

SM/07/24

January 17, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Portugal—Publication of Detailed Assessment of Observance of IAIS Insurance Core Principles**

Attached for the **information** of Executive Directors is the staff's detailed assessment of Portugal's observance of IAIS Insurance Core Principles. Management has consented to a request from the Portuguese authorities to publish the assessment, and it will be posted on the Fund's external website after **January 24, 2007**.

Questions may be referred to Mr. Swinburne, MCM (ext. 34777).

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

Att: (1)

Other Distribution:  
Department Heads



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FINANCIAL SECTOR ASSESSMENT PROGRAM

PORTUGAL

IAIS INSURANCE CORE PRINCIPLES

# DETAILED ASSESSMENT OF OBSERVANCE

DECEMBER 2006

INTERNATIONAL MONETARY FUND  
MONETARY AND CAPITAL MARKETS DEPARTMENT

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**GLOSSARY**

|         |   |
|---------|---|
| AML/CFT | Anti-money laundering, combating the financing of terrorism                           |
| BdP     | Banco de Portugal   |
| CMVM    | Comissão do Mercado de Valores Mobiliários (the Portuguese Stock Exchange Commission) |
| DL      | Decree Law  |
| FATF    | Financial Action Task Force on Money Laundering                                       |
| FSAP    | Financial Sector Assessment Program   |
| IAIS    | International Association of Insurance Supervisors                                    |
| IAP     | Instituto dos Actuários Portugueses (the Portuguese Institute of Actuaries)           |
| ICP     | Insurance Core Principle  |
| ISP     | Instituto de Seguros de Portugal  |
| MoU     | Memorandum of Understanding   |
| PCES    | Plano de contas para as empresas de seguros (Accounting code)                         |

## **I. GENERAL**

1. This assessment of the insurance regulatory and supervisory system in Portugal was carried out from January 30 to February 10, 2006 in the context of an IMF Financial Sector Assessment Program (FSAP). The assessment reviews the effectiveness of Portuguese insurance legislation (including supporting regulation and rules) in the context of current insurance supervisory best practices—the Insurance Core Principles (ICP). In addition, it examines the effectiveness of the supervisory body, which in Portugal’s case is the Instituto de Seguros de Portugal (ISP).
2. This assessment has been based on the ICP of the International Association of Insurance Supervisors (IAIS) dated October 2003. Given the developed nature of the Portuguese insurance market, this assessment comments on both the essential and advanced criteria underpinning each core principle. However, in accordance with Annex 2 of the ICP, only essential criteria have been taken into account in assessing the overall level of observance of a core principle.
3. Key recommendations arising from the assessment cover two main issues.
  - i. ISP not only performs supervisory tasks but also administers the guarantee fund for third party liability motor insurance and workers’ compensation, including the management of related funds. Management of this fund should therefore be transferred to other organizations as soon as possible.
  - ii. The current requirements for internal control procedures are sub-optimal. The ISP should widen its definition of key functionaries for the assessment of the appropriateness and suitability of persons. As the new regulation has already been issued and will be fully implemented in 2007, appropriate measures have been taken.
4. The Portuguese insurance market is dominated by personal lines products, life and pension. These classes are 80 percent distributed through associated banks. Long-term care/full health insurance might become an additional product as changes in social security are on the way. The general lines market is relatively underdeveloped with a high concentration in motor and workers compensation, while other products, such as property and casualty insurance, are relatively undersold. The general lines market is mainly distributed through personalized intermediaries, with about 39,000 registered in Portugal.
5. This assessment was carried out by Henning Göbel (Bafin, Germany).

## **II. INFORMATION AND METHODOLOGY USED FOR ASSESSMENT**

6. The IAIS Methodology approved in October 2003, together with an IMF Template based on this methodology, was employed in preparing this assessment. The assessment was greatly facilitated by the detailed Self Assessment and other information supplied by the

authorities. The assessor would like to express his appreciation for the substantial efforts, inputs, and time given by the ISP in facilitating the assessment. Other representatives from the public and private sectors with whom the assessor interacted were also generous with their time, hospitality, helpfulness and openness in expressing their views.

### **III. MARKET ANALYSIS – THE PORTUGUESE INSURANCE MARKET**

#### **Market participants**

7. In 2004, Portugal ranked as the 27th largest market in the world insurance industry according to the Swiss Re insurance market report.<sup>1</sup> It was paired with Norway and Mexico and its premiums represented 7.85 percent of GDP. With premiums per capita at US\$1,294 compared to an EU-15 average of almost US\$3,000, the market has huge growth potential.

8. By the end of 2004 there were 69 insurance companies operating in Portugal, of which 40 are domestic insurance companies, 28 are branches of EU companies, and 1 is the branch of a company registered outside the EU. Only 2 of the 40 domestic companies are registered as mutual companies, with the others being limited companies.

9. Of the 40 domestic companies 14 operate in life assurance, 21 in non-life insurance and 5 are licensed as composites. The 28 branches comprise 9 operating in life, 18 in non-life and 1 in both lines of business. In addition to those, 288 licenses have been issued to provide freedom of services.

10. The degree of concentration is relatively high with the top 5 companies representing almost 60 percent of the market, and the next 5 companies holding a market share of about 20 percent (Tables 1 and 2). The main insurance companies are part of financial groups dominated by Portuguese banks.

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<sup>1</sup> Swiss Re, “World insurance in 2004: Growing Premiums and Stronger Balance Sheet,” Sigma, No. 2/2005, Zurich, Switzerland.

Table 1. Portugal: Largest Insurance Companies in 2004

|                          | Type      | Total Balance Sheet  |              | Gross Premium 1/ |                  |                      |              |
|--------------------------|-----------|----------------------|--------------|------------------|------------------|----------------------|--------------|
|                          |           | Total Assets         |              | Life             | Non-Life         | Total                |              |
|                          |           | In thousands of euro | Market share |                  |                  | In thousands of euro | Market share |
| Fidelidade Mundial, S.A. | Composite | 7,869,569            | 21.3         | 1,162,805        | 985,279          | 2,148,083            | 20.8         |
| Ocidental Vida, S.A.     | Life      | 7,001,606            | 18.9         | 1,233,493        | -                | 1,233,493            | 11.9         |
| Tranquilidade Vida, S.A. | Life      | 5,826,704            | 15.7         | 898,654          | -                | 898,654              | 8.7          |
| BPI Vida, S.A.           | Life      | 2,141,699            | 5.8          | 833,395          | -                | 833,395              | 8.1          |
| Império-Bonança, S.A.    | Composite | 2,475,161            | `            | 161,659          | 606,427          | 768,086              | 7.4          |
| <b>Total</b>             |           | <b>25,314,738</b>    | <b>68.4</b>  | <b>4,290,006</b> | <b>1,591,706</b> | <b>5,881,712</b>     | <b>56.9</b>  |

Source: Instituto de Seguros de Portugal.

1/ Gross Premium includes direct insurance and reinsurance acceptances.

Table 2. Portugal: Insurance Market Concentration; 1994–2004  
(In percent)

| Market Share 1/              | 1994 | 1999 | 2004 |
|------------------------------|------|------|------|
| Life                         |      |      |      |
| Largest Insurance Company    | 13.4 | 22.3 | 20.1 |
| 5 Major Insurance Companies  | 55.3 | 70.9 | 77.2 |
| 10 Major Insurance Companies | 81.0 | 88.9 | 90.2 |
| Non-Life                     |      |      |      |
| Largest Insurance Company    | 12.8 | 19.6 | 23.8 |
| 5 Major Insurance Companies  | 57.0 | 58.1 | 62.4 |
| 10 Major Insurance Companies | 77.8 | 78.5 | 83.0 |

Source: Instituto de Seguros de Portugal.

1/ Market shares are calculated referring to gross premium (direct insurance).

11. There are 38,814 insurance intermediaries, of which 6,051 are tied agents; 22,619 are multiple agents and 1,060 are agent societies. There are also 137 brokers and 8,947 canvassers, a form of employed or contracted sales forces.

12. Portuguese insurance companies are mostly domestically owned, with about 83 percent of shareholdings in possession of Portuguese entities and 12 percent of EU-domiciled entities.

### Market Performance

13. With the exception of 2000–02, the Portuguese market has provided profitable returns. General lines, in particular, have achieved a turn-around and provided a return on equity ratio exceeding 15 percent for 2005 (Table 3).

Table 3. Portugal: Insurance Sector Return on Equity Ratio; 1999–2004  
(In percent)

|                               | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|-------------------------------|------|------|------|------|------|------|
| Life insurance companies      | 13.1 | 15.0 | 9.5  | -3.8 | 14.8 | 14.9 |
| Non-life insurance companies  | 3.0  | 5.5  | 2.4  | -0.7 | 17.6 | 18.1 |
| Composite insurance companies | 3.9  | -4.3 | -0.2 | -7.3 | 4.3  | 14.1 |
| Total                         | 4.9  | -0.1 | 3.2  | -4.4 | 10.9 | 15.3 |

Source: Instituto de Seguros de Portugal.

14. The Portuguese insurance market has grown at rates above the EU average. The strongest contributor has been the life business, which in 2004, accounted for nearly 60 percent of the total Portuguese market.

Table 4. Portugal: Insurance Sector Gross Premiums Written; 2000–04  
(In percent)

|   | 2000        | 2001        | 2002        | 2003        | 2004        |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>Life</b>                                       | <b>52.6</b> | <b>53.7</b> | <b>52.8</b> | <b>55.9</b> | <b>58.8</b> |
| Life Assurance                                    | 36.1        | 35.6        | 34.3        | 37.5        | 39.2        |
| Unit Linked                                       | 11.0        | 14.9        | 16.6        | 15.8        | 16.5        |
| Capital Redemption Operations                     | 5.6         | 3.1         | 1.9         | 2.5         | 3.2         |
| <b>Non-Life</b>                                   | <b>47.4</b> | <b>46.3</b> | <b>47.2</b> | <b>44.1</b> | <b>41.2</b> |
| Accident and Health Insurance                     | 14.5        | 14.0        | 14.4        | 13.9        | 12.7        |
| Insurance against Fire and Other Damage           | 6.9         | 6.5         | 7.1         | 6.7         | 6.5         |
| Motor Insurance                                   | 22.9        | 22.7        | 22.2        | 20.3        | 18.9        |
| Marine and Transport Insurance                    | 0.3         | 0.3         | 0.3         | 0.2         | 0.2         |
| Aviation Insurance                                | 0.1         | 0.3         | 0.3         | 0.3         | 0.2         |
| Goods in Transit                                  | 0.5         | 0.4         | 0.4         | 0.4         | 0.3         |
| General Liability                                 | 0.8         | 0.7         | 0.8         | 0.8         | 0.9         |
| Others  | 1.3         | 1.4         | 1.6         | 1.5         | 1.4         |
| <b>Memorandum item:</b>                           |             |             |             |             |             |
| Total gross premium written (in millions of euro) | 7,037       | 7,984       | 8,533       | 9,492       | 10,337      |

Source: Instituto de Seguros de Portugal.

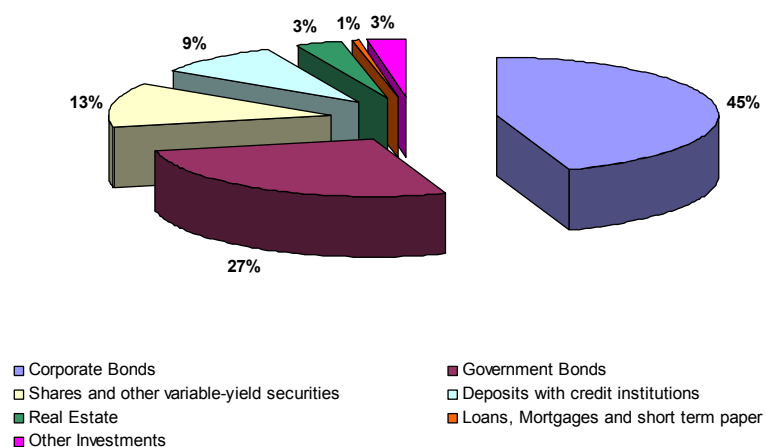
## Investment

15. The investment portfolio of Portuguese insurance companies is evenly spread and diversified. A high proportion of assets is allocated to fixed-income securities, roughly 72 percent of total assets (Figure 1). A more conservative approach to equities has led to a steady reduction and, subsequently, to an increase in bonds. Still, with an exposure of about 13 percent in equities and other variable-yield securities (of which 5.7 percent are invested

directly in equities), Portuguese companies continue to be significantly involved in that segment.

16. Since the starting of the Euro-area, around 65 percent of the securities held by insurance companies were issued outside of Portugal. Investment in domestic government bonds has decreased and is outweighed by non-domestic government bonds (65 percent).

