Core Principles); (c) *Ley de Ordenación y Supervisión de los Seguros Privados* (Private Insurance Organization and Supervision Law, LOSSP); (d) *Reglamento de Ordenación y Supervisión de los Seguros Privados* (Private Insurance Organization and Supervision Code, ROSSP); (e) *Ley de Mediación de los Seguros Privados* (Private Insurance Intermediation Law, LMSP); (f) *Ley de Contrato de Seguro* (Insurance Contract Law, LCS); and (g) relevant secondary regulations (*Real Decreto*, *Órdenes Ministeriales*, *Consultas*, *Criterios* and *Instrucciones*) on the insurance activity issued by the Ministers Council (*Consejo de Ministros*), Ministry of Economy and Finance (ME) and the DGSFP.

3. From June 22 to July 1, 2005, several meetings were held with officers of the ME and the DGSFP. The mission also met representatives from the *Unión Española de Entidades Aseguradoras y Reaseguradoras* (Insurance and Reinsurance Spanish Entities Union, UNESPA), the *Consorcio de Compensación de Seguros* (Insurance Compensation Consortium, CCS), *Investigación Cooperativa de Entidades Aseguradoras* (Insurance Entities Cooperative Research, ICEA), and private insurance companies.

4. The mission also consulted several Annual Reports of the DGSFP, information published in its webpage and in its Intranet system. Additionally, the DGSFP officers provided information notes and presentations on several regulatory and supervisory issues. The mission thanks the Spanish authorities for their cooperation and excellent arrangements for the assessment.

[1] This assessment was carried out by Manuel Aguilera-Verduzco (President of the *Comisión Nacional de Seguros y Fianzas*, Mexico). The assessment took place from June 22 to July 1, 2005.

C. Institutional and Macro Prudential Setting—Overview

5. With net premium income in 2004 of €45.5 billion, the Spanish insurance market is the tenth largest in the world and the sixth largest in Europe after the United Kingdom, France, Germany, Italy, and the Netherlands. Its importance is higher in the nonlife sector in which it is the eighth largest market globally and the fifth in Europe, while in the life sector it ranks sixteenth internationally and eighth in the European area.

6. In terms of penetration and density, Spain ranks relatively low compared to the premium income analysis. Spain presents a penetration index (premiums to GDP) of 5.77 percent, being ranked twenty-seventh globally and fourteenth in Europe. With respect to density (€1,080 of premiums per capita), it ranks twenty-fourth internationally and fifteenth in Europe.

7. At the end of 2004, the Spanish insurance sector comprised 330 insurance entities: 227 insurance companies[2] (*Sociedades Anónimas*), that accounted for 81 percent of total premiums written; 44 mutual societies (*Mutuas*), 18.5 percent; and 59 social mutual societies (*Mutualidades de Previsión Social*), with only 0.2 percent market share. One-third of the premiums in 2004 were written by insurers owned by international insurance corporations strongly dominated by those domiciled in the European area.

8. In 2004, the insurance market was dominated by the nonlife sector, which represented about 58 percent of premium income. The most important lines of business were: automobile insurance, with 24.5 percent of total premiums; multi-risk[3] insurance, 9.3 percent; health insurance, 8.7 percent; third-party liability insurance, 3.5 percent; and funeral insurance, 2.7 percent.

9. From the assets management perspective, in 2004 total assets managed by the insurance sector reached €177,444 million, 61 percent held by life insurers. Assets of the life and nonlife sectors grew in 2002-04, by 2 percent and 60 percent, respectively.

10. Traditional life products have experienced renewed growth in the past years, while unit-linked insurance products have declined in importance in the total portfolio.[4]

11. The Spanish insurance market is increasingly competitive. Throughout 2000–04 the overall level of concentration has shown a decreasing trend, especially in life business. In 2004, the top five life insurers accounted for 34.1 percent of total premium income while the top five nonlife insurers accounted for 27.7 percent.

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[2] This figure includes two local reinsurance companies.

[3] Multi-risk insurance includes traditional property coverage such as home, business and industrial risks.

[4] At the end of 2004, unit-linked products (in which the insurer does not offer an interest rate guarantee) represented only 8 percent of total life technical provisions.

12. At the end of 2004, there were 154,049 insurance agents and 5,012 brokers[5] operating in the Spanish market. On the nonlife business, the distribution of insurance products is dominated by brokers (40.4 percent of premiums written in 2004) and agents (34.4 percent of premiums written). However, on the life business the most important distribution channel is *bancassurance*. Banks and *cajas* branches distributed insurance products that represented 71.1 percent of total written premiums, while the participation of agents was only 14.9 percent.

13. In Spain, the *Comunidades Autónomas* have legal capacity to license and supervise insurance companies[6] and intermediaries. However, only some of the *Comunidades Autónomas* exercise this legal power, mainly with respect to a limited number of social mutual societies (*Mutualidades de Previsión Social*) and insurance agents and brokers.[7]

14. In line with international best practices, solvency and integrity of the insurance market is based on: (a) the sufficiency of technical provisions; (b) the existence of a solvency margin;[8] and (c) adequate investments covering both requirements. In general, regulation provides appropriate mechanisms for insurers to calculate both the technical provisions and capital requirements linked to the solvency margin.[9] Additionally, investment regulations have created a sound portfolio profile strongly concentrated in fixed income investments that, at the end of 2004, represented 65 percent of total portfolio; investments in equity shares reached 6.3 percent and real estate investments only 3.4 percent.

15. In general, Spanish insurers cover appropriately their technical provisions and capital requirements. By the end of 2004, assets covering technical provisions exceeded by

[5] This figure also includes brokerage societies.

[6] The *Comunidades Autónomas* license and supervise very small social mutual societies (*Mutualidades de Previsión Social*) representing a negligible market share. These insurers are allowed to cover risks that could occur only in the geographical area of the *Comunidad Autónoma*. More that 80 percent of these social mutual societies are concentrated in two *Comunidades Autónomas*: Cataluña and País Vasco.

[7] About 33 percent of total brokers are licensed by the *Comunidades Autónomas*. The rest is directly licensed and supervised by the DGSFP. The entities in charge of these activities at the *Comunidades Autónomas* maintain a regular coordination mechanism with the DGSFP (*Foro de Colaboración*), to preserve homogeneous criteria on licensing and supervision.

[8] The LOSSP establishes, additionally to the solvency margin, the obligation for insurers to maintain a guarantee margin (*fondo de garantía*) which represents one third of the solvency margin requirement and cannot be less than €3 million for life, bail, credit or third-party liability insurers, and €2 million for other kinds of insurers. Most insurers already comply with the *fondo de garantía*. However, the regulatory framework has defined a transitory period, which will end in December 2008 to fully meet this requirement.

[9] The EU Solvency II Project might also create the obligation for insurers to conduct regular stress tests to estimate capital requirements under different scenarios. The Solvency II Project could also modify capital requirements for insurers in Spain. However, according to a preliminary stress testing analysis conducted by the DGSFP, it is not expected that these modifications will necessarily imply the need for an additional injection of capital to the market.

15 percent the statutory level and the overall solvency margin surplus was about 158 percent. The surplus on solvency requirements tends to be higher in nonlife business.[10]

16. The Spanish market has developed a strong infrastructure to enhance its functioning. From the private side, several organizations have been created by the industry to support market development: (a) *Investigación Cooperativa de Entidades Aseguradoras* (Insurance Entities Cooperative Research, ICEA) which purpose is to conduct studies and research on insurance topics and provide technical support to insurers; (b) *Tecnologías de la Información y Redes para la Entidades Aseguradoras* (Information Technologies and Networks for Insurers, TIREA) in order to standardize the protocols for the exchange of information within the market; (c) *Oficina Española de Aseguradores de Automóviles* (Spanish Office of Automobile Insurers, OFESAUTO), which is the Green Card National Bureau (international certificate of motor vehicles legal liability insurance); and (d) *Asociación Española de Entidades Aseguradoras de los Seguros Agrarios Combinados* (Spanish Association of Insurers for Combined Crop Insurance, AGROSEGUROS), which is the entity that manages the agricultural insurance system offered by private insurers under a format of co-insurance.