Figure 1. Portugal: Insurance Companies' Investment Portfolio  
(In percent)

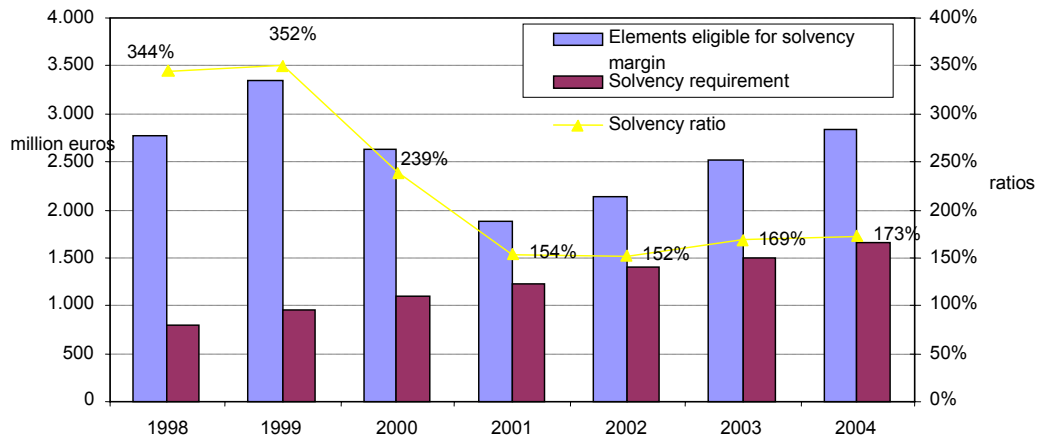


Source: Instituto de Seguros de Portugal.

## Capital

17. The average capital adequacy ratio of the market has been kept at very comfortable levels; as of end-2004, it was 173 percent (Figure 2). During the difficult period of 2000–02, some less comfortable individual situations were under closer supervision and were addressed successfully by means of increases in capital or through the issuing of subordinated debt.

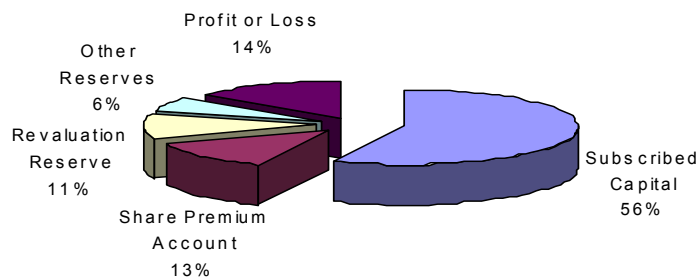
Figure 1. Portugal: Insurance Sector Capital Adequacy; 1998–2004



Source: Instituto de Seguros de Portugal.

18. The structure of own funds has been subject to the revaluation reserve that incorporates the changes in the market value of investments. At the end of 2004, capital represented about 70 percent of the total amount of own funds.

Figure 3. Portugal: Insurance Sector Structure of Capital in 2004

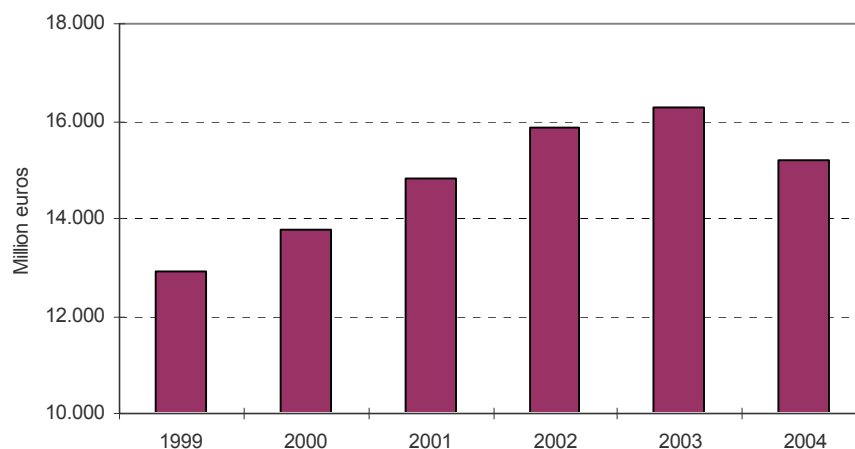


Source: Instituto de Seguros de Portugal.

### The pension funds market in 2004

19. In 2004, a total of 221 pension funds existed, of which 173 were closed funds. Those funds were managed by 14 life insurance companies and 13 pension fund management companies. The global asset value of the Portuguese pension funds market reached about €15 billion, equal to 11.2 percent of GDP (Figure 4).

Figure 4. Portugal: Total Value of Pension Funds; 1999–2004



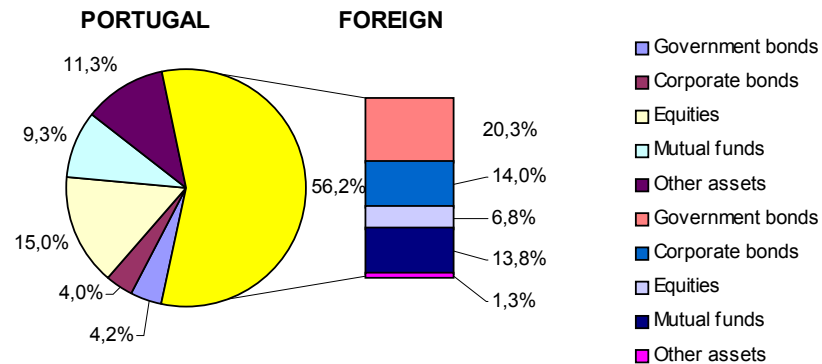
Source: Instituto de Seguros de Portugal.

20. Private pension funds cover the three pillars of private social protection. The main points regarding these funds in 2004 are:

- Whilst the first pillar accounted for 72 percent of the total private social protection, the main two sponsors were the banking (83 percent) and communications (17 percent) sectors;
- The closed pension funds accounted for 95 percent of the market;
- Individual membership accounted for 60 percent of the amount in open pension funds;
- There were 265,000 members (58 percent in closed pension funds) in respect of the first and second pillars, corresponding to 3.7 percent of the Portuguese employed population;
- The beneficiaries of the pension funds represented about 110,000, corresponding to around 4 percent of the number of beneficiaries of the general social security system;
- The benefits paid by pension funds corresponded to 11 percent of the total amount paid by the social security system; and
- The closed pension funds achieved an average funding level of around 106 percent.

21. Pension fund assets are mainly government bonds (24 percent), mutual funds (23 percent), corporate bonds (18 percent) and equities (22 percent) (Figure 5). The exposure to non-domestic assets was 56 percent, of which almost two-thirds were in bonds.

Figure 5. Portugal: Assets Structure of Private Pension Funds; 2004



Source: Instituto de Seguros de Portugal.

22. In 2004, the annual rate of return was about 7.2 percent. For open pension funds, the rate of return was 4.8 percent.

### **Instituto de Seguros de Portugal**

23. According to its Charter, the Portuguese Insurance Supervisory Authority (Instituto de Seguros de Portugal – ISP) is a public body, with administrative and financial autonomy and endowed with its own assets, but subject to the authority of the Minister of Finance. However, that authority is limited by the scope of powers that the minister can exercise under the terms set out in the ISP’s Charter. The ISP is responsible for the regulation, inspection and supervision of the businesses of insurance, reinsurance, insurance intermediaries and pension funds, as well as related or complementary activities.

24. Within the framework of its duties, the ISP shall also:

- Assist the Government and the Minister of Finance, at the latter’s request or on its own initiative, in defining policy guidelines for the insurance sector, including activities related with or complementary to the business of insurance, re-insurance, insurance intermediaries and pension funds;
- Implement that policy and control its performance;
- Cooperate with the peer authorities in other States, in particular with the authorities in European Union Member-States;
- Cooperate with other Portuguese authorities in their respective fields and, in particular, with the other financial supervisory authorities;
- Manage the funds ascribed to it by law.

25. According to ISP's Charter, supervision shall be carried out in accordance with the national and European Union's legislation in force and in a manner that ensures the proper functioning and protection of the market, guaranteeing the interests of insurance creditors. The ISP's Charter confers on the ISP extensive powers for the discharge of its duties and responsibilities. In regard to supervision, ISP shall, among others, carry out the following functions and powers:

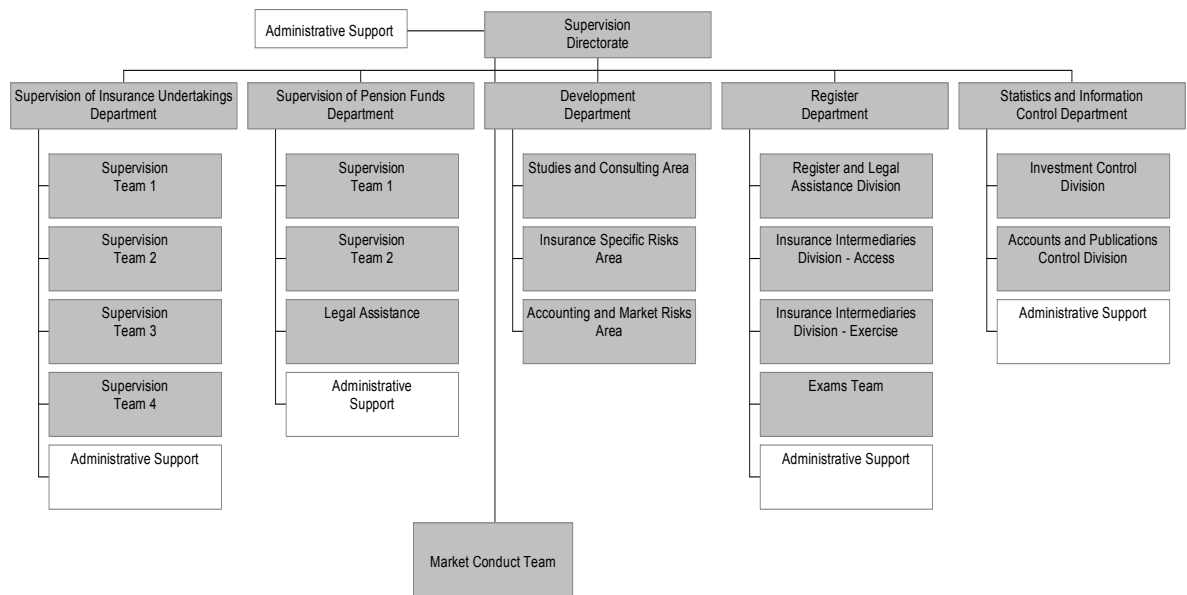
- Appraise and decide upon operations relating to undertakings subject to its supervision, namely the setting up, splitting and merging of insurance and re-insurance companies, and pension fund management companies, as well as their closure and winding-up and other matters related to their supervised activities and undertakings;
- Give its opinion on the manner in which companies with their head office in Portugal should pursue the business of insurance, re-insurance or pension funds in other countries, and grant them authorization to open agencies, branches and other forms of representation outside the European Union;
- Evaluate the technical provisions of companies subject to ISP supervision;
- Review the annual accounts of companies subject to ISP supervision and require adjustments, giving detailed grounds for this;
- Monitor the activities of companies subject to its supervision and control their compliance with applicable legislation and with rules on prudential control;
- Inspect, whenever it is deemed appropriate or in accordance with legal provisions, the companies subject to its supervision, request information and documents and conduct investigations and examinations of any entity at any location whilst performing its functions;
- Suspend authorization and determine the temporary suspension or definitive withdrawal of clauses, rates and the sale of products whenever there is a breach of the law, or whenever interested parties or the stability of the company or insurance sector are subject to an illegal risk;
- Keep a register of the management and audit bodies of undertakings subject to ISP supervision and of any agreements between the shareholders of those undertakings;
- Certify insurance and re-insurance intermediaries and carry out the corresponding supervision;
- Prepare infringement proceedings and set the corresponding fine;
- Prepare proceedings for any breach of regulations and apply or propose the corresponding fine and additional penalties.

26. The Decree-Law 94-B/98, of 17 April, which lays down the conditions governing the taking up and pursuit of the insurance business, defines in detail the tasks of the ISP

regarding the insurance companies subject to its supervision, covering in particular the following aspects: the authorization process; appraisal of the suitability of qualifying shareholders; appraisal of the suitability, technical skills and experience of the members of the management and auditing boards; prudential guarantees (technical provisions, solvency margin and guarantee fund); supervisory instruments; recovery measures; winding up of a company; portfolio transfers; complementary supervision of undertakings which are part of an insurance group; imposition of sanctions, among others.