17. From the government side, the *Consorcio de Compensación de Seguros*[11] (Insurance Compensation Consortium, CCS) is an insurance corporation that offers: (a) coverage on extraordinary risks[12] as a complement to private policies; (b) automobile insurance for those that are not able to obtain it from private insurers; and (c) coinsurance and reinsurance for crop insurance[13]. In its activities as insurer, the CCS is subject to the same requirements applicable to private insurers according to the LOSSP.

18. The CCS is also an essential part of the winding-up mechanism. The CCS is responsible for conducting the administrative liquidation of insurance entities.[14] Even though

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[10] In the non-life sector, the surplus on technical provisions at the end of 2004 was 34 percent and 227 percent on the solvency margin, while in the life sector these ratios were 11 percent and 101, respectively.

[11] While CCS is a government agency, its board is composed of public officers and insurance industry representatives in equal proportions.

[12] CCS risk coverage includes the following: flood, earthquake, volcanic eruption, storms, meteor fall, terrorism, riot, rebellion, sedition, and acts of the military forces in peace time. CCS coverage is added to policies issued by private insurers in the following lines: home, business, industrial, automobile, civil work, loss of profits, and accident insurance.

[13] For extraordinary risks and crop insurance, the CCS has the guarantee of the Spanish government. In the first case, government support has never been used and, at the end of 2004, the CCS had accumulated a provision of €2,808.3 million. In the case of crop insurance, the Spanish government provides an allowance of 50 percent of the premiums to farmers. The State guarantee on crop insurance has not been necessary since 1997, but the CCS considers that losses in 2005 might require financial support from the *Ministerio de Agricultura, Pesca y Alimentación*.

[14] For that purpose, a 0.3 percent levy is charged to every insurance policy.

there is not a guarantee fund for insurance in Spain,[15] historically this winding-up mechanism has paid around 70 percent of the credits to policyholders involved in a liquidation process.

19. Looking at the shocks that the international insurance industry has faced in the past years, the Spanish insurance sector has demonstrated its resilience. The effect of the reduction of interest rates[16] and the adverse movement in the equity markets in 2001–03 have been absorbed smoothly. Additionally, since 2000 the nonlife sector has maintained a clear growth path. In the case of the life sector, after a slowdown in 2003,[17] the market has also resumed growth.

20. Besides the positive effect of macroeconomic fundamentals, there seem to be several factors that could contribute to a stable and sound growth of the market: (a) the strengthening of asset-liability management techniques as part of the regulatory requirements and market practices; (b) the limited impact of interest rate guaranteed life products;[18] (c) the conservative structure of the investment portfolio of the industry; (d) the limited credit risk transfer activity from the banking to the insurance sector; and (e) the effective functioning of a compensation mechanism to deal with catastrophic and extraordinary risks.

21. In the years to come, authorities will face the challenge to implement EU Directives on insurance and, very importantly, the outcome of the Solvency II Project, specifically on risk management and stress testing. Spain is a leader in this area.[19] In addition, insurance regulatory and supervisory authorities have the enhancement of corporate governance, internal control, risk management, innovation, and market conduct issues. Furthermore,

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[15] There is only full protection for policyholders in the mandatory insurance for automobile, travelers and hunters. It is expected that an EU Directive to be issued next year will establish the obligation for EU State members to create an insurance guarantee fund.

[16] Regarding the impact on technical provisions derived from guaranteed interest rate insurance products sold in the past, the authorities have established transitory regime to cover annual insufficiencies in the provisions. Additionally, the DGSFP has conducted analysis that confirm that implicit surplus (due to conservative accounting criteria on real state investments) on the balance sheet of life insurers could also compensate this effect.

[17] An important factor that explains part of the slowdown in the life market in 2003 has to do with the finalization of the transition period for commercial and industrial companies to move out their pension obligations from their balance sheets. Most of them were transferred to life insurers as annuity products, contributing to growth in premius before 2003.

[18] The liability of this type of product was less important in Spain than in some other countries, because of its relatively small size in the overall portfolio. In order to have a smooth absorption of the impact produced by the gap between the guaranteed rate and market rate, life insurers were subject to a transition period since 1999, when, additionally, prudential rules were implemented to avoid future problems of this nature.

[19] At the time of the mission, there were five EU Directives on insurance pending to be implemented (2002/92/CE on insurance intermediaries; 2003/41/CE on pension funds; 2004/113 on equitable gender treatment in the access to insurance services; 2005/1 on organizational structure of financial services committees; and 2005/14 on third-party liability on automobile insurance). On the insurance intermediaries EU Directive, Spanish authorities were about to send the project of the new LMSP to the legislative branch.

Spain authorities will face the challenge that will imply the implementation of the international accounting standards on insurance that will be produced as part of the project conducted by the International Accounting Standard Board (IASB).

II. General Preconditions for Effective Insurance Supervision

22. Insurance regulation and supervision in Spain relies on a clear legal framework.[20] This framework already considers the implementation of most of EU Directives on insurance. Secondary regulation is issued through complementary legal mechanisms, such as *Real Decreto* and *Órdenes Ministeriales*, and administrative mechanisms used directly by the DGSFP defined as *Consultas, Criterios* and *Instrucciones*, which are not binding.

23. Regulation and supervision of the insurance activity falls directly under the control of the ME through the DGSFP, which is part of the ministry.

24. Spain has a professional and reliable judicial system that operates in an efficient manner. Additionally, alternative mechanisms for the resolution of conflicts, such as private arbitration, are usually used.

25. The accounting and auditing professions are well developed in the country. The *Instituto de Contabilidad y Auditoría de Cuentas* (Accounting and Auditing Institute, ICAC) is an autonomous entity whose objective is to implement EU accounting principles and policies in Spain.[21] In general, accounting and auditing rules for insurance activities are in line with internationally accepted practices. There is also an organized actuarial profession.[22]

III. Principle-by-Principle Assessment

26. The detailed assessment of observance of each one of the IAIS ICP[23] is shown in Table 1.

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[20] See paragraph 2.

[21] The ICAC is also in charge of the control of the quality of the auditing activity.

[22] There are two main actuarial organizations: (i) the *Instituto de Actuarios Españoles* (Spanish Institute of Actuaries, IAE); and (ii) the *Colegio de Actuarios de Cataluña* (Actuaries Association of Cataluña, CAC).

[23] According to the assessment methodology included in the *IAIS Insurance Core Principles and Methodology*, a principle is considered **observed** whenever all the essential criteria contained in the respective principle are considered to be observed or when all the essential criteria are observed except for a number that are considered not applicable. It is worth to mention that for a criterion to be considered **observed** it is necessary that the authority not only has the legal power to perform its tasks, but also that it exercises this authority to a satisfactory standard. In the case in which the authority has a history of using a practice for which it has no explicit legal authority, the assessment is considered as **observed** if the practice is clearly substantiated as common and undisputed. For a principle or criterion to be considered **largely observed,** it is necessary that only minor shortcomings exist which do not raise any concerns about the authority's ability to achieve full observance with them. A principle or criterion is considered **partly observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A principle or

(continued)