- The ISP's tasks and powers are also defined in the Decree-Law 475/99, of 9 November, that governs the setting up and management of pension funds and pension fund management companies, and in the Decree-Law 388/91, of 10 October, that regulates the taking up and pursuit of insurance intermediation activities.
- Within the scope of its duties, the ISP has the power to issue regulations binding on the entities subject to its supervision, which are published in the Official Journal. The infringement of the regulations issued by the ISP is an administrative offence, which may be sanctioned by a fine and other additional penalties.
- Additionally, in the performance of its duties, the ISP issues binding instructions aimed at remedying any irregularities of which it is aware among the undertakings subject to its supervision. Any actions made in breach of specific instructions or bans issued by the ISP in the performance of its duties are null and void.
- Supervision of insurance, reinsurance, insurance intermediaries and pension funds is performed by the Supervision Directorate of the ISP. This Directorate, which comprises 67 staff members, 60 of them with technical functions, has recently been reorganized (Figure 6).
- The ISP issues and makes available on its website the Insurance and Pension Funds' Sector Report that describes and analyzes the structure and the technical and financial performance of the insurance and pension funds' market in Portugal. The report aims to identify the relevant trends and obtain reliable causal interpretations for any market changes that may be observed, by analyzing the data in terms of both national and international contexts. Statistical data are also supplied through aggregate financial data.

Figure 6. Portugal: Instituto de Seguros de Portugal – New structure of the Supervision Directorate



#### IV. PRINCIPLE-BY-PRINCIPLE ASSESSMENT

|                     |   |
|---------------------|---|
| <b>Principle 1.</b> | <b>Conditions for effective insurance supervision</b><br>Insurance supervision relies upon <ul style="list-style-type: none"> <li>• a policy, institutional and legal framework for financial sector supervision</li> <li>• a well developed and effective financial market infrastructure</li> <li>• efficient financial markets.</li> </ul>   |
| Description         | <p><b>Financial sector policy framework:</b></p> <p>The financial sector operates within a legal and institutional framework, which is publicly disclosed. There is a specific framework for each financial sector (banking, securities and insurance/pension). For the insurance sector, the fundamental legal framework consists of the insurance supervisory law, the Decree Law (DL) 94-B/98, of 17 April that lays down the conditions governing the taking up and pursuit of the insurance business. Subsequent regulation is issued in Norms, which are legally binding. Guidelines are issued as Circulars to express how the ISP wishes insurance undertakings to conduct business.</p> <p>All financial sectors are subject to the supervision of a public authority, whose governing bodies, functions, duties and powers are legally defined. The supervisory authority for the insurance business, re-insurance, insurance intermediaries and pension funds is the ISP.</p> <p>For the insurance sector, the Government's policy is established through the approval by the Minister of Finance of the annual plan of activities and of the annual report on the operations of the ISP [article 15 (a) (c) of the ISP's Charter]. The annual plan is made available to all interested parties, while the report on ISP's operations is available on the ISP website and published in the Official Journal.</p> <p><b>Financial market infrastructure:</b></p> <p>Portugal's judicial system has a constitutional basis. Courts are recognized as a sovereign body. In addition to the judicial system, the Constitution authorizes the implementation of courts of arbitration and justices of the peace, and other out-of-court dispute settlement bodies. These alternative dispute mechanisms have been enhanced during the last few years.</p> <p>Insurance undertakings apply rules and standards of the Insurance Undertakings Accounting Code (Plano de Contas para as Empresas de Seguros - PCES), approved by the Regulation of ISP 7/94-R, of 27 April. The structure and content of the annual accounts and of the consolidated accounts and the criteria to be used in evaluation are set out in the above-mentioned Code in accordance with the standards laid down in European Union Directives on this matter. In addition, for specific questions (such as mergers and deferment of the income tax) it is common to apply the accounting directives and the International Financial Reporting Standards.</p> <p>The ISP has recently approved the Regulation 5/2005-R, of 18 March, that allows insurance undertakings to prepare their consolidated accounts (if they are not already obliged to do so because they have issued securities admitted to trading on a regulated market of a Member State) and/or their annual accounts in conformity with the international accounting standards laid down in article 6(2) of the Regulation (EC)</p> |

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| <p>1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.</p> <p>The PCES requires the disclosure, in the notes on the accounts, of information related to the accounting standards that have been applied.</p> <p>With reference to the auditing standards, the auditing work is subject to technical standards and accounting directives approved and recognized by the Chamber of Statutory Auditors (Ordem dos Revisores Oficiais de Contas, the public association with which the statutory auditors must be registered) to ensure the application of international standards. On the other hand, the rules and international recommendations on auditing issued by the International Federation of Accountants are applied on a supplementary basis.</p> <p>The auditing and accounting professions are self-regulated professions. Registration requires the fulfillment of fit and proper requirements.</p> <p>Auditors must comply with several incompatibility requirements that aim at the preservation of the independence of the auditor regarding audit entities. Some issues about the auditors' independence included in the Recommendation 2002/590/CE, of 16 May, of the European Commission, are not yet incorporated into national law. However, a relevant proposal has been prepared and is awaiting final approval. The complete independence of the auditors will then be entirely assured.</p> <p>With reference to the actuarial standards, although the Instituto dos Actuários Portugueses (IAP – the Portuguese Institute of Actuaries) has been developing some guidelines on the responsibilities of actuaries, there is not a complete list of applicable actuarial standards. Market practice, however, shows that standards approved by actuarial professional bodies of the UK and US are used as references. The responsible actuaries must produce a report to the board of directors that should include the actuarial standards that were applied. This report is also copied to ISP, but is not available to the public.</p> <p>The responsible actuaries must be certified by the ISP based on the demonstration of their capabilities, as assessed by a committee.</p> <p>The Instituto Nacional de Estatística (Statistics National Institute) is the state-owned corporate body responsible for the collection, analysis, coordination and diffusion of official statistical data. It produces and makes available to anyone interested, on-line or on paper, statistical information on a wide range of subjects.</p> <p>The Banco de Portugal (BdP) ensures the collection and compilation of the monetary, financial, foreign exchange and balance of payments statistics, particularly within the scope of its co-operation with the European Central Bank. The Bank makes available to anyone interested, on paper or on its website, a broad set of statistical data included in the scope of its functions.</p> <p>In a similar way, the ISP ensures the collection, processing and publication of statistics on the insurance, reinsurance and pension funds sector, as well as other items of information needed for statistical purposes.</p> <p><b>Efficient financial markets:</b></p> <p>Capital and securities markets operate within a legal and institutional framework and infrastructures that are comparable to best international standards.</p> <p>An analysis of the investment portfolios of the insurance undertakings points to an</p> |
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|                     |  |
|---------------------|--|
|                     | increase in the securities listed on European markets, indicating the adoption of diversified investment strategies.   |
| Assessment          | Observed   |
| Comments            | Good conditions for effective supervision are in place. All professional resources are available and of a high standard. Market infrastructure allows for the efficient management of the sector. A wide range of operational services is available to insurance undertakings and allows them to focus on technical related aspects of the business. Supervision makes extensive use of actuarial services and allows for risk based supervision.  |
| <b>Principle 2.</b> | <b>Supervisory objectives</b><br>The principal objectives of insurance supervision are clearly defined.  |
| Description         | <p>The DL includes a clear statement of the mandate and responsibilities of the ISP. Further objectives related to the forthcoming year are also publicly defined and foster transparency.</p> <p>Legislation and regulation clearly define the objectives of insurance supervision. The key objectives of supervision promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.</p> <p>When deviating from its objectives, the supervisory authority gives reasons and explanations.</p> <p>The main objectives of insurance supervision are clearly defined, although in a generic way, in the Charter of the ISP. According to article 4 (2) of ISP's Charter, supervision shall be carried out in accordance with the national and Community legislation in force and in a manner that ensures the proper working and protection of the market, guaranteeing the interests of insurance creditors."</p> <p>The specific insurance supervision objectives are set out in the annual plan of activities of the ISP, taking into account the national state of affairs and European and international developments. The plan of activities is public; it can be made available, on request, to all interested parties.</p> <p>The annual report on ISP's operations describes the activities undertaken by the supervisory authority for the fulfillment of the annual objectives. Measures and actions taken in order to carry out the objectives are identified and progress in implementation is checked against the initial objectives. The annual report on operations is available on the ISP's website and is published in the Official Journal.</p> <p>In addition to ISP objectives purely related to insurance supervision, there are activities related to the management of guarantee funds and its claims settlement for Motor and Workers compensation which ought not to be necessarily within the scope of the organization. There are historic reasons for this alignment of supervision and guarantee funds but the work on those funds represents a potential reputation issue. Also, claims management should not be amongst the core competencies of the ISP.</p> |
| Assessment          | Observed   |
| Comments            | The objectives for ISP should be adjusted to allow the ISP to be freed from tasks related to guarantee funds and claims management. Given the current organizational structure, the smooth segregation of responsibilities on a departmental basis would be possible.  |
| <b>Principle 3.</b> | <b>Supervisory authority</b><br>The supervisory authority: <ul style="list-style-type: none"> <li>• has adequate powers, legal protection and financial resources to exercise its</li> </ul>   |

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|             | <p>functions and powers</p> <ul style="list-style-type: none"> <li>• is operationally independent and accountable in the exercise of its functions and powers</li> <li>• hires, trains and maintains sufficient staff with high professional standards</li> <li>• treats confidential information appropriately.</li> </ul>  |
| Description | <p><b>Legal framework</b></p> <p>The legislation identifies the ISP as the responsible authority for the regulation, inspection and supervision of the business of insurance, re-insurance, insurance intermediaries and pension funds, as well as connected or complementary activities. ISP has the power to issue regulations binding on the entities subject to its supervision, which are published in the Official Journal. The infringement of a regulation issued by the ISP is an administrative offence, which may be sanctioned with a fine and other additional penalties.</p> <p>ISP possesses extensive powers for the discharge of its duties and responsibilities. Among many others, the ISP possesses the powers and means to:</p> <ul style="list-style-type: none"> <li>• Verify that the activities of the insurance and reinsurance undertakings under its supervision comply with the technical, financial, legal and tax requirements;</li> <li>• Obtain detailed information about the insurance undertakings' financial position and activities as a whole, particularly, through data collection, requests for documents relating to the conduct of their business, and on-site inspections;</li> <li>• Adopt all sufficient and necessary measures to guarantee that the activities of the undertakings comply with the applicable legislation and regulations and to avoid or eliminate any irregularities prejudicial to the interests of the policyholders or beneficiaries.</li> </ul> <p><b>Independence and accountability</b></p> <p>ISP's independence is expressed in its Charter. The ISP is a state-owned corporate body with administrative and financial autonomy and its own assets. The ISP is subject to the authority of the Minister of Finance, but it is no longer under the Minister's supervision. According to the ISP's Charter, the Minister of Finance has the following powers:</p> <ul style="list-style-type: none"> <li>• To approve the ISP's annual budget, plan of activities and additional budgets;</li> <li>• To approve the ISP's annual report, balance sheet and annual accounts;</li> <li>• To approve the main internal regulation that defines the ISP's organizational structure, the powers and tasks of the various departments, the general rules to be observed when performing its activities, and, in general, all matters deemed relevant to its proper running;</li> <li>• To authorize the purchase, financial leasing or sale of property;</li> <li>• To review Management Board decisions suspended by the Chairperson if he/she deemed that they were in breach of the ISP's Charter or against the public interest.</li> </ul> <p>The supervisory powers have been almost exclusively assigned to the ISP. However, in some cases, the Minister of Finance has the following specific powers:</p> <ul style="list-style-type: none"> <li>• Authorization of branches of insurance companies whose head offices are outside the EU;</li> <li>• Authorizing ISP to demand that an undertaking increase its capital without following the standard procedures set out in the commercial law.</li> </ul> |

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|  | <p>The circumstances where the executive authority (through the Minister of Finance) can override the supervisory authority are specified and very few. There is no general right of administrative appeal to the Government against ISP's decisions.</p> <p>ISP's governance structure is clearly defined in its Charter and internal regulation. The ISP's Charter identifies the ISP's governing bodies – the Management Board, the Consultative Committee and the Audit Committee – defines their composition, mandate, appointment and term of office and delimits the powers of each body.</p> <p>The members of the Management Board, who are to be individuals of recognized ability, independence and competence, are appointed by the Council of Ministers under a proposal from the Minister of Finance for a period of five years, renewable for a second term only. The holding of any other office or the performance of any other functions by Management Board members shall be governed by the legislation dealing with incompatibilities. The Management Board members shall only leave office under specific circumstances.</p> <p>ISP's employees are also subject to a set of rules that strengthen the independence of the supervisory authority.</p> <p>Unless so indicated by the ISP for its own purposes, ISP employees may not work or provide services, with or without remuneration, for any undertaking subject to its supervision nor act as insurance intermediaries.</p> <p>Employees have to comply with a Code of Conduct that sets out several ethical principles related, among other issues, to the prevention of acts that could damage their own and the supervisory authority's independence.</p> <p>ISP is financed in a manner that does not undermine its independence from political, governmental or industry bodies. Although the ISP's annual budget is submitted to the Minister of Finance for approval and is then approved by the Parliament (because the budget of state-owned corporate bodies with administrative and financial autonomy is considered a component of the General State Budget), the ISP's revenue does not include any funds from the State Budget. Nevertheless, the Ministry possesses the power to confiscate the budget surpluses of ISP. These powers have been executed in 2004 and hence affected the limited financial resources available within ISP. ISP's revenue consists essentially of fees paid by the supervised undertakings.</p> <p>Although in recent years some State Budget Law provisions have reduced the degree of financial autonomy of the ISP on particular issues, for 2006 it expressly recognized that the public bodies, whose independent nature results from being financial supervisory authorities, are exempt from some of the budget restrictions imposed on other public bodies.</p> <p>Decisions of the ISP are subject to the legal framework and must always be technically based. This procedure grants consistency to the decisions of the ISP, preventing inappropriate decisions that could undermine its independence.</p> <p>The institutional relationship between the supervisory authority and the judiciary branches are also clearly defined and transparent. Like any other public body, the ISP's decisions may be subject to jurisdictional control.</p> <p><b>Powers</b></p> <p>ISP has been granted comprehensive powers in regard to the regulation, monitoring and supervision of the insurance business.</p> |
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|  | <p>In the performance of its duties, the ISP can issue binding instructions aimed at remedying any irregularities it is aware of among the undertakings subject to its supervision and can take all necessary actions. Any actions made in breach of specific instructions or bans issued by the ISP in the performance of its duties are invalid. More specifically, the ISP has the powers to impose recovery measures, whenever an insurance undertaking is in an inadequate financial position, in order to protect the interests of insured persons and beneficiaries and to safeguard the normal operating conditions of the insurance market. ISP can suspend authorization and determine the temporary suspension or definitive withdrawal of clauses, rates and the sale of products whenever there is a breach of the law, or whenever interested parties or the stability of the undertaking or insurance sector are subject to an unlawful risk.</p> <p>As a last resort, the ISP has the power to withdraw an insurance undertaking's authorization when serious irregularities in the management, accounting systems or internal auditing, or the infringement of laws or regulations governing its activities can put at risk the interests of insured persons or the normal operating conditions of the insurance market.</p> <p><b>Financial and Human resources</b></p> <p>The ISP's budget has been adequate to the performance of its regulatory and supervisory duties. The Minister of Finance establishes annually the effective fee payable, taking into account the ISP's proposal based on its estimated annual budget.</p> <p>The supervisory authority has been able to attract and retain skilled staff (although with limits on experienced staff), hire outside experts as necessary, provide training, and rely upon an adequate supervisory infrastructure and tools. The challenges of the implementation of Solvency II will emphasize even more the importance of attracting and retaining skilled and experienced staff.</p> <p>The ISP's annual report, balance sheet and annual accounts are published in the Official Journal and are available to the public on the ISP's website.</p> <p><b>Human resource and legal protection</b></p> <p>ISP has been able to attract and retain skilled staff and provides adequate training. The members of the board and the staff of ISP are protected against civil lawsuits in connection with the exercise of their official duties, provided they have acted in good faith.</p> <p>The ISP's staff and board members are subject to rules that are targeted at the prevention of a conflict of interests. In fact, the holding of any other office or the performance of any other functions by management board members is governed by legislation dealing with incompatibilities, which establishes few exceptions to the principle of exclusivity (for instance, to teach at the university, to receive author fees, to exercise inherent functions to the board member function).</p> <p>The ISP staff, unless so indicated by the ISP for its own purposes, may not work or provide services, with or without remuneration, for any undertaking subject to its supervision nor act against them nor act as insurance intermediaries.</p> <p>The ISP's staff and board members have to comply with a Code of Conduct that sets ethical standards that they should observe in their internal and external relationships and that establishes principles regarding the prevention and management of risks to</p> |
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|                     | <p>independence and risks of conflicts of interest.</p> <p><b>Confidentiality</b><br/> Members of the governing bodies of the ISP, as well as all persons working or who have worked for the ISP are bound by the obligation of professional secrecy in respect of all information they may exclusively acquire in the performance of their duties.<br/> The obligation of professional secrecy means that no confidential information received in the performance of their duties may be disclosed to any person or authority, except in a summary or aggregate form such that individual undertakings cannot be identified.<br/> The obligation of professional secrecy does not prevent the ISP from exchanging information needed to supervise the business of insurance with the competent authorities of other Member States. If the information comes from another Member State it may only be disclosed with the express agreement of the competent authorities that provided it and, if it is the case, only for the purposes to which the said authorities have agreed.<br/> The ISP may use confidential information received from another authority only in the performance of its functions. The ISP denies all information requests that do not comply with the above-mentioned requirements.<br/> Any public or private bodies or individuals providing any services on a permanent or temporary basis to the ISP must keep confidential all facts that they learn in the provision of those services. They must not, for any purpose, disclose nor use to their own or another's benefit, directly or through a third party, the knowledge they acquire from those facts.<br/> Notwithstanding any civil and criminal liability arising, a breach of the confidentiality, when committed by an individual or entity bound to the ISP by a service provision agreement, entitles the Management Board to terminate that agreement.</p> |
| Assessment          | Largely Observed  |
| Comments            | <p>ISP needs approval for its budget from the Ministry of Finance. Although all the expenses of the authority are covered by the fees charged to the supervised entities, ISP may be subjected to interventions throughout the year which could prevent it from achieving its goals. The charter should be amended to grant more independence in this respect. Moreover, ISP should be protected against inappropriate interference from executive branches and should be allowed to fully utilize its financial resources. Furthermore, ISP should reassess the staff resources required to fully implement Solvency II.</p>   |
| <b>Principle 4.</b> | <p><b>Supervisory process</b><br/> The supervisory authority conducts its functions in a transparent and accountable manner.</p>  |
| Description         | <p>The regulatory and supervisory processes have to comply with the legal framework, which guarantees that they are transparent and consistent. The supervisory process must be based on the law or/and on ISP's regulations, which exclude arbitrary or non-justified decisions. Nevertheless, the manuals on supervisory practices and procedures are being extended to a wider range of supervisory areas, in order to further facilitate the consistency of the decisions.</p> <p>The ISP decisions take into account the risk profiles of the companies. Some steps have been taken to implement a framework for a risk based supervisory policy.</p> <p>The laws and regulations are published in the Official Journal and are accessible on the</p>  |

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|                     | <p>ISP's website. The regulations issued by the ISP are subjected to a prior public consultation procedure.</p> <p>Appeals may be lodged under the general law against administrative acts performed by the Management Board, its Chairperson or by the ISP's departments, when performing delegated powers. The right of appeal does not prevent the ISP from making timely interventions in order to protect policyholders' interests.</p> <p>ISP makes the following available to the public on its website:</p> <ul style="list-style-type: none"> <li>• Information about its main role, duties, powers and organizational structure;</li> <li>• Its annual report, in which the following are described: (i) the measures and actions taken by the supervisory authority in respect of the annual objectives, and (ii) the degree to which those objectives have been implemented;</li> <li>• Statistics and general data about insurance and pension funds;</li> <li>• The main decisions of the management board.</li> </ul> <p>The ISP publishes and also makes available to the public on its website an annual activity report that: (i) describes and analyses the structure and technical and financial performance of the insurance and pension funds' market in Portugal; and (ii) tries to identify the relevant trends and obtain reliable causal interpretations for the changes observed in the market by adequately placing them both into the national and international contexts.</p>  |
| Assessment          | Observed   |
| Comments            | None   |
| <b>Principle 5.</b> | <p><b>Supervisory cooperation and information sharing</b></p> <p>The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.</p>  |
| Description         | <p>The cooperation and information sharing with other supervisory authorities is based on various agreements within the EU or with non-EU Member States. The existence of formal agreements is not a prerequisite for information sharing between the ISP and insurance supervisory authorities from other EU Member States or with the following entities in Portugal or in other Member States:</p> <ul style="list-style-type: none"> <li>• Authorities responsible for the official supervision of credit institutions and other financial institutions and the authorities responsible for the supervision of financial markets;</li> <li>• Bodies involved in the winding-up and bankruptcy of insurance undertakings and the competent supervisory authorities of those bodies;</li> <li>• Entities responsible for the detection and investigation of infringements of company law;</li> <li>• Bodies charged with managing winding-up or guarantee funds;</li> <li>• Central banks and other similar entities when acting as monetary authorities and other authorities responsible for supervising payment systems.</li> </ul> <p>However, the exchange of information is subject to professional secrecy commitments. ISP has not concluded any formal agreement with non-EU Member States.</p> <p>ISP has joined several EU-protocols:</p> <ul style="list-style-type: none"> <li>• Protocol of 26th October 1995 on the collaboration of the supervisory authorities of the countries of the European Economic Area with a view to the application of directives concerning life assurance and non-life insurance;</li> </ul> |

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| <ul style="list-style-type: none"> <li>• Protocol of 30th October 1997 relating to the collaboration of the supervisory authorities of the Member States of the European Community in particular in the application of the Directives on life assurance and non-life insurance;</li> <li>• Protocol of 11th May 2000 relating to the collaboration of the supervisory authorities of the Member States of the European Union in the application of the Directive on the supplementary supervision of insurance undertakings which are part of an insurance group.</li> </ul> <p>These Protocols are disclosed in the Committee of European Insurance and Occupational Pensions Supervisors website.</p> <p>The ISP has also concluded a Memorandum of Understanding (MoU) with the BdP as a basis for facilitating co-operation and the exchange of information. An equivalent MoU to be signed with the Comissão do Mercado de Valores Mobiliários (Portuguese Stock Exchange Commission – CMVM) is being presently developed.</p> <p>The ISP is allowed to exchange information with insurance supervisory authorities from other EU Member States, and thus it must, under certain circumstances, be obliged to provide them with certain information, namely:</p> <ul style="list-style-type: none"> <li>• If the ISP has knowledge of matters that suggest that the activities of a branch of an insurance undertaking whose head office is in another Member State and which is established in Portugal, is putting at risk the undertaking's financial soundness, this situation should be communicated to the competent authorities of the undertaking's home Member State;</li> <li>• If an insurance undertaking whose head office is in another Member State and which operates in Portugal through a branch or under the freedom to provide services, after being instructed by the ISP to put an end to an irregular situation, fails to remedy the situation, the ISP shall inform the competent authorities of the home Member State and ask it to take appropriate measures;</li> <li>• If, despite the measures taken, the undertaking remains in an irregular situation, the ISP shall adopt the legally prescribed steps to put an end to the committed irregularities or new irregular situations, after informing the competent authorities of the home Member State;</li> <li>• If the ISP applies any sanctions against an insurance undertaking whose head office is in another Member State, it must notify the competent authorities of the home Member State;</li> <li>• When it is within the scope of portfolio transfers;</li> <li>• When it is necessary for the supplementary supervision of insurance undertakings that are part of an insurance group.</li> </ul> <p>The information received from other supervisory authorities is subject to the conditions of professional secrecy and may only be disclosed with the express agreement of the competent authorities that provided it and, if it is the case, only for the purposes to which those authorities have agreed. In such cases, those authorities shall be informed of the identity and precise powers of the entities to which the information will be sent.</p> <p>In addition, the ISP may only use confidential information received from other supervisory authorities in the performance of its functions and to the following objectives:</p> <ul style="list-style-type: none"> <li>• To analyze conditions governing the establishment of the insurance business and to</li> </ul> |
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|                     | <p>supervise the conduct of such business, especially with regard to the monitoring of technical provisions, solvency margins, administrative and accounting procedures and internal control mechanisms;</p> <ul style="list-style-type: none"> <li>• To impose sanctions;</li> <li>• To deal with administrative or judicial appeals against decisions taken under the act that lays down the conditions governing the establishment and conduct of the insurance business or the respective supplementary legislation.</li> </ul> <p>The insurance supervisory authorities of the other EU Member States are subject to the same restrictions, and as mentioned above, the exchange of information with non-EU Member States is subject to a reciprocal guarantee of professional secrecy.</p>  |
| Assessment          | Observed  |
| Comments            | None  |
| <b>Principle 6.</b> | <p><b>Licensing</b></p> <p>An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.</p>   |
| Description         | <p><b>Definition of insurers</b></p> <p>An insurer is defined in paragraph 1 of article 8 of the DL as a financial institution whose exclusive aim is the pursuit of the business of direct insurance and/or of reinsurance, except for those classes or types which are legally reserved for certain kinds of insurers. They may also pursue business related or complementary to that of insurance or reinsurance, namely that which relates to salvage acts and contracts, to the reconstruction and repair of buildings, to the repair of vehicles, to the maintaining of medical facilities and to the application of provisions, reserves and capital.</p> <p><b>Permissible legal forms of insurers</b></p> <p>Insurance entities have to choose in accordance with article 7(1) of the DL one of the following legal forms: limited companies, mutuals, branches of insurance undertakings, public insurance or public capital companies or insurance companies that adopt the form of a European Company.</p> <p>The vast majority of insurance companies are operating in Portugal as limited companies and branches of insurance undertakings whose head offices are within the territory of other EU Member States. Only two authorized insurers are mutuals and only one is a branch of an insurance undertaking whose head office is outside of the EU.</p> <p><b>Responsibility for issuing licenses</b></p> <p>Establishment as an insurance undertaking is subject to authorization granted by ISP in accordance with articles 12(1) and 23 of the DL. For insurers of other Member States that intend to conduct business through a branch or under the freedom to provide services, licensing by the Portuguese supervisory authority is not required.</p> <p>The performing of insurance acts or operations without the necessary license is considered a criminal offence and is punishable by imprisonment for up to three years.</p> <p><b>Requirements for licensing of insurers</b></p> <p>The members of the boards and auditing bodies, have to possess suitable qualifications (namely through professional experience or academic qualifications) and recognized soundness (article 51 of the DL), despite the fact that the verification of these</p> |