Table 1. Detailed Assessment of Observance of IAIS Insurance Core Principles

Principle 1.	**Conditions for Effective Insurance Supervision** Insurance supervision relies upon: ▪ a policy, institutional, and legal framework for financial sector supervision ▪ a well-developed and effective financial market infrastructure ▪ efficient financial markets.
Description	**A. Financial sector policy framework** Based on the *Plan de Acción de Servicios Financieros* (Financial Services Action Plan), Spanish authorities act accordingly to the international strategy to pursue financial soundness and stability. Under this framework, the Spanish government has established a comprehensive framework for regulation and supervision in the financial sector, and specifically in the insurance markets. Institutional arrangements for financial supervision, including laws and regulations, are clearly defined and publicly disclosed. **B. Financial market infrastructure** Market infrastructure supports an effective supervisory scheme. As mentioned, Spain has a professional and reliable judicial system, complemented with private arbitration mechanisms for the solution of conflicts. The accounting, auditing, and actuarial professions are well developed and the rules applicable to insurance activities are, in general, in line with internationally accepted best practices. **C. Efficient financial markets** Financial markets in Spain are competitive and efficient allowing insurance companies to have access to a wide range of financial instruments to properly comply as institutional investors and to manage their risks in an appropriate manner.
Assessment	Observed.
Comments	None.
Principle 2.	**Supervisory Objectives** The principal objectives of insurance supervision are clearly defined.
Description	The objectives of the supervisory scheme are clearly defined in the LOSSP (Article 1). These objectives are defined in terms of pursuing the sound and transparent development of the insurance industry and the protection of policyholders and beneficiaries. Additionally, according to Article 70.1 of the LOSSP, the role of the insurance supervisor is clearly defined and there are no other objectives for insurance supervision that might create a conflict with the main one.
Assessment	Observed.
Comments	None.

criterion is considered **not observed** whenever no substantive progress toward observance has been achieved. And finally, a principle or criterion is considered to be **not applicable** when the essential criteria do not apply given the legal and institutional conditions of the country or jurisdiction.

Principle 3.	**Supervisory Authority** The supervisory authority: ▪ has adequate powers, legal protection and financial resources to exercise its functions and powers ▪ is operationally independent and accountable in the exercise of its functions and powers ▪ hires, trains, and maintains sufficient staff with high professional standards ▪ treats confidential information appropriately.
Description	**A. Legal framework** The LOSSP (Articles 69, 70, 71, and 72) clearly identifies the responsibility of the ME, trough the DGSFP, to supervise insurance entities. The legal framework gives the Spanish government and the ME the power to issue regulations and secondary rules based on the proposals prepared by the DGSFP. However, the DGSFP has no legal capacity to issue rules by administrative means that are binding on the insurance industry. On the other hand, the LOSSP and the ROSSP consider the necessary mechanisms for the DGSFP to enforce rules. **B. Independence and accountability** As part of the ME, the government structure of the supervisory authority (DGSFP) is clearly defined and the necessary internal audit arrangements exist in order to ensure integrity of the supervisory activities. There are no procedures in place regarding the appointment and dismissal of the head of the supervisory authority. The relationship between the supervisor and the executive and judiciary branches of the State are well defined and transparent. Even though the DGSFP is not independent from the ME, there is no evidence of undue political influence. Subject to the legal regulations on the programming and use of the budget, the DGSFP is able to allocate its available resources according to its mandate, even though these resources seem to be insufficient to attract and retain highly skilled personnel and to develop all the necessary supervisory infrastructure and tools. The insurance supervisory authority has a well-defined and clear institutional relationship with the insurance companies and industry associations. Material changes to insurance legislation and secondary regulations are subject to prior consultation with market participants. In general, supervisory decisions made by the DGSFP are based on consistent and transparent processes and procedures. **C. Powers** Based on the LOSSP and the ROSSP, the insurance supervisory authority has the necessary general powers to adopt the actions required to preserve policyholders' interests. However, due to the lack of legal capacity to issue secondary regulation by administrative means, in those areas in which the LOSSP and ROSSP are not explicit enough, the DGSFP issues general recommendations that are not binding. **D. Financial resources** There is no specific source (such as a levy) to finance insurance supervision. Therefore, the DGSFP does not have its own budget. The budget allocated to the supervisory activities seems to be insufficient to attract and retain highly skilled staff and to develop the necessary supervisory infrastructure.

	As the insurance supervisory authority is not independent from the ME, it does not publish financial statements. **E. Human resources and legal protection** The staff of the DGSFP, as members of the *Administración General del Estado* (General Administration of the State), is comprised of professional officers that receive specific and specialized training on insurance. The staff has a legal protection scheme and is adequately protected against the costs of defending their actions while discharging their duties. Subject to budgetary constraints, the supervisory authority is entitled to hire external specialists. This possibility, however, cannot be extended with respect to on-site inspection activities. At the time of the assessment, the total staff of the DGSFP was 241. Out of this number, 28 inspectors were in charge of on-site supervision of 332 insurance companies, 49 fund managers, 1,163 pension funds, and 3,362 brokers. With these human resources, the DGSFP is able to conduct on-site examination of insurance companies only once every four or five years, and to conduct about 20 inspections of other entities under its surveillance every year. **F. Confidentiality** According to the LOSSP (Article 57), DGSFP staff maintains appropriate safeguards for the protection of confidential information.
Assessment	Partly observed.
Comments	The DGSFP, in its function as insurance supervisory authority, has no legal powers to issue secondary regulation (such as *Circulares*) that are binding on the industry. The possibility to issue this kind of secondary regulation relies only on the ME. According to ICP 3, the insurance supervisor must be fully empowered to achieve its objectives and one of these essential capacities is to issue secondary regulation based on its technical knowledge and expertise. As the DGSFP is not an independent agency, there is no regulatory governance scheme in place. Among others, there are no explicit procedures regarding the appointment and dismissal of the head of the insurance supervisory authority. This situation is not compliant with ICP 3 in terms of independence and governance of the supervisory body. The current institutional arrangement for insurance supervisions seems to create some inflexibility in the use of the DGSFP's available budget. This might create obstacles to allocate resources in a timely manner in accordance with the risks the supervisory authority perceives. For the same reason, the institutional arrangement under which insurance supervision is conducted does not provide the required resources to attract and retain highly skilled personnel and to develop all the necessary supervisory infrastructure and tools.
Principle 4.	**Supervisory Process** The supervisory authority conducts its functions in a transparent and accountable manner.
Description	The DGSFP has clear and comprehensive supervisory procedures in place for insurance supervision (LOSSP, Articles 26 to 48, 70, 71, and 72). These procedures are regularly updated according to the market situation. The application of this set of rules and procedures considers the different risk profiles of insurance companies and is done in a consistent and equitable way.

	The structure of the insurance supervisory authority is clearly established; the decision-making process allows the timely implementation of necessary measures. Insurance companies can appeal decisions adopted by the DGSFP before the ME, and, if necessary, before the judicial system. The insurance supervisory authority, through its Web Page and Annual Report, makes public information about the general condition of the market, the supervisory function undertaken by the DGSFP, the most recent developments in regulations, and some of the international topics that might have impact in the domestic market in the near future.
Assessment	Observed.
Comments	None.
Principle 5.	**Supervisory Cooperation and Information Sharing** The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.
Description	The LOSSP (Articles 2.2, 75.3, and 77) establishes the general legal framework for the collaboration and exchange of information with other financial supervisors. Overall, the regulatory framework has a precise definition for cooperation with EU supervisors through the use of collaboration protocols. In the case of non-EU insurance authorities, legislation also establishes the conditions for collaboration and exchange of information. In this respect, the basic condition for the exchange of information process relies on the appropriate level of confidentiality in its use. Additionally, the DGSFP has bilateral MoUs with the BE and the CNMV for the exchange of information and cooperation on the supervision of the Spanish financial sector.
Assessment	Observed.
Comments	None.
Principle 6.	**Licensing** An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective, and public.
Description	Legislation applicable to insurance companies in Spain has an appropriate definition of insurance and insurance activity, requires a license to conduct insurance activity, and clearly establishes the responsibility for the licensing process. Licensing requirements include fit and proper requirements for owners, Board members, and senior management and auditors. Even though current regulation includes general suitability requirements for managers, it does not consider specific requirements for actuaries who will be in charge of the technical issues within the company. The licensing process considers the analysis of the projected business plan which must reflect the business lines and risk profile, and provide information on projected costs, capital requirements, projected development of business, risk management systems, internal control systems, information technology systems, products to be offered by the