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|  | <p>requirements is not obligatory for licensing.</p> <p>On the other hand, by the article 122-B, the insurance companies whose registered office is in Portugal shall appoint a responsible actuary, who must be fit and proper, as specified in ICP 7. The appointment of the responsible actuary only occurs after the licensing of the insurer.</p> <p>According to the company law, a statutory auditor must be part of the auditing body, which is responsible for the issuing of the legal certification of accounts. The statutory auditor must be a fit and proper person, either to join the profession of statutory auditors, or to be a member of the auditing body.</p> <p>Regarding shareholders, the incorporation of the insurance companies depends on, besides other factors, the verification of the aptitude of the shareholders who are significant owners, to ensure sound and prudent management of the insurance company, directly or indirectly. For more developments, see ICP 7.</p> <p>In addition to the requirements with which the board members of a new insurer must comply, the company must equally have economic and financial viability, and therefore the licensing of an insurance company depends on, among others, compliance with the following requirements:</p> <ul style="list-style-type: none"> <li>• The human resources are appropriate and sufficient to meet the company's aims;</li> <li>• The technical means and financial resources are appropriate and sufficient in relation to the classes of insurance to be pursued.</li> </ul> <p>In the terms of article 14(3) of DL, an application for the incorporation of an insurance undertaking, addressed to the ISP, shall contain a business operations plan, which shall include, among others, the following items:</p> <ul style="list-style-type: none"> <li>• The nature of the risks or commitments to be covered, plus an indication of the class or classes, types, insurances or operations to be undertaken;</li> <li>• The proposed guiding principles for reinsurance;</li> <li>• The items constituting the minimum guarantee fund;</li> <li>• The organizational structure of the undertaking (technical, financial and human resources to be used);</li> <li>• Estimates for each of the first three financial years: <ul style="list-style-type: none"> <li>• Forecast balance sheet and profit and loss account containing details, at least, to the subscribed and paid-up share capital, incorporation and installation costs, investments and technical provisions for direct insurance, reinsurance acceptances and reinsurance concessions, premiums, investment income, cost of claims and changes in technical provisions for both direct insurance and reinsurance acceptances and concessions, acquisition costs, detailing commissions and direct costs;</li> <li>• Number of employees and the respective wages bill;</li> <li>• Cash flow statement;</li> <li>• Financial resources needed to cover the technical provisions;</li> <li>• Solvency margin and the financial resources needed to cover it.</li> </ul> </li> </ul> <p>In operational terms, the ISP normally requests the balance sheet and profit and loss account, in accordance with the framework defined in the PCES, which includes more items than are legally demanded. Moreover, the ISP may request the applicant's representative for any explanations or additional items it considers useful and necessary</p> |
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|                     | <p>to analyze the file.</p> <p>If an insurance undertaking wishes to pursue certain classes or kinds of compulsory insurance, it shall register with the ISP the general and special conditions of the respective policies, as well as any amendments. Nevertheless, such notification does not constitute a prior condition for conducting business.</p> <p>Furthermore, related to insurance other than compulsory, the ISP may require insurers to provide systematic notification of the technical basis used to calculate life insurance tariffs, benefits, contributions and technical provisions. Also in this case, such notification does not constitute a prior condition for conducting business.</p> <p>In spite of that, the ISP's supervisory practice is to request and analyze such information in the evaluation of the applicant to assess the level of liabilities it is going to support, taking into account the parameters used and the economic aspects of the contract.</p> <p>In the scope of authorization file, information on reporting arrangements is not required. However, the insurance companies under the supervision of the ISP must send, periodically, a set of financial and statistical information, according to the legal framework.</p> <p>Finally, the authorization may only be granted provided all the founding shareholders agree to provide the undertaking with share capital of not less than the legal minimum. On the date of incorporation, the said minimum amount shall be paid-up and the balance, if any, shall be paid up within six months of that date.</p> <p>According to the article 9 of the DL, the business of direct life assurance and reinsurance may only be pursued in conjunction with accidents and sickness classes of non-life insurance. In addition, as stated by article 101 of the DL, the insurance undertakings, which pursue both the business of non-life insurance and the business of life assurance, shall establish a solvency margin for each business.</p> <p><b>Additional requirements</b></p> <p>It is a supervisory practice to demand additional information, taking into account the business volume or the solvency level required.</p> <p>During the three financial years that are subject to the estimates set out in the business operations plan, the insurance undertaking shall present a detailed annual report to the ISP on the implementation of the plan. If there is an imbalance in the undertaking's financial position, measures to strengthen the respective financial guarantees are imposed. Non-compliance may result in the authorization being withdrawn on the basis of a reasoned decision of the ISP. Any change to the estimates set out in the business operations plan shall require prior authorization from the ISP.</p> <p>Authorization to conduct the business of insurance may be withdrawn when authorization for changes to the estimates set out in the plan is not requested, is not granted, or is not approved.</p> <p>ISP has only granted two licenses within the last five years. The thorough assessment of required material will also be undertaken when companies are pursuing a recovery path.</p> |
| Assessment          | Observed  |
| Comments            | None  |
| <b>Principle 7.</b> | <p><b>Suitability of persons</b></p> <p>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</p>   |

| appropriate integrity, competency, experience and qualifications. |  |
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| Description   | <p><b>Governing bodies</b></p> <p>According to articles 51 and 54 of the DL , of 17 April, members of board and auditing bodies (including non-executive members), and the authorized agent of branches of insurance companies whose head office is outside the European Union territory have to be registered by the ISP.</p> <p>The legislation sets out the presumption that board members ought to be suitably qualified through professional experience, with the individual concerned having previously successfully held a position of responsibility in the financial or insurance field. The duration of that experience plus the nature and rank of the position of responsibility previously held should be in accordance with the characteristics and size of the insurance undertaking. Also, board members should have a sufficient knowledge of the Portuguese language. The ISP requires from the insurers, documentation demonstrating these requirements.</p> <p>The members of the auditing bodies, including the statutory auditor, shall also have suitable qualifications and recognized soundness. The ISP accepts as statutory auditors, those who are registered within the self-regulatory professional body (the Ordem dos Revisores Oficiais de Contas), which requires the fulfillment of a set of requirements for qualification.</p> <p>If ISP refuses registration, the insurers shall take the necessary steps to ensure that the persons concerned immediately cease to perform their functions.</p> <p>ISP may withdraw authorization to pursue the insurance business when the notification does not take place or the appointment of any member of the management or auditing bodies is refused.</p> <p>Regarding the incompatibility of the functions of the members of the governing bodies, besides incompatibility with the exercise of the functions of the responsible actuary, as outlined below, there are some functions that the auditing body may not exert [article 414 (3) of the Company Law]. According to paragraph 1 of the same article, the statutory auditor cannot be a shareholder of the insurer. Additionally, when the statutory auditor is a member of the auditing body, he is subject to the incompatibilities foreseen in articles 75 to 79 of the Legal Regimen of Statutory Auditors (Decree-Law 487/99, of 16 November).</p> <p><b>External auditor</b></p> <p>As regards the "external auditor", although mentioned in the DL (articles 105, 105-A and 161), the legislation does not identify specific fit and proper requirements. However, since auditors must always be statutory auditors, they have to comply with the established requirements in order to be registered with the Ordem dos Revisores Oficiais de Contas.</p> <p>The supervisory authority has no power to disqualify the appointment of “external auditors” of insurers that do not comply with fit and proper requirements.</p> <p><b>Responsible actuary</b></p> <p>Insurers shall appoint a responsible actuary (article 122-B of the DL), who must comply with the requirements set out in the regulations (Administrative Rule 111/94, of 30 June and ISP’s Regulation 9/94-R, of 27 July). The ISP certifies the responsible actuaries</p> |

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|            | <p>after the demonstration, before a jury, that they comply with the professional qualification and suitability requirements.</p> <p>That jury decides about the certification of the responsible actuaries through a curriculum evaluation and a curricular discussion exam that can be dispensed with, should the jury decide to do so.</p> <p>The IAP has approved a Code of Conduct for its members, and it can exercise disciplinary powers when its members fail to comply with that Code or with any other part of its Charter.</p> <p>While exercising that function, the responsible actuary cannot: i) be an employee or a member of the permanent staff of a supervisory authority; ii) be part of the jury that certifies the responsible actuary; iii) be a member of the governing body of an insurance undertaking; iv) or hold a qualifying holding in the insurance undertaking that nominated him as responsible actuary.</p> <p>ISP shall cancel the certification of the responsible actuary if he falls into a situation that would indicate incompatibility.</p> <p>ISP shall also cancel the certification of the responsible actuary if the requirements for the certification are no longer fulfilled or the actuary fails to comply with the necessary duties, although, until now, the ISP has not had to exercise this power.</p> <p><b>Significant owners</b></p> <p>An application for authorization shall contain a certification of no criminal records from founding shareholders who are natural persons and from the respective administrators, directors or managers, in the case of legal persons, and a declaration that neither the founding shareholders nor the undertakings they have managed or have been administrators, directors or managers of, have been declared insolvent or bankrupt [article 14 (1) of the DL].</p> <p>Any natural or legal person, or legally equivalent entity, who, directly or indirectly intends to acquire a qualifying holding in an insurance undertaking or who intends to increase his qualifying holding, must have recognized soundness, as required of board members of insurers, and must give information about his patrimonial situation. The requirements demanded from a legal person are related to the undertaking's financial position and the possibility of guaranteeing adequate supervision (article 43 of the DL).</p> <p><b>Senior management</b></p> <p>The Portuguese legislation does not set fit and proper and incompatibility requirements for senior management and the ISP does not have the power to disqualify the appointment of key officers.</p> <p>In accordance with the article 213 (b) of the DL , failure to inform the ISP of facts regarding the legal requirements relating to board members and auditing bodies or to authorized agents after notice has been given of their composition or identity, is a serious administrative offence, subject to a fine. In addition, ISP may ban the offender from membership of the governing bodies of entities subject to its supervision for a period of up to one year.</p> <p>A similar provision does not exist for the responsible actuaries, external auditors or senior management.</p> |
| Assessment | Largely Observed   |

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| Comments            | <p>The Law does not address fit and proper requirements for senior management and other key officers to a sufficient extent. There are no specific fit and proper requirements regarding insurance undertakings' external auditors and the supervisory authority does not have the power to disqualify an auditor that does not comply with such requirements. Also, the supervisory authority is not able to demand that significant owners that no longer meet fit and proper requirements dispose of their interests in the insurance undertaking.</p> <p>ISP will in the course of the next year, propose an amendment to the law that lays down the conditions governing the conduct of the insurance business, in order to:</p> <ul style="list-style-type: none"> <li>• Set specific requirements of fit and proper regarding external auditors and senior management;</li> <li>• Confer on the supervisory authority the necessary powers to: <ul style="list-style-type: none"> <li>• disqualify an external auditor or a senior manager that does not comply with fit and proper requirements;</li> <li>• demand that significant owners that no longer meet fit and proper requirements dispose of their interests in the insurance undertaking.</li> </ul> </li> </ul> <p>Furthermore, in anticipation of the legal amendment, ISP has already acted to inform the industry of the intended changes and asked companies to review the suitability of their personnel accordingly. There were no known cases where a correction of the existing situation would be required by the new regulation.</p> |
| <b>Principle 8.</b> | <p><b>Changes in control and portfolio transfers</b></p> <p>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.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>  |
| Description         | <p><b>Changes in control</b></p> <p>As stated in article 3 of DL, of 17 April, a relationship of control or power means the relationship that exists between a natural or legal person and an undertaking when one of the following situations arises:</p> <ul style="list-style-type: none"> <li>• The natural or legal person in question holds the majority of the voting rights;</li> <li>• As a partner in the undertaking the natural or legal person has the right to appoint or dismiss over half of the members of the governing body or the auditing body;</li> <li>• The natural or legal person is able to exercise a dominating influence on the undertaking by way of a contract or a clause in its memorandum or articles of association;</li> <li>• As a partner in the undertaking, the natural or legal person is able to control, by himself, by virtue of an agreement made with the other partners, a majority of the voting rights;</li> <li>• The natural or legal person holds not less than 20 percent of the capital in the undertaking, and effectively exercises a dominating influence on the undertaking or when they are both subject to the same management.</li> </ul> <p>Article 3 also defines qualifying holding as a direct or indirect holding that represents not less than 10 percent of the capital or of the voting rights of the undertaking in which the holding exists or which, for any other reason, makes it possible to exercise a</p>   |