	insurer, outsourcing arrangements, solvency margins, and reinsurance. The supervisory scheme considers the necessary elements to avoid that a domestic or foreign insurance establishment could escape supervision.[24] International insurers, both from the EU and from third countries, operating through branches or subsidiaries, are subject to supervision. The licensing process for foreign insurers requires confirmation from the home supervisory authority that the insurer is authorized to carry on the types of business proposed and meets all the regulatory requirements in the home jurisdiction. In the case of branches, Spanish regulation takes into account all the specific requirements set up in ICP 6. The LOSSP does not allow insurers to operate life and nonlife insurance business.[25] As part of the licensing process, and properly motivated, the DGSFP is able to ask for additional requirements where it considers this appropriate. The Insurance Law establishes a term of six months to resolve an application. If the license is denied, the resolution should be provided with the necessary explanation of the reasons. Once a license has been granted, the insurance supervisory authority monitors for a three-year period in compliance with the original plan of activities presented to obtain the license.
Assessment	Largely observed.
Comments	As part of the licensing process, the regulatory framework does not include specific requirements for actuaries who will be in charge of the technical issues of the insurer.
Principle 7.	**Suitability of Persons** The significant owners, board members, senior management, auditors, and actuaries of an insurer are fit and proper to fulfill their roles. This requires that they possess the appropriate integrity, competency, experience, and qualifications.
Description	The LOSSP (Articles 14 and 15) establishes the general fit and proper requirements that owners should meet and key personnel of an insurer. According to the Insurance Law, these requirements should be met not only when obtaining the license but also during the operation of the insurer. If the owners or key personnel no longer meet these requirements, the DGSFP may withdraw the license. The responsibility to assess the suitability of auditors is in the hands of the ICAC. If there is a problem regarding the quality of an external auditor, the ICAC can act, based on a specific and motivated request of the DGSFP. With respect to actuaries, regulation does not include specific fit and proper requirements. The DGSFP exchanges information with other supervisory authorities when necessary to verify the suitability of persons owning or managing insurance companies. The Spanish Insurance Law also establishes general regulations on simultaneous positions that could result in a material conflict. Meeting fit and proper requirements for owners and key personnel is a condition to obtain and maintain a license by an insurer. However, there is no legal requirement

[24] Licensing requirements in Spain are based on the implementation of the criteria established in EU Directives, which are in line with ICP 6.

[25] Before 1984, the Insurance Law allowed insurers to operate jointly life and nonlife business. In those cases, regulation requires separate accounting and a clear segregation of capital and solvency margins.

	for an insurer to notify the supervisory authority about circumstances that could affect the fitness and propriety of its key personnel.
Assessment	Largely observed.
Comments	The fit and proper scheme applicable to key personnel does not include specific requirements for actuaries participating in the technical management of insurers. When an insurer becomes aware of circumstances that may be relevant to the fitness and propriety of its key personnel, it is not legally obliged to notify this situation to the supervisory authority.
Principle 8.	**Changes in Control and Portfolio Transfers** The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer. The supervisory authority approves the portfolio transfer or merger of insurance business.
Description	**A. Changes in control** The LOSSP (Article 22) defines significant participations as the ownership of 10 percent or more of the capital of an insurer. The regulation also takes into account any other possibility to exercise a significant influence on the management of an insurer as a criterion for "significant participation." Any significant participation must be informed to the DGSFP, and the supervisory authority can, within a three-month period, deny authorization for acquisition or change in control. This process also considers the necessary coordination (through collaboration protocols) with other supervisors when the ultimate owner is outside Spain. To allow changes in control, the DGSFP analyzes that the intended owner meets the fit and proper requirements and that the structures of the groups containing potential controlling owners are sufficiently transparent so that supervision will not be hindered. **B. Portfolio transfer** Any total or partial portfolio transfer must have prior approval of the ME (LOSSP, Article 23). Additionally, the ROSSP (Article 70) regulates the requirements that an insurer should meet in order to implement a portfolio transfer. Finally, the LOSSP (Article 23.1) and the ROSSP (Article 70.2) also establish specific mechanisms to protect the interests of the policyholders of both the transferee and transferor.
Assessment	Observed.
Comments	None.
Principle 9.	**Corporate Governance** The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.
Description	General corporate governance requirements are established in the *Orden del Ministerio de Economía* 3722/2003, and in the *Circular* 1/2004 of the CNMV. This regulation, however, applies only to those insurance companies that are listed in the Spanish stock exchange market.

	At the time of the assessment, only two insurance companies were listed in the stock exchange market. For the rest of insurers, there were no specific requirements on corporate governance. Nevertheless, some other insurers (mainly subsidiaries of major multinational insurance corporations and some insurers integrated with financial conglomerates) maintain the corporate governance regimes applicable to their parent companies.
Assessment	Partly observed.
Comments	In general, neither general law nor Insurance Law establishes requirements on corporate governance for insurance companies. The existing regulation is applicable only to a limited number of insurers listed in the Spanish stock exchange.
Principle 10.	**Internal control** The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.
Description	As part of on-site examinations, the DGSFP (LOSSP, Article 5.6, and ROSSP, Articles 71.3 and 110.1) reviews the internal controls and checks their adequacy with respect to the nature and the scale of the business and requires strengthening of these controls where necessary. Regulation, however, does not require explicitly the existence of internal control frameworks that includes internal auditing areas for insurers, risk management systems, accountability for outsourced functions and clear responsibilities for the board of directors (see assessment of ICP 9). As occurs with corporate governance, some major insurers (mainly subsidiaries of major multinational insurance corporations, insurers integrated with financial conglomerates and some of the big Spanish insurers) maintain auditing areas complying with the internal control regime applicable to their parent companies.
Assessment	Largely observed.
Comments	Currently, the insurance regulatory framework does not require explicitly that insurers be required to have an internal control framework that includes internal auditing, risk management systems, assessment of outsourced functions and a clear responsibility of the board of directors (see assessment of ICPs 9 and 18).
Principle 11.	**Market Analysis** Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.
Description	The DGSFP conducts analysis of market conditions only on a case-by-case basis. The insurance supervisory authority does not require insurers to engage in market-wide systematic reporting, or to analyze and monitor particular market-wide events of importance for the financial stability of insurance markets. To conduct particular analysis, the insurance supervisory authority usually requires additional data, because the information filed by insurers on a regular basis lacks the required level of detail. The insurance supervisory authority produces aggregated market data that are publicly available to interested parties. Additionally, insurance industry also makes public aggregated data on the market, through UNESPA and ICEA.

Assessment	Partly observed.
Comments	The insurance supervisory authority does not conduct regular analysis of market conditions (including dynamic solvency tests and stress tests) to identify main trends, scenarios, and issues that could have an impact on the development and financial position and stability of the market. This kind of analysis is conducted only on a case-by-case basis and usually requires additional information to that filed by insurers for supervisory purposes. The DGSFP does not require insurers to engage in market-wide systematic reporting, or to analyze and monitor particular market-wide events of importance for the financial stability of insurance market.
Principle 12.	**Reporting to Supervisors and Off-Site Monitoring** The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	The ROSSP (Article 66) establishes a detailed regulation on the regular information that insurers must submit to the DGSFP for supervision purposes. Through the DECs mechanism (*Documentación Estadístico-Contable,*[26] the supervisory authority defines the scope and frequency (on an annual and a quarterly basis) of the reports and information. External auditors are required to provide an opinion of the financial position of insurers on an annual basis. The DGSFP is also able to request more frequent and more detailed additional information from an insurer whenever there is a need. In the case of branches and companies incorporated in the country, regulation is in line with the EU Directives. For those insurers coming from third countries, the requirements are equivalent to those applicable to Spanish insurers. The information requirements for insurers deal with their financial condition and performance on both, solo and insurance group-wide basis. The DGSFP may also request financial information on any subsidiary of the supervised entity (LOSSP, Article 72.1 and ROSSP, Article 67). There are general accounting principles and norms that must be followed by insurers (*Real Decreto* 2014/1997). In general, these principles allow a consistent and prudent valuation of assets and liabilities. Based on the information filed by insurers (or on specific requests to insurers), the DGSFP conducts regular off-site analysis using a comprehensive early warning system (*Sistema de Indicadores y Alertas Tempranas,* SIAT) that allows the insurance supervisor to prevent or detect situations that might affect the financial position of an insurer. The SIAT also permits to create a general risk profile and a ranking that is the base to allocate the supervisory resources within the DGSFP.[27]
Assessment	Observed.
Comments	None.

[26] Statistical and Accounting Information (DEC) requirements are clearly established in the respective *Orden Ministerial* (23.12.1998).

[27] At the time of the assessment, the SIAT had just been concluded by the DGSFP and it was in an early implementation stage.

Principle 13.	**On-Site Inspection** The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.
Description	The DGSFP has wide-ranging powers to conduct on-site inspections and gather information. This legal capacity is clearly defined in the LOSSP (Article 72). There are also clear and comprehensive procedures to conduct on-site examinations (ROSSP, Articles 112–9), including the verification of information provided by insurers through regulatory returns. Examinations can be conducted either on a full scale or a focused basis investigating areas of specific concern. Spanish Law permits only inspectors belonging to the DGSFP to conduct on-site examinations, so this function cannot be outsourced to third parties. According to the on-site inspection procedures, acting inspectors are able to discuss with the insurers the findings of the examination and the need for corrective actions. Once the on-site inspection is concluded and a formal resolution has been communicated to the insurer, the DGSFP has in place a comprehensive follow-up mechanism to ensure that any required action is taken in a timely manner by the insurer (see assessment of ICPs 14, 15, and 16). In the case of pension funds, the supervisory authority can extend on-site inspections to obtain information from companies that have accepted outsourced functions. An amendment to the ROSSP will extend this possibility to the supervision of insurers. Currently, the DGSFP is able to obtain this information indirectly through the insurer.
Assessment	Observed.
Comments	None.
Principle 14.	**Preventive and Corrective Measures** The supervisory authority takes preventive and corrective measures that are timely, suitable, and necessary to achieve the objectives of insurance supervision.
Description	The LOSSP (Articles 38 and 39) enables the DGSFP to adopt different preventive and corrective measures. The *Medidas de Garantía de la Solvencia Futura* (Future Solvency Guarantee Measures, MGSF) consist of a set of actions that the insurance supervisor can make use of in those cases in which it can be assumed that the current operation of the insurer may adversely affect its future financial position. Among others, the MGSF permit the DGSFP to require a financial recovery plan and a higher solvency margin (LOSSP, Article 39). The LOSSP (Article 39) also defines a set of assumptions in which the DGSFP can adopt *Medidas de Control Especial* (Special Control Measures, MCE). The MCE includes the possibility for the insurance supervisor to require a plan for correction of problems detected in off-site analysis or in on-site inspections. These measures include, among other: short-term financing plans, restrict asset transfers, suspension of dividend payment, and limitation to write new policies or renew those already written. The LOSSP (Article 39.7) regulates the possibility to make public the application of any MCE in which the insurer has not complied with the actions that should have been adopted in the timetable approved by the DGSFP.
Assessment	Observed.
Comments	None.

Principle 15.	**Enforcement or Sanctions** The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	The DGSFP has adequate power to properly enforce corrective actions. The LOSSP (Article 46) defines clearly the legal power to impose sanctions based on clear criteria that are publicly disclosed (LOSSP, Articles 40–45). The DGSFP has the legal capacity to apply MCE and MGSF which includes the power to prevent the insurer from issuing new policies, to suspend dividend payments and to require additional solvency margin (see assessment of ICP 14). For the protection of the policyholders, insurance supervisor may also replace directors and managers and, in extreme cases, take control of the insurer. The corrective measures adopted are periodically checked to determine that the insurer is complying with them. The regulation also considers the possibility for the DGSFP to make public the application of any MCE in the case in which the insurer has not complied with the required actions. The LOSSP provides an administrative sanctions scheme as a way to enforce the rules, regulations and specific requirements. Fines applied by the insurance supervisory authority can reach up to €300,000 or 1 percent of free capital of the insurer, or even the withdrawal of the license where appropriate. The sanctions scheme also provides for fines applicable to managers and directors. LOSSP (Article 42) also establishes that individuals can be barred from acting in responsible capacities in the future. Based on LOSSP (Articles 43 and 44), the DGSFP ensures consistency in the way insurers are sanctioned. The supervisory authority or other authority takes action against those individuals or entities that are operating an insurance business without a license.
Assessment	Observed.
Comments	None.
Principle 16.	**Winding-up and Exit from the Market** The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedures for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.
Description	The situations in which an insurer should exit the market and the procedures for winding-up are clearly defined in the regulation (LOSSP, Articles 26, 27, and 28–37). According to EU Directives on insurance, a high level of priority is given to the policyholders and beneficiaries in a liquidation process regarding the resources covering the technical provisions. Even though a guarantee fund operates only with respect to mandatory insurance, the winding-up procedure in charge of the CCS allows timely payment to policyholders beneficiaries and a high recovery level of their unearned premiums.
Assessment	Observed.
Comments	None.
Principle 17.	**Group-wide Supervision** The supervisory authority supervises its insurers on a solo and a group-wide basis.

Description	The Spanish financial regulatory scheme identifies clearly what constitutes an insurance group (LOSSP, Article 20 and ROSSP, Articles 56, 57, 58, 60, 66–69, and 110) and a financial conglomerate (*Ley* 13/1992 and *Real Decreto* 1343/1992). The scope of supervision of financial conglomerates is also appropriately defined in the *Ley de Supervisión de los Conglomerados Financieros* (Financial Conglomerates Supervision Law). The regulatory framework requires that insurance groups and financial conglomerates have reporting systems in place that adequately meet the supervisory information demands. The DGSFP has signed MoUs with the BE and the CNMV in order to create a general framework for collaboration and coordination on financial supervision. These agreements are focused essentially to exchange of information on a case-by-case basis and from the insurance perspective there is a very limited scope on group-wide supervision of financial conglomerates. In line with ICP 6 and 15, the insurance supervisory authority may deny or withdraw the license when the organizational or group structure hinders effective supervision (LOSSP, Articles 5.2 and 8).
Assessment	Partly observed.
Comments	Even though the insurance supervisory authority has signed MoUs with the BE and the CNMV to create a general framework for coordination and collaboration on financial conglomerates supervision, in the practice these agreements are limited to exchange of information on a case-by-case basis. There is no evidence of group-wide analysis or group-wide supervision of financial conglomerates from the insurance standpoint. From the insurance supervision perspective, the lack of human resources of the DGSFP seems to be a key factor that hinders this objective.
Principle 18.	**Risk assessment and management** The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.
Description	As part of the licensing process, the Insurance Law (LOSSP, Article 5.6) establishes the obligation for insurers to implement general internal control procedures. However, regulation does not consider specific requirements for insurance companies to have in place comprehensive risk management policies and systems capable of identifying, measuring, assessing, reporting and controlling their risks. Nevertheless, the most relevant insurers, in terms of market share (subsidiaries of major multinational insurance corporations, insurers integrated to financial conglomerates, and major Spanish insurers) have this kind of systems and the capacity in place to assess properly their main risks. As part of its general views of the internal control of insurers, the DGSFP checks the existence and operation of systems on risk management. However, this verification does not include an assessment of the impact of risk diversification, aggregation and correlation of risks, and the overall effect of specific financial and non-financial risks on the global position of insurers.
Assessment	Partly observed.
Comments	The regulatory framework does not establish specific requirements on risk assessment and management for insurers to recognize the wide range of risks that they face and to assess and manage them in an appropriate manner.