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|            | <p>significant influence over its management.</p> <p>The supervisory authority requires that the potential controlling owners apply for approval for the acquisition, or change in control, of the insurers. Therefore, the above Decree-Law establishes that, any natural or legal person, or legally equivalent entity, who, directly or indirectly proposes to acquire a qualifying holding in an insurance undertaking or who proposes to increase his qualifying holding so that the proportion of the voting rights or share capital held by him would reach or exceed 20 percent, 33 percent or 50 percent or so that the undertaking would become his subsidiary, shall give prior notice to the ISP of his intention and the size of holding he proposes to acquire (article 43). ISP may oppose the plans if it considers the person concerned is not in a position to ensure sound and prudent management of the insurance undertaking. Administrative Order 292/99, of 28 April, which addresses acquisitions or changes in a qualifying holding in an insurance undertaking, requires natural person information about their patrimonial situation, and legal person information about their financial position and their ability to guarantee adequate supervision.</p> <p>The requirements also refer to the acquisition or change of control where the intermediate or ultimate beneficial owner(s) of an insurer is (are) outside the jurisdiction where the insurer is incorporated. According to point 5.6 of the protocol relating to the collaboration of the supervisory authorities of the Member States of the EU, exchanges of information between the Member States may include information on the good repute, competence or professional experience of a person who proposes to acquire a qualifying holding in an insurance undertaking, or to increase his qualifying holding so that the proportion of the voting rights or share capital held by him would reach or exceed 20 percent, 33 percent or 50 percent.</p> <p><b>Portfolio transfer</b></p> <p>The ISP approves the transfer of all or any part of the insurance business (articles 148 to 155 of DL), the merger or split of insurance undertakings and their winding-up (articles 238 and 121 of DL).</p> <p>The portfolio transfer may be authorized if the established requirements to assess insurers' applications provided in articles 148 to 155 of the DL are fulfilled. The requirements to assess insurers' applications for a merger or split of an insurance undertaking and its winding-up are not specifically included in the legislation. However, as these situations involve a portfolio transfer, the ISP always requires documentation to the accepting undertaking to check its financial capacity to assume the liabilities inherent to the contracts being transferred.</p> <p>In accordance with article 154 of the DL, from the ISP's authorization any transfer of portfolios produces effects for the policyholders, the insured persons and any other persons having rights or obligations arising out of the corresponding insurance contracts. However, the insured persons and policyholders may cancel their respective contracts within 30 days of the publication of the transfer in the Portuguese Official Journal. These procedures are also applied to the merger or split of insurance undertakings and their winding-up, as these situations include a portfolio transfer.</p> |
| Assessment | Observed  |
| Comments   | In the last five years, there have been 59 transactions involving mergers, qualifying holdings and portfolio transfers. None of those cases have presented severe problems or   |

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|                     | required refusal.  |
| <b>Principle 9.</b> | <p><b>Corporate governance</b></p> <p>The corporate governance framework recognizes and protects the rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.</p>   |
| Description         | <p>The principles of corporate governance that insurance undertakings must comply with are not codified in a single document, but they result from the legal framework applicable to the insurance business.</p> <p><b>Governance structure</b></p> <p>In accordance with the Portuguese Commercial Companies Law, corporations must adopt one of two management systems:</p> <ul style="list-style-type: none"> <li>• A unitary system, which consists of a board of directors overseen by an audit board or statutory auditor;</li> <li>• A dual system in which the management powers are shared between a board of directors and an advisory board, overseen by a statutory auditor.</li> </ul> <p>Both structures allow a clear delimitation of the powers, duties and responsibilities of each body or agent. Portuguese Commercial Companies Law sets rules about the composition, designation, and duration of mandates.</p> <p><b>Governing body</b></p> <p>The governing body is responsible for the review and guidance of the corporate strategy and for the monitoring of the insurance undertaking's activities.</p> <p>If the company's Charter does not forbid it, the governing body may delegate day-to-day management decisions to an executive committee composed of members of the governing body or to one or more members of the governing body.</p> <p>The Portuguese Commercial Companies Law establishes some rules that address the conflict of interest issue. In fact, the company is forbidden to grant loans or credit to members of the governing body, to make payments on their behalf, to guarantee their compliance with regulations in carrying out their duties or to give them advances of over one month. A member of the governing body cannot, as long as he has that function, hold, in the company or companies belonging to the same group, any temporary or permanent function as an employee, nor can he sign a contract to provide services after the term of the mandate as a member of the board.</p> <p>The DL requires members of the boards and auditing bodies of insurance undertakings to have suitable qualifications, namely through professional experience or academic qualifications and to have recognized soundness.</p> <p><b>Senior management</b></p> <p>Regarding senior management, the law does not impose fit and proper requirements. However, the ISP's regulation on risk management and internal control defines the senior management functions and responsibilities in relation to these important issues.</p> <p><b>Actuary and auditor</b></p> <p>The appointment of an actuary and auditor that comply with some legal professional requirements is obligatory.</p> |

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|            | <p>While exercising that function, the responsible actuary cannot: i) be an employee or a member of the permanent staff of a supervisory authority; ii) be part of the jury that certifies the responsible actuary; iii) be a member of the governing body of an insurance undertaking; iv) or hold a qualifying holding in the insurance undertaking that nominated him as the responsible actuary. The actuary has also a ‘whistle-blowing’ function: in the reports that he presents to the governing body of the insurance undertaking, he must, on detecting situations of material non-compliance or inaccuracy, propose measures which will allow for the resolving of these situations and should then be informed of the measures taken following his proposal.</p> <p><b>Risk management systems</b><br/>ISP’s regulations already define requirements on risk management related to specific issues like: i) assets that represent technical provisions; ii) definition, implementation and control of investment policy mechanisms; and iii) use and accounting of derivative instruments.<br/>ISP’s regulation on risk management and internal control requires insurance undertakings to implement a risk management system and defines the principles with which the insurance undertakings must comply.<br/>(For a more comprehensive explanation, see ICP 18).</p> <p><b>Internal control</b><br/>The DL establishes that insurance undertakings should have good administrative and accounting organization and adequate internal auditing. Minimal requirements regarding internal control have been established in extremely relevant areas like investments, derivatives, and anti-money laundering procedures.<br/>ISP’s regulation on risk management and internal control requires insurance undertakings to implement an internal control system and defines the principles with which the insurance undertakings must comply.<br/>(For a more comprehensive explanation, see ICP 10).</p> |
| Assessment | Largely Observed  |
| Comments   | <p>There is a low percentage of non-executive directors on governing bodies.<br/>The law does not expressly address some issues that relate to specific responsibilities of a governing body, such as:</p> <ul style="list-style-type: none"> <li>i) the establishment and monitoring of compliance with the standards of business conduct and ethical behavior for directors, senior management and other personnel;</li> <li>ii) the establishment and regular review of the policies that deal with conflicts of interest, fair treatment of customers and information sharing with stakeholders.</li> </ul> <p>There are a significant number of insurance undertakings that have not instituted audit committees.<br/>The responsible actuary is not granted direct access to the governing body nor is his independence from insufficient orders of the insurer completely assured.<br/>In 2005, ISP conducted an inquiry in order to collect relevant data on insurance undertakings’ governance structure and mechanisms (including internal control and risk management systems). In 2006, ISP will propose amendments to the law that lays down</p>   |

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|                      | <p>the conditions governing the conduct of the insurance business, in order to (i) establish the main and specific responsibilities of the insurance undertaking's governing body, and (ii) require insurance undertakings to approve and monitor compliance with the standards of business conduct and ethical behavior for directors, senior management and other personnel.</p> <p>The remaining weaknesses related to the statutory audit will be addressed when the Directive on statutory audit of annual accounts and consolidated accounts is transposed into national law. The preparatory work of that transposition is already being developed by a Working Group that includes representatives of the ISP, the BdP and the CMVM.</p>   |
| <b>Principle 10.</b> | <p><b>Internal control</b></p> <p>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 operations.</p>   |
| Description          | <p>The DL establishes that insurance undertakings should have good administrative and accounting organization and adequate internal auditing. They shall also ensure high levels of professional competency, complying with the minimum requirements regulated by the ISP. Insurance undertakings subject to supplementary supervision shall also have internal control procedures adequate for the production of data and information that would be useful in carrying out this supervision.</p> <p>Insurance undertakings should maintain written internal rules that establish the procedures according to which investment policies will be implemented and monitored, and which should identify the chain of responsibilities, define the procedures for recommendation, approval, implementation and monitoring of investment decisions and define the frequency and format of the internal report.</p> <p>Insurance undertakings must also ensure that (i) investment policies are implemented by persons with a suitable level of knowledge, (ii) their personal situation is not likely to cause a conflict of interest, and (iii) investment policies are monitored by persons other than those responsible for their respective implementation. Suitable internal control procedures for the purposes of monitoring the exposure to different types of investment risk must be maintained and, whenever there are deviations from the adopted investment policies, they must be described in a written internal report, together with the measures that the insurance undertaking proposes to implement, in order to resolve any deviation that has been detected and prevent future occurrences.</p> <p><b>New regulation on risk management and internal control</b></p> <p>Anticipating Solvency II project, a set of principles and requirements has already been incorporated in ISP's regulation (Regulatory Norm 14/2005). The main issues contained in this regulation are:</p> <ul style="list-style-type: none"> <li>• Organization structure. It is stated that the organizational structure of an insurance undertaking should be adequate to the dimension, nature and complexity of their business, assuring adequate support for the implementation of risk management and internal control systems.</li> <li>• Internal control and Audit. Similarly, a set of principles to be fulfilled in the implementation of the internal control system is specified.</li> </ul> <p>The internal control system should comprise all the organizational structure and all the</p> |

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|                      | <p>activities of the insurance undertaking.</p> <p>As for risk management, responsibilities are defined for the board of directors and for top management in regard to the internal control system.</p> <p>Concerning the audit function, explicit requirements are stated as regards its independence, authority, responsibilities and qualifications. Some principles concerning the valuations to be done by the audit function are also set out.</p> <p>Analyses following on-site inspections, ISP has made some recommendations to the insurers for the strengthening and implementation of their internal control procedures. Those analyses enabled ISP to assess the insurance undertaking's capability.</p> <p>During on-site inspections, it was possible to check that some insurers have formal procedures in different areas, such as commercial and claims management functions. In general, in financial and accounting areas the internal controls have been regarded as (almost) indispensable, considering the nature of the financial function itself.</p> <p><b>Audit and actuarial functions</b></p> <p>The role of both the external auditors and the responsible actuaries in the insurance business has already been taken into account in the legislation. The supervision process defined in the legislation comprises the existence of an audit function for prudential purposes, namely to certify the financial guarantees (covering of technical provisions and solvency margin) and other financial and statistical elements relating to the end of the financial year, that must be sent to the ISP. The new regulation on risk management and internal control systems establishes that the implementation of those systems must be audited by an external auditor.</p> <p>When preparing the reports, the responsible actuary shall understand the administrative, accounting and internal control procedures of the insurance undertaking that have a material influence on the analysis to be carried out. The responsible actuary shall carry out, in general terms, his appraisal on: i) the risk acceptance policy; ii) the contingent event management procedures; iii) the investment policy; iv) the reinsurance policy and other forms of transfer and acceptance of risks; and v) the information storage procedures. The responsible actuary should also issue an opinion on the structure of data used in his analysis and indicate the respective sources of information and should, whenever this is justified, indicate any inconsistencies found.</p> |
| Assessment           | Largely Observed   |
| Comments             | With the new regulation already approved and under implementation, ISP has ensured sufficiently that by 2007 all procedures for internal control will be in force. The "largely observed" assessment reflects the transitional period until full implementation.   |
| <b>Principle 11.</b> | <p><b>Market analysis</b></p> <p>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.</p>   |
| Description          | Article 16 of the ISP's Charter provides assurance that statistical data on the insurance, reinsurance and pension funds sector will be collected, processed and published. Also, annual reports on the insurance, reinsurance and pension funds market, its economic, financial and assets position and its place in the country's overall economic situation, will be published. ISP has to promote the preparation of technical studies relevant to the performance of its supervisory functions.   |