	The insurance supervisory authority does not include in its on-site processes the revision with respect to the existence and adequate operation of these kinds of policies and systems.
Principle 19.	**Insurance Activity** Since insurance is a risk-taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.
Description	The LOSSP (Article 25) and the ROSSP (Articles 76–80) consider specific requirements for insurers to have in place underwriting and pricing policies. The DGSFP checks regularly that insurance companies evaluate the risks that they underwrite, and establish and maintain an adequate level of premiums. The DGSFP has powers to review the methodology used by insurance companies to set premiums and assess if the assumptions used are reasonable to enable the companies to meet its commitments. In the case the DGSFP detects a systematic use of insufficient premiums or an inadequate level of technical provisions it can adopt the necessary corrective measures (LOSSP, Article 38 and ROSSP, Article 77). Insurance Law (LOSSP, Article 58) establishes that insurers must design their reinsurance programs considering their financial capacity in order to preserve an adequate technical and financial balance. The DGSFP regularly reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable and properly accounted.
Assessment	Observed.
Comments	None.
Principle 20.	**Liabilities** The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.
Description	Insurance Law and secondary regulation consider clearly the necessary elements for establishing adequate technical provisions and for the assessment of their adequacy. The LOSSP (Article 16) and the ROSSP (Articles 29–48) regulate the calculation of technical provisions based on prudent actuarial and accounting principles. Among others, regulatory principles consider the kind of liabilities that must be included as part of the technical provisions, and the methods and assumptions for assessing, on a prudent basis, provisions to cover expected and some unexpected claims and expenses. The regulatory scheme includes the principles for the valuation of the amounts recoverable under reinsurance arrangements for provisions adequacy and solvency purposes. According to ROSSP (Article 29.1) an actuary must certify the methodology used by the insurer for the calculation and adequacy assessment of technical provisions. The LOSSP and the ROSSP also establish clear powers for the insurance supervisory authority to verify and assess the calculation of technical provisions. Through off-site and on-site mechanisms, the DGSFP reviews on a regular basis the sufficiency of the technical provisions. The supervisory authority is also entitled to require the technical

	provisions to be increased if they are not assessed as sufficient.
Assessment	Observed.
Comments	None.
Principle 21.	**Investments** The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.
Description	The insurance regulatory framework includes requirements for investment management. These requirements address the mixture of investments (ROSSP, Article 49), diversification criteria (Articles 50, 53, and 55 and the *Orden Ministerial de 23 de diciembre de 1998*), safekeeping of assets (Article 51), asset-liability matching (Article 33.2 and *Orden Ministerial*), and liquidity (ROSSP, Article 50). Investments are valuated according to prescribed and prudent methods (*Plan de Contabilidad de las Entidades Aseguradoras*). Even though major insurers in the market have in place overall strategic investment policies approved and reviewed regularly by the board of directors, there is no explicit regulatory requirement for that. The regulatory framework establishes different specific conditions for an insurer to manage risks associated with investment activities that might affect the coverage of technical provisions (ROSSP, Articles 33.1, 50 and 51, and the *Orden Ministerial*). The ROSSP (Article 65) considers a general mechanism for the control of the investments of insurers (*Libro de Inversiones*). The DGSFP regularly checks in its examinations that insurers have in place adequate controls in this area. Regulation, however, does not establish that oversight of, and clear management accountability for, insurer's investment policies and procedures remain ultimately with the board of directors (see assessment of ICP 9). The LOSSP (Articles 15 and 71) and ROSSP (Article 110) requires, in general, that staff involved with operation of insurers have the appropriate levels of skills and experience. However, there are no specific requirements for staff involved with investment activities. As part of its regular on-site examinations, the DGSFP checks audit procedures that insurers have in place. Currently, regulatory scheme does not require explicitly that insurers have in place audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies as well as contingency plans (see assessment of ICP 10). The LOSSP (Articles 33.1 and 33.2) and the *Orden Ministerial* requires that insurers have in place procedures for managing their asset-liability position in order to properly manage their liability and risk profiles.
Assessment	Largely observed.
Comments	The current regulatory framework does not include the obligation for insurers to have in place an overall strategic investment policy approved and reviewed regularly by the Board of Directors that addresses aspects such as risk profiles; strategic asset allocation; internal limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency; conditions to operate with illiquid or volatile assets or derivatives; conditions to pledge or lend assets; use of financial derivatives and structured products; and accountability policies for asset transactions and associated risks. In the same sense, regulatory framework does not require that oversight of, and clear management accountability for, insurer's investment policies

	and procedures remain ultimately with the board of directors. There are no specific requirements for staff involved with investment activities, in terms of appropriate levels of skills and experience. Regulation does not require explicitly that insurance companies implement audit procedures to ensure the timely identification of internal control weaknesses and operating system deficiencies on investment operations, including contingency plans.
Principle 22.	**Derivatives and Similar Commitments** The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements as well as internal controls and monitoring of the related positions.
Description	The Spanish insurance regulatory framework includes different aspects insurers have to take into account in using derivative products: internal control measures (ROSSP, Article 110.2); valuation (Article 52.1); accounting principles (Norm 13, *Plan de Contabilidad de las Entidades Aseguradoras*); admissible type of derivatives (Articles 4 and 5, *Orden Ministerial*), and limits (Article 5, *Orden Ministerial*). In the annual report (*Memoria*) that insurers include as part of their financial statements, there are general disclosure requirements. There is no explicit requirement for the board of directors to satisfy itself that it has the necessary expertise to understand the issues related to the use of derivatives, and to approve and review periodically a policy on their use. The regulatory scheme does not require explicitly that insurers have in place risk management systems and audit procedures covering the risks from derivatives (see assessment of ICPs 10 and 18).
Assessment	Largely observed.
Comments	Currently, there is no explicit requirement for the Board of Directors to satisfy itself that it has the necessary expertise to understand the issues related to the use of derivatives, and to approve and review periodically a policy on their use. The regulatory scheme does not require explicitly that insurers have in place risk management systems and audit procedures covering the risks from derivatives.
Principle 23.	**Capital adequacy and solvency** The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.
Description	The Spanish regulatory scheme deals appropriately with capital adequacy and solvency issues. The regime addresses consistently the valuation of technical provisions; the different issues related to assets covering these provisions; the asset-liability matching; and capital adequacy requirements and the mechanisms to meet them. According to the current solvency scheme adopted by the EU, capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations. This mechanism will be enhanced with the outcome of the EU Solvency II Project that is intended to be fully implemented by 2008. Solvency control levels are established by the DGSFP. According to the LOSSP (Article 39), where the solvency position falls below one or more control levels, the DGSFP is able to intervene and require the insurer to adopt MCE (see assessment of

	ICP 14).
Assessment	Observed.
Comments	None.
Principle 24.	**Intermediaries** The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.
Description	The *Ley de Mediación de Seguros Privados* (Private Insurance Intermediation Law, LMSP) requires intermediaries to be licensed. The Law defines two kinds of intermediaries: (i) insurance agents (most of them working with a single insurer); and (ii) brokers. At the time of the assessment, a proposal to modify the LMSP had been prepared. This modification, that would implement EU Directive 2002/92/CE, would encourage the licensing of independent insurance agents working for several insurance companies. The current LMSP (Articles 12, 16, 17, 21.3, and 21.1) requires intermediaries to have adequate general, commercial and professional knowledge and ability as well as a good reputation. The LMSP also considers powers for the DGSFP to take corrective actions and the possibility to cancel the intermediary's license when appropriate. Regulation requires agents and brokers having sufficient safeguards in place to protect policyholders' funds. The amendment to the LMSP will enhance current standards on disclosure regarding the independency of the agent or broker. The LMSP (Articles 26 and 27) establishes sanctions against individuals or entities carrying on insurance intermediation activity without license.
Assessment	Observed.
Comments	None.
Principle 25.	**Consumer Protection** The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete, and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.
Description	Financial regulation in Spain considers a broad range of elements for the protection of financial consumers. In the insurance area in particular, the LOSSP and the LMSP establish requirements to both insurers and intermediaries, to act with due skill, care, and diligence in their dealing with their consumers. The *Orden* ECO/734/2004 requires insurance companies and intermediaries to set up special claims departments which must be properly organized and have the necessary resources to treat consumers fairly. The LOSSP (Article 60), the ROSSP (Articles 104, 105, and 106) and the *Orden* ECO/734/2004 (Article 9) regulate information that financial institutions must present to their clients in order to guarantee a fair treatment. The *Ley* 44/2002 on reform measures of the financial system requires all financial institutions, including insurance companies, to deal properly with claims presented by their clients.
Assessment	Observed.

Comments	None.
Principle 26.	**Information, Disclosure and Transparency Towards the Market** The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.
Description	The LOSSP (Article 66) contains a detailed regulation on information requirements to be provided to insurers and insurance groups. Insurers have to prepare and report to the public their audited financial statements on an annual basis. Additionally, insurers must include as part of their public financial statements an annual report (*Memoria*); a management report; and an audit report. These reports contain detailed information on the insurer, the basis for the preparation of annual statements, distribution of benefits and profits, asset and liability valuation methods and procedures, information on different sections of the financial statements, specific technical information on the life and nonlife sections of the business, coverage of technical provisions and solvency margin. The insurance supervisory authority monitors the information disclosed by insurers and is able to take the necessary actions to ensure compliance with legal disclosure requirements.
Assessment	Observed.
Comments	None.
Principle 27.	**Fraud** The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.
Description	Insurance fraud is addressed by General Law (*Ley Orgánica 10/1995 del Código Penal*) and it is considered as a criminal activity. On the administrative side, the supervisory authority has powers to enforce regulations in this area, to report this kind of activity to the competent authorities and to collaborate with other local and foreign authorities. As part of the on-site inspection process, the DGSFP reviews the internal control systems in place by the insurers to detect, and prevent fraudulent activities. Even though the insurance supervisory authority has no legal power to require insurers to take measures to prevent fraud, industry itself has taken specific actions on that direction. Among other measures, UNESPA has signed an MoU with the State Secretary of Security in order to formalize cooperation mechanisms in this area. Similar agreements have been signed with the Interior Departments of the *Gobierno Vasco* and the *Generalitat de Cataluña*. Additionally, UNESPA, though ICEA, conducts regular activities to support industry on the prevention and control of insurance fraud.
Assessment	Observed.
Comments	None.
Principle 28.	**Anti-Money Laundering, Combating the Financing of Terrorism (AML/CFT)** The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect, and report money

	laundering; and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).
Description	Life insurers are subject to the *Ley* 19/1993 on anti-money laundering (AML) that, in general, considers Financial Action Task Force on Money Laundering (FATF) recommendations. The specific rules for the instrumentation of this law were amended in January 2005 (*Real Decreto* 54/2005). Additionally, the *Ley* 19/2003 regulates capital flows and economic transactions abroad in order to prevent AML. In Spain, there is a specific entity responsible for AML/CFT activities: the *Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales* (FIU). The FIU is centralized in the BE and in which participate all financial supervisory authorities. Based on the LOSSP (Articles 71 and 72), the DGSFP is able to conduct on-site examinations to verify the compliance of the insurers with AML/CFT requirements. The DGSFP has signed a MoU with the FIU in order to define the specific aspects to be verified as part of insurance examinations. Unlike life insurers, insurance agents and intermediaries are not subject to AML/CFT requirements.
Assessment	Largely observed.[28]
Comments	The DGSFP undertakes examinations on the compliance with AML/CFT requirements. Insurance brokers are not required to adopt AML/CFT measures. Most of the insurance agents work for a single insurer and, therefore, the implementation of AML/CFT measures is done through the general management systems of the company. However, the amendments of the LMSP will incentive the licensing of independent insurance agents working for several insurance companies (see assessment of ICP 24). In this case, requirements on AML/CFT seem to be necessary. A similar situation occurs in the case of brokers (by definition, independent from the insurance companies), where the existence of AML/CFT requirements is needed to fully observe ICP 28.

[28] A full AML/CFT assessment by FAFT will take place in September 2005.

Table 2. Summary Observance of the IAIS Insurance Core Principles (I)

Principles	O[1/]	LO[2/]	PO[3/]	NO[4/]	NA[5/]
1. Conditions for effective insurance supervision	X				
2. Supervisory objectives	X				
3. Supervisory authority			**X**		
4. Supervisory process	X				
5. Supervisory cooperation and information sharing	X				
6. Licensing		X			
7. Suitability of persons		X			
8. Changes in control and portfolio transfers	X				
9. Corporate governance			X		
10. Internal control		X			
11. Market analysis			X		
12. Reporting to supervisors and off-site monitoring	X				
13. On-site inspection	X				
14. Preventive and corrective measures	X				
15. Enforcement or sanctions	X				
16. Winding-up and exit from the market	X				
17. Group-wide supervision			X		
18. Risk assessment and management			X		
19. Insurance activity	X				
20. Liabilities	X				
21. Investments		X			
22. Derivatives and similar commitments		X			
23. Capital adequacy and solvency	X				
24. Intermediaries	X				
25. Consumer protection	X				
26. Information, disclosure and transparency towards the market	X				
27. Fraud	X				
28. Anti-money laundering, combating the financing of terrorism (AML/CFT)		X			

[1/] O: Observed
[2/] LO: Largely observed
[3/] PO: Partly observed
[4/] NO: Not observed
[5/] NA: Not applicable

Table 3. Summary Observance of the IAIS Insurance Core Principles (II)

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	17	1, 2, 4, 5, 8, 12, 13, 14, 15, 16, 19, 20, 23, 24, 25, 26, 27
Largely observed	6	6, 7, 10, 21, 22, 28
Partly observed	5	3, 9, 11, 17, 18
Not observed	-	-
Not applicable	-	-

IV. Recommended Action Plan and Authorities' Response to the Assessment

A. Recommended Action Plan

27. Table 4 presents the actions on insurance supervision that the mission recommends based on the main findings of the IAIS ICP assessment.

Table 4. Recommended Action Plan to Improve Observance of the IAIS Insurance Core Principles

Reference Principle	**Recommended Action**
Principle 3. Supervisory authority	To implement an institutional arrangement for insurance supervision that enables: (i) strengthening of regulatory governance in terms of independence of the supervisory body (i.e., the establishment of procedures regarding the appointment and dismissal of the head of the supervisory authority and members of the governing body); (ii) the supervisory authority to issue secondary regulation by administrative means that is binding to the insurance industry; and (iii) a budgetary scheme that could allocate more financial resources to insurance supervision and a more flexible scheme for the allocation of resources; increase supervisory authority's staff and to attract and retained high skilled personnel; and provide the necessary resources to enhance supervisory infrastructure and tools.
Principle 6. Licensing	To include, as part of the licensing process for insurance companies, specific suitability requirements for the actuaries that will participate in the technical management of the company.
Principle 7. Suitability of persons	To consider, as an additional element for the fit and proper scheme applicable to key functionaries, specific fit and proper requirements for actuaries. To introduce the obligation for insurers to inform the supervisory authority, in a timely manner, of circumstances that may affect the fitness and propriety of its key functionaries.