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|                      | <p>The analyses are mainly based on the comprehensive financial and statistical elements that are annually sent to ISP by insurance companies (Regulation of ISP 21/2003-R, of 26 December) (see ICP 12). These elements, as other non-systematic information received by ISP, are gathered, processed and then analyzed, in a quantitative and qualitative way. These analyses, which are done both at an individual and at an aggregated level, allow for the identification of trends and potential situations that may influence the financial stability of the insurance market.</p> <p>ISP's market analyses focus not only on past developments, but also, when possible, on the anticipation of problems that may come up in the insurance market as a result of macro, micro or international economic factors. In this context, some recent studies may be pointed out:</p> <ul style="list-style-type: none"> <li>• Decomposition and analysis of insurance companies results;</li> <li>• Study of the socio-economic function of insurance;</li> <li>• Impact of extraordinary costs resulting from mergers;</li> <li>• Impact of the stock market fall at the end of 2001 and its implication for companies' solvency;</li> <li>• Insurance companies eager to underwrite policies covering war and terrorism risks and its reinsurance cover;</li> <li>• The seismic risk coverage in Portugal, and the need to review the calculation rules for the equalization provision;</li> <li>• Analysis of the different profit participating mechanisms foreseen in life insurance contracts in the Portuguese market;</li> <li>• Mortality evolution of insured persons and pension fund beneficiaries;</li> <li>• The use of financial derivatives as a portfolio immunization technique in Life business;</li> <li>• The quality of credit of the bond portfolio of insurance undertakings and pension funds;</li> <li>• The health insurance market;</li> <li>• The importance of unit-linked products in life insurance;</li> <li>• The quality of credit of insurance undertakings and pension fund investments;</li> <li>• Equity capital control in the Portuguese insurance market.</li> </ul> <p>The statistics and studies prepared by ISP are made available, to the insurance industry and other interested parties, both through publications and on its website.</p> |
| Assessment           | Observed  |
| Comments             | None  |
| <b>Principle 12.</b> | <p><b>Reporting to supervisors and off-site monitoring</b></p> <p>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.</p>  |
| Description          | <p>ISP may request from all government departments and other public bodies, as well as from any private bodies, any information that is deemed relevant for ISP to fulfill its duties.</p> <p>ISP reviews the annual accounts of insurance companies subject to its supervision and, if necessary, requires adjustments and evaluates the coverage of technical provisions. It monitors the activities of insurance undertakings and controls compliance with applicable legislation and prudential control rules.</p>  |

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|  | <p>All insurance companies under ISP's supervision are also obliged to prepare a large number of reports and financial and statistical documents, and provide detailed individual and consolidated financial statements, so that its financial position and overall solvency may be known and assessed by ISP.</p> <p>The time period for submitting relevant documents is set at 15 days after the approval of the accounts in the Annual General Meeting (this meeting usually takes place by March 31st), and never later than April 30th (even if the accounts have not yet been approved). The information to be sent is organized in different modules: accounts and accounting elements; solvency; investments; technical provisions and technical analysis of non-life business; technical provisions and technical analysis of life business; reinsurance; and statistical analysis. This information is to be sent to ISP in standardized files and should be submitted electronically.</p> <p>Consolidated accounts must be prepared in accordance with the principles and rules set out in Regulation of ISP 31/95-R and should follow the same accounting principles existing for the insurance business.</p> <p>An insurance company in an inadequate financial position is required to submit for ISP's approval a recovery plan to restore the company's sound financial position (articles 109 to 112 of Decree-law).</p> <p>A set of analyses is taken into consideration:</p> <ul style="list-style-type: none"> <li>• Ratio analysis;</li> <li>• Evolution analysis;</li> <li>• Liabilities measurement analysis;</li> <li>• Scenario testing of solvency margin.</li> </ul> <p>The main ratios used are the growth of premiums ratio, the claims ratio, the expense ratio, the provisioning ratio, the portfolio structure ratios, the solvency ratio, the profitability ratio and the combined ratio.</p> <p>These ratios are analyzed not only on an annual basis, but also considering their evolution over time. The analysis allows for ratio comparisons with the market and/or with specific segments of insurers.</p> <p>Additionally, based on quantitative but mainly qualitative business information, and even though not yet in a totally structured way, a primary risk assessment is done within the supervisory analysis.</p> <p>In this context, changes of strategies, new classes of business, changes or delays in implementing business plans, poor information quality, poor response to audit management letters, the existence of a merger, acquisition or other significant transaction, reinsurance arrangements not consistent with commercial practices, numerous consumer or intermediary complaints, etc, are also considered relevant indicators in the supervisory process.</p> <p>There is no explicit reference in the legislation regarding timing for submission of the report on material changes that affect the evaluation of an insurer's condition. Nonetheless, it is foreseen in the legislation that, whenever a significant change may affect the situation of the insurance company, it should be previously communicated and/or authorized by ISP, namely in regard to:</p> <ul style="list-style-type: none"> <li>• Qualifying holdings;</li> <li>• Portfolio transfer/acquisition;</li> <li>• Take up of new classes or types of risk;</li> </ul> |
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|                      | <ul style="list-style-type: none"> <li>• Mergers / Divisions;</li> <li>• Opening of branches;</li> <li>• LPS.</li> </ul> <p>Apart from the aforementioned elements, insurance companies shall also, quarterly, draw up the balance sheet and the profit and loss account, as well as calculate the solvency margin situation and that of the coverage of technical provisions. Except for information on the coverage of technical provisions, these elements do not have to be systematically sent to ISP. In practice, whenever the situation of an insurance company justifies closer supervision, the information is required.</p>   |
| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 13.</b> | <b>On-site Inspection</b><br>The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.   |
| Description          | <p>The ISP requests information and documents and conducts investigations and examinations of any entity at any location whilst performing its function. In this context, ISP can extend on-site inspections to obtain information from intermediaries and companies that have accepted functions outsourced by the supervised insurer. The on-site inspections are performed by ISP employees. When performing those functions, staff enjoys the following prerogatives: i) may identify the entities that infringe the regulations, for subsequent action; ii) may request assistance from the administrative and judicial authorities; iii) may have access to the premises of the entities subjected to ISP supervision.</p> <p>According to article 157 of DL, when exercising the supervisory functions, the ISP has powers and means to obtain detailed information about the insurance company's position and their activities as a whole, particularly, through data collection, requests for documents relating to its operations in the insurance business, and on-site inspections. According to article 157-C, ISP can also carry out verification in loco of the information necessary to the carrying out of supplementary supervision.</p> <p>The governing body of the undertaking, directly or through the company's structures, shall present to the supervisors all the appropriate documents, give all the requested information and explanations and provide all the necessary conditions for an efficient on-site inspection.</p> <p>Most on-site inspections are planned starting from the detailed analysis of the information received by ISP (see ICP 12). Actually, the criteria to define the on-site inspections are frequently based on indicators that point out the existence of potential problems. Companies that have recently commenced operations are frequently inspected on-site in order to evaluate the accomplishment of the business plan, and better understand the organizational and functional structure of the entity, etc. It is also common to conduct on-site inspections of undertakings where a change of the governing body has occurred so as to assess the new strategies to be implemented in the company. There is no legal limitation concerning the areas that may be verified during an on-site inspection. In this sense, ISP has powers to conduct full-scale or focused inspections. Nonetheless, for practical reasons, it has been a supervisory preference to conduct inspections of specific areas.</p> <p>Furthermore, when planning and conducting the on-site inspections, supervisors usually</p> |

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|                      | <p>take as reference the reports from previous inspections on the matter.</p> <p>After the accomplishment of an on-site inspection, a report is prepared describing, in formal terms, the analysis performed and the conclusions and corresponding recommendations/corrective actions for any problematic situation observed.</p> <p>The main points are transmitted to the governing body of the insurance undertaking by letter and/or in a meeting with the members of the governing body of the entity.</p> <p>The systematic and technological approach should contribute to the more timely communication of the conclusions and recommendations. Nevertheless, most conclusions and recommendations are frequently transmitted during the on-site inspection, despite being subsequently formalized by letter.</p> <p>Generally, ISP's recommendations are well received by insurance companies. However, especially with regard to subjects which are more subjective and might have direct consequences on the company's results (namely, provisioning), closer monitoring of the implementation of the necessary corrective measures is frequently needed.</p> <p>Companies are required to inform ISP of the measures taken as a consequence of the recommendations made. When ISP considers the matter to be important, it closely follows up the implementation of those measures.</p> <p>On average, ISP performs twelve on-site inspections per year, which equals a full cycle about every four years.</p>  |
| Assessment           | Observed  |
| Comments             | None  |
| <b>Principle 14.</b> | <p><b>Preventive and Corrective Measures</b></p> <p>The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>  |
| Description          | <p>ISP has powers that enable timely preventive and corrective measures if an insurer fails to operate in a manner that is consistent with sound business practices or legal and regulatory requirements. In effect, the ISP has the following powers:</p> <ul style="list-style-type: none"> <li>• To seek injunctions whenever necessary to protect the stability of the insurance sector and to guarantee the interests of specific insurance creditors;</li> <li>• To issue binding instructions aimed at remedying any irregularities it is aware of among the undertakings subject to its supervision and to implement any necessary measures. Any actions taken in breach of specific instructions or bans issued by the ISP in the performance of its duties are invalid;</li> <li>• To suspend authorization and determine the temporary suspension or definitive withdrawal of clauses, rates and the sale of products whenever there is a breach of the law, or whenever interested parties or the stability of the undertaking or insurance sector are subject to an unlawful risk.</li> </ul> <p>The DL sets out a series of progressive and gradual measures that the ISP has the power to apply, taking into account the nature of the problem and proportionally to its degree of seriousness.</p> <p>At the first stage, if the ISP deems that an insurance undertaking is at risk of entering into an unsound financial position and if it considers that policyholders', insured persons' and beneficiaries' rights are threatened, it may adopt measures such as:</p> <ul style="list-style-type: none"> <li>• To require the insurance undertaking to submit a recovery plan based on a suitable scheme of operations for its approval;</li> <li>• To oblige the insurance undertaking to have a required solvency margin higher than</li> </ul> |

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|  | <p>that set forth in general.</p> <p>In practice, ISP seeks to anticipate, as much as possible, situations that could result in financial unsoundness. To achieve that purpose, the ISP requires more frequent reports on the coverage of technical provisions and/or on the solvency margin.</p> <p>Often, this preventive approach is the basis for the undertaking to take the necessary measures (e.g., increasing the capital, changing the risk pattern, changing the underwriting policy) in order to avoid future financial difficulties.</p> <p>At the second stage, whenever an insurance undertaking is already in an unsound financial position, the ISP, in order to protect the interests of policyholders, insured persons and beneficiaries and to safeguard the normal operating conditions of the insurance market, may decide to apply, for a period it shall set and to the extent appropriate, any or all of the following recovery measures:</p> <ul style="list-style-type: none"> <li>• Correction of the technical provisions or submission of a finance or recovery scheme;</li> <li>• Restrictions on the activities exercised, namely the pursuit of certain insurance classes and types or operations;</li> <li>• Restrictions on the acceptance of credit and on the application of funds to certain types of assets;</li> <li>• Ban or restriction on dividend payments;</li> <li>• Prior authorization from the ISP to carry out certain operations or actions;</li> <li>• Authorization or imposition of a reduction in share capital;</li> <li>• Restrictions or prohibitions on the free availability of its assets;</li> <li>• Suspension or discharge of members of the company's governing bodies;</li> <li>• Appointment of an auditing committee;</li> <li>• Closure and sealing of establishments.</li> </ul> <p>The ISP has also the power to impose corrective measures regarding insurance undertakings that are subject to supplementary supervision as insurance undertakings in an insurance group. If the adjusted solvency is negative, the ISP may require the insurance undertaking to submit a recovery plan.</p> <p>ISP may also, either as an isolated measure or in conjunction with any of the measures previously mentioned, appoint one or more temporary directors to the insurance undertaking.</p> <p>If ISP appoints one or more temporary directors or an auditing committee, it may also, together with the shareholders of the company in difficulty or otherwise, approve other measures needed for the recovery of the company, namely, an increase in share capital and the transfer of holdings in the company to third parties. When it is essential to the company's recovery, the ISP may oblige the shareholders to increase the company's share capital. Finally, if, after adopting recovery measures, it is clear that recovery of the company is not possible, authorization to conduct its respective activities shall be totally or partially withdrawn (see ICP 15).</p> <p>The measures to be adopted are gradually and progressively considered, taking into account the specificity of the problem and the subsequent corrective actions taken by the company.</p> <p>The adoption of these measures takes into account the nature and dimension of the financial problems and it may involve informal or formal methods depending on the sort</p> |
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|                      | <p>and importance of the required measure.</p> <p>In the last five years, ISP has imposed 1292 sanctions, most of which addressed the lack of timeliness in submitting information on workers' compensation claims. More severe breaches, totaling 85, were reported to the Public Prosecutor's Office.</p>   |
| Assessment           | Observed  |
| Comments             | None  |
| <b>Principle 15.</b> | <p><b>Enforcement or sanctions</b></p> <p>The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.</p>  |
| Description          | <p>In the performance of its duties, the ISP has, in general, the power to issue binding instructions aimed at remedying any irregularities it is aware of among the undertakings subject to its supervision and it shall take any measure necessary. Any actions made in breach of specific instructions or bans issued by the ISP are invalid. The hindering or obstructing of ISP's supervision is considered a serious administrative offence subject to a fine.</p> <p>Specifically, in order to protect the interests of insured persons and beneficiaries and to safeguard the normal operating conditions of the insurance market, ISP was granted a wide set of powers. In that situation, ISP may decide to apply, for a period it shall set and to the extent they are appropriate, any or all of the following measures:</p> <ul style="list-style-type: none"> <li>• Correction of the technical provisions or submission of a finance or recovery scheme;</li> <li>• Restrictions on the activities exercised, namely the pursuit of certain insurance classes and types or operations;</li> <li>• Restrictions on the acceptance of credit and on the applying of funds to certain types of assets;</li> <li>• Restriction or prohibitions to the free availability of its assets.</li> </ul> <p>Non-compliance with the instructions demanding the correction of the technical provisions, failure to present a recovery plan or financial scheme and the non-acceptance, on two consecutive occasions, or non-compliance with the aforesaid plan or scheme entitles ISP to suspend the insurance company from writing new contracts.</p> <p>If the ISP appoints an auditing committee or temporary directors to the insurance company, it may also, approve other measures needed for the recovery of the company. There is no specific rule allowing the ISP to adopt measures in order to protect an insurance company from financial difficulties arising from other entities of its group. Nevertheless, the ISP, if an insurance company belongs to a group, must certify that the structure of the group, and especially the proposed relationship between the company and the other entities in the group, allows for efficient supervision. This fact, along with the above-identified set of rules, contributes to close monitoring and to the possibility of intervention in order to protect the insurance company from financial difficulties in other parts of the group.</p> <p>The ISP has also adequate means to deal with management problems. The ISP may suspend, in whole or in part, the board of directors, the general council and any other bodies with similar functions, while, simultaneously or not, appointing temporary directors. The ISP may also appoint an auditing committee in conjunction or otherwise with the appointment of temporary administrators.</p> <p>The ISP has the power to oppose the plans to acquire or to increase a qualified holding</p> |

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|  | <p>in an insurance undertaking so that the proportion of the voting rights or share capital held would reach or exceed 20 percent, 33 percent or 50 percent, if it considers the person concerned is not in a position to ensure its sound and prudent management. ISP has the power to impose fines and other penalties on insurance undertakings and members of their governing body if they commit any administrative offences resulting from the failure to comply with the provisions of the legislation or regulations issued by the ISP.</p> <p>The failure to send the documents required by the ISP within the set period, the failure to provide information, notice or explanations and the supply of incomplete or inaccurate information to the ISP are considered administrative offences.</p> <p>The process of applying sanctions does not delay necessary preventive and corrective measures and enforcement. In fact, while the administrative offence procedure is taking place the ISP may impose preventive and corrective measures.</p> <p>Without prejudice to the provisions concerning sanctions to be applied for infringements of the insurance business regulations or concerning the non-existence or inadequacy of minimum guarantee funds, authorization may be withdrawn when any of the following situations arise:</p> <ul style="list-style-type: none"> <li>• Authorization was obtained by means of false declarations or other illicit means, regardless of the penal sanctions relating to the case;</li> <li>• The insurance undertaking ceases trading or significantly reduces its operations for a period of more than six months;</li> <li>• One of the legally required conditions relating to the taking up and pursuit of the insurance business required is no longer fulfilled;</li> <li>• Serious irregularities are detected in the management, accounting systems or internal auditing of the undertaking, that put at risk the interests of insured persons or the normal operating conditions of the insurance market;</li> <li>• The undertaking's total equity is valued at less than half of the legal amount for share capital and, at the same time, does not cover the undertaking's solvency margin;</li> <li>• Notification of the appointment of any member of the management or auditing bodies does not take place or it is refused;</li> <li>• The authorization to alter the business operations plan is either not requested or is not granted, or approval of the plan is withdrawn;</li> <li>• The undertaking infringes the laws or regulations governing its activities in a way that puts at risk the interests of insured persons or the normal operating conditions of the insurance market.</li> </ul> <p>Finally, with the aim of protecting the insurance market and the policyholders, performing any actions or operations concerning insurance or reinsurance on one's own behalf or on behalf of a third party, without the necessary authorization is punishable, as a criminal offence, by imprisonment for up to three years, and as a very serious administrative offence, by a fine and additional penalties.</p> <p>The criminal offence is processed by the Court.</p> |
| Assessment   | Observed  |
| Comments   | None:   |
| <b>Principle 16. Winding-up and exit from the market</b> |   |

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|             | <p>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.</p>  |
| Description | <p>The Portuguese law regulates the situations in which insurance undertakings can cease operations:</p> <ul style="list-style-type: none"> <li>• Voluntary winding-up;</li> <li>• Winding-up as a result of the withdrawal of the ISP's authorization, for either financial or non-financial reasons;</li> <li>• Winding-up as a result of a court's decision that in Portugal can only be required by the ISP.</li> </ul> <p>Although complete information is garnered from several sources, the law sets out the situations and procedures to be followed in regard to the insolvency and winding-up of an insurance undertaking for financial reasons:</p> <ul style="list-style-type: none"> <li>• The objective situations that are grounds for a court to declare an insurance undertaking insolvent (when the insurance undertaking's assets are clearly insufficient to meet its liabilities);</li> <li>• The situations that are grounds for the ISP's decision to withdraw the insurance undertaking's authorization (the continuation of the insurance undertaking's operations is no longer possible because, after adopting recovery measures, it is clear that recovery of the undertaking is not possible);</li> <li>• The requirements concerning publicity, information and drawing up of the list of creditors;</li> <li>• The liabilities liquidation procedures.</li> </ul> <p>The protection of the rights and entitlements of policyholders and other policy beneficiaries in the event of an insurer becoming insolvent and winding-up is the main principle of the winding-up system.</p> <p>In fact, the law grants to insurance creditors (insurance policyholders, insured persons, beneficiaries or any injured third party that has the right to file a claim against an insurance undertaking as a result of an insurance business contract) a "double preference" over any other claim:</p> <ul style="list-style-type: none"> <li>• With respect to assets covering the technical provisions, with the exception of the expenses arising from the winding-up procedure;</li> <li>• On the remaining share capital required in order to reach the amount that was not satisfied under the terms of the previous preference over any other claim on the insurance undertaking, with the following exceptions: <ul style="list-style-type: none"> <li>• Claims by employees arising from employment relationships;</li> <li>• In the case of the "Non-Life" classes of business, claims in relation to assets subject to a right <i>in rem</i>.</li> </ul> </li> </ul> <p>In spite of this "double preference" system in favor of insurance creditors, the ISP has been favorable to the approval of a EU Directive regarding the setting up of insolvency guarantee funds, because it can assure a greater level of protection to insurance creditors in case of an insurance company winding-up.</p> |
| Assessment  | Observed   |
| Comments    | None   |

| <b>Principle 17.</b> | <b>Group-wide supervision</b><br>The supervisory authority supervises its insurers on a solo and a group-wide basis.  |
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| Description          | <p><b>Insurance groups</b></p> <p>DL addresses the supplementary supervision on a group-wide basis. Article 172-B e 172-A of DL defines which insurance companies are parts of the insurance group, and which companies will be taken into consideration in the scope of the supplementary supervision.</p> <p>In the application for authorization, the founding shareholders, direct or indirect, shall be identified, plus detailed information about the structure of the group. The structure of the group shall allow adequate and efficient supervision; otherwise ISP may even deny authorization.</p> <p>Insurance companies are required (article 16 of Regulation of ISP 23/2002-R, of 5 December) to send a complete and detailed organizational structure of the insurance group, making it possible to identify the chain of relationships between all undertakings of the group.</p> <p>Undertakings that control one or various companies (on an exclusive basis or jointly with one or more undertakings that are not included in the consolidation) shall, according to article 2 of Decree-Law 147/94, 25 May, be obliged to draw up consolidated accounts and a consolidated annual report. Those consolidated annual reports and accounts shall be submitted to and analyzed by ISP.</p> <p>As foreseen in the legislation ISP may waive the calculation of the adjusted solvency calculation when, for the same group, a calculation is done at a “higher” group level. The adjusted solvency calculation shall be done annually, certified by an official auditor and submitted to ISP.</p> <p>The insurance companies’ annual report includes generic information on reinsurance, where any connections of the reinsurer with the insurance company should be indicated, namely, if the reinsurer belongs to the group. This information allows, in some way, a preliminary analysis of reinsurance in the context of the group.</p> <p>It should also be emphasized that the information requested by ISP has been reformulated and, regarding reinsurance, significant, new and relevant information is being required.</p> <p>Concerning the risk concentration, even though there is no specify regulation established at the group level, some dispersion limits should be observed regarding the assets covering technical provisions (e.g., taken as a whole, securities and short-term debt instruments issued by the same company and credits resulting from loans granted to this same company may not represent more than 5 percent; the previous limit is 20 percent for the set of companies that hold, between each other or with the insurance company, a controlling interest or group relationship, including within this limit deposits in credit institutions in an identical relationship).</p> <p>Under the terms of article 172-E(3) of DL, the ISP should also exercise general supervision over intra-group transactions. These transactions concern namely loans, guarantees and off-balance-sheet transactions, elements eligible for the solvency margin, investments, reinsurance operations, agreements to share costs, credits, operations with derivatives, alternative risk transfer operations, services transfer agreements regardless of whether or not they involve payments, and distribution of dividends in advance.</p> <p>The process of cooperation and coordination of supplementary supervision is dealt with</p> |

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|                      | <p>according to the Helsinki protocol. Each coordination committee is defined on a case-by-case basis considering the specific characteristics of the insurance group and, even though the responsibility for the supplementary supervision stays with each supervisor, one supervisory authority that should be in charge of coordinating the supervision of that group is usually appointed.</p> <p><b>Financial Conglomerates</b></p> <p>The legislation that considers the supplementary supervision of financial conglomerates has been prepared together with BdP and CMVM and it has already been approved by the Council of Ministers.</p> <p>For determining whether activities in different financial sectors are significant, the weight of the smallest financial sector entities in the group should exceed 10 percent in terms of the average total balance sheet and solvency requirements. The legislation also indicates which entities shall be subjected to supplementary supervision at the level of the financial conglomerate.</p> <p>In order to facilitate and establish supplementary supervision on a broad legal basis, it is anticipated that the coordinator and other directly relevant competent authorities, and where necessary other competent authorities concerned, might have coordination arrangements in place, whereby additional tasks might be assigned to the coordinator. Adequate procedures ensure that the risk monitoring systems are well integrated into the organization, and that the internal control mechanisms include adequate mechanisms as regards capital adequacy to identify and measure all material risks incurred.</p> |
| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 18.</b> | <p><b>Risk assessment and management</b></p> <p>The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.</p>  |
| Description          | <p>Although the legal and regulatory environment already identifies risk management and internal control as essential pillars of the prudent and sound management of insurance companies, only recently have specific requirements on these matters been established. Regarding risk management the main issues of this regulation are:</p> <p>A set of principles to be adopted in the implementation of the risk management system, focusing on the need to identify, measure and manage the risk to which the undertaking is exposed, are included in the new regulation. The risks to be taken into account by the risk management system are clearly indicated (insurance risk, market risk, credit risk, liquidity risk and operational risk) and qualitative and quantitative analyses (namely stress tests and scenario analysis) are required.</p> <p>In practice, and even though the requirements are recent, some insurance companies, namely the bigger ones and those that belong to international groups, are already acting in accordance with a risk management perspective (this was evident in the answers to ISP's questionnaire on corporate governance matters). Also insurance companies that belong to financial conglomerates take advantage from the banking regulations that already include the identification and definition of certain risks.</p> <p>The insurance undertaking's investment policy should be tailored to its specific needs, and should take into special consideration the nature of commitments assumed within the framework of the insurance contracts that are underwritten, the characteristics of the</p>                          |

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|                      | <p>insured population and the duration of the commitments assumed.</p> <p>Insurance undertakings should define, implement and monitor internal procedures according to the investment policies. Those procedures should identify the chain of responsibilities; define the procedure for recommendations, approval, implementation and monitoring of investment decisions; and define the frequency and format of the internal report.</p> <p>The procedures adopted for implementation and control of investment policies should be subject to appraisal by an official auditor and an analysis of the investment policies should be included in the responsible actuary's annual report.</p> <p>Regarding the establishment of risk management committees, although not explicitly required in legislation, some insurance companies, namely the bigger ones, have this kind of committee to deal with investment risk in particular. Some risk management functions are also observed regarding portfolio management and asset-liability management.</p>  |
| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 19.</b> | <p><b>Insurance activity</b></p> <p>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.</p>   |
| Description          | <p>The responsible actuary should present in the annual report the analysis undertaken in order to verify the suitability, sufficiency and conformity with prevailing legislation of the premiums practiced by the insurance undertaking. The analysis to be carried out by the responsible actuary should take into consideration the factors that may affect the results of the class of insurance, including all direct or indirect income and costs, namely:</p> <ul style="list-style-type: none"> <li>• Claims incurred, including adjustments that may have to be introduced;</li> <li>• The costs resulting from the acceptance of insurance contracts, in particular brokerage and mediation commissions (acquisition costs);</li> <li>• The costs resulting from the management of insurance contracts, in particular costs related to the collection of premiums, management of the insurance portfolio (administrative costs), as well as costs associated with investment management;</li> <li>• Any other costs that may lead to obligations resulting from insurance contracts.</li> </ul> <p>Actuarial reports address the calculation of the provision for unexpired risks and discount rates applied. The responsible actuary should also present the analyses carried