Principle 9. Corporate governance	To establish general requirements on corporate governance applicable to insurers in which clear responsibilities for the board of directors and senior management are included.
Principle 10. Internal control	To explicitly consider in regulation the requirement for insurers to maintain a framework for internal control that includes internal auditing procedures, risk management systems, assessment of outsourced functions, and clear responsibilities for the board of directors.
Principle 11. Market analysis	▪ To implement regular analysis of the conditions of the market, not only in terms of the past developments and present situation, but also to identify trends, scenarios and issues that could have an impact on future development, financial position, and/or financial stability of the market. ▪ To include as part of the systematic financial and statistical information required of insurers for supervision purposes, the information required to conduct regular analysis of market conditions.
Principle 17. Group-wide supervision	▪ To strengthen the coordination and collaboration framework between the insurance supervisory authority, and the BE and the CNMV, in order to create and implement effective mechanisms for group-wide analysis and effective group-wide supervision of financial conglomerates. ▪ To provide the necessary resources to the insurance supervisory authority so it can participate effectively on group-wide supervision (see recommendation on ICP 3).
Principle 18. Risk assessment and management	▪ To include explicitly in the regulatory framework specific requirements on risk assessment and management for insurers, in order to recognize the wide range of risks that they face and to assess and manage them in a comprehensive and effective manner. ▪ To include, as part of the supervisory process, a regular assessment of the aggregation and correlation of risks, risk diversification, and the overall effect that specific financial and technical risks might have on the global position of supervised insurers.
Principle 21. Investments	▪ To incorporate in the insurance regulatory framework explicit requirements for insurers to have in place an overall strategic investment policy approved and reviewed regularly by the Board of Directors, that addresses the different aspects linked to investment risks (see recommendation on ICP 9). ▪ To include in the regulation specific fit and proper requirements for staff involved with investment activities, in terms of appropriate levels of skills, experience, and integrity. ▪ To consider within the regulatory framework requirements for insurers to implement audit procedures to ensure the timely identification of internal control weaknesses and operating system deficiencies on investment operations that include contingency plans (see recommendation on ICP 10).

Principle 22. Derivatives and similar commitments	To consider in the regulatory framework explicit requirements on the board of directors to satisfy itself that it has the necessary expertise to understand the important issues related to the use of derivatives; to approve and review periodically a policy on their use; and to have in place risk management systems and audit procedures covering the risks from derivatives (see recommendations on ICP 9, 10, and 18).
Principle 28. Anti-money laundering, combating the financing of terrorism (AML/CFT)	▪ To provide the necessary resources to the insurance supervisory authority so it can maintain an effective supervision on AML/CFT requirements to insurers (see recommendation on ICP 3). ▪ To draft legislation on AML/CFT requirements for insurance agents and brokers.

B. Authorities' Response to the Assessment

27. The DGSFP appreciates the quality, precision and rigorous analysis carried out by the IMF mission and the assessor in connection with the IAIS Insurance Core Principles observance assessment. In general, the DGSFP shares the contents of the assessment. However, it considers necessary to comment on some specific aspects.

Principle-by-principle assessment: Principle 18

28. Regarding Principle 18 on risk assessment and management, it is stated that the DGSFP does not check, as part of its supervisory process, the existence and adequate operation of policies and systems on risk assessment and management. The above-mentioned statement does not take into consideration on-site inspections carried out, which include actions oriented to control and verify financial and non-financial risks. Inspection plans include specific references to that kind of evaluation. Moreover, the Inspection Manual, in its section on internal control and risk assessment, includes a questionnaire on risk assessment by insurers.

29. The responses given in the self-assessment questionnaire may have lead to confusion with respect to the absence of an analysis on risk aggregation and risk interrelation. When at the self-assessment it is stated that no checks are performed with respect to the effects of different risks aggregations, it aims to underline that, up to date, there is a lack of a system to weigh and quantify in a reliable manner the impact of diversification, aggregation and correlation of risks, in order to measure the effect of specific risks in the global risk position of an insurance entity. We understand that, in no way, does this situation imply that risk management systems of supervised insurers are not verified.

The following regulatory initiatives already under way, or about to be launched, aim at bringing current regulations in line with IMF recommendations following the assessment of compliance with IAIS principles:

Principle 6. Licensing

30. Among the requirements that insurance companies must meet in order to obtain licensing, the regulatory framework does not specifically require the appointment of an insurance actuary, nor does it specify the latter's qualifications, because Spanish regulations assign responsibility for the management of an insurance company to its directors. Spanish law, however, requires insurance companies to have an insurance actuary at their disposal. For instance, Article 29.1 of the Private Insurance Organization and Supervision Regulations (ROSSP) requires that the technical provisions be certified by an insurance actuary; the insurance company must therefore choose an insurance actuary and be accountable for the appointed actuary's actions.

Principle 7. Suitability of Persons

31. With regard to the suitability of insurance actuaries and, in particular, the requirement concerning the fitness of these professionals, it should be noted that in Spain, insurance actuaries are university graduates; hence, their fitness is demonstrated by their possession of a bachelor's degree (*licenciatura*) in actuarial and financial sciences, issued by the Ministry of Education and Science. As to the requirement concerning the propriety of insurance actuaries, it is understood that insurance company managers are responsible for verifying compliance with this requirement, bearing in mind that the company is responsible for their actions. A forthcoming legislative amendment will include the requirement of propriety for insurance actuaries, although the insurance company that appointed the actuary remains accountable for noncompliance with this requirement.

Principle 9. Corporate Governance
Principle 10. Internal Control

32. Consideration is being given to a draft amendment to the ROSSP that provides for the establishment, documentation, and maintenance, at all times, of internal control procedures adapted to the company's organization. In line with the principle of proportionality, it is recognized that the procedures implemented must take into account the company's size and risk exposure; that notwithstanding, the application of the principle of proportionality can never lead to situations in which insured persons are unprotected. The draft amendment provides that ultimate responsibility for establishing the aforesaid procedures rests with the board of directors, and that the insurance company's management is responsible for implementing them. Internal control will include supervision of the procedures, to be exercised by independent expert staff from the supervised areas, and the assessment of internal and external risks to which the company is exposed. Contingency plans must be established in case circumstances arise that could jeopardize the company's viability. Lastly, the draft amendment provides that an annual report, containing an assessment by the board of directors of the effectiveness of the internal control procedures in place, identifying problems, and proposing solutions, is to be submitted by the company to the supervisory body.

Principle 21. Investments
Principle 22. Derivatives and Similar Commitments

33. With regard to investments (principle 21) and financial derivatives (principle 22), the text in preparation establishes clearly that responsibility for formulating and approving the investment policy rests with the insurance company's board of directors, which must ensure the identification, follow-up, measurement, reporting, and management of risk. With regard to the use of financial derivatives and structured products, it will be necessary to provide clear, written rules on the usable categories, purpose, maximum positions, and authorized counterparties. The rules must provide for a sharing of the authorization, execution, and control functions, and for periodic documentation of all activities.

Principle 28. Anti-Money Laundering, Combating the Financing of Terrorism (AML/CFT)

34. Article 2.1 of the Regulations contained in Law No. 19/1993, of December 28, 1993, on measures to prevent money laundering, approved by Royal Decree No. 925/1995, of June 9, 1995, provides that insurance companies are accountable for the actions of individuals and legal entities acting as dealers or intermediaries for them, an obligation that also applies to insurance brokers.

35. Since insurance brokers are independent from the insurance companies, a forthcoming legislative amendment will propose to maintain the aforesaid accountability of the companies for the actions of their agents, and will provide that insurance brokers remain directly bound by legal obligations with regard to specific measures to prevent money laundering, irrespective of the insurance companies for which they carry out trading activities. The latter provision will require the amendment of Article 2.1 of the aforesaid Law, which enumerates the parties required to comply with the provisions of that rule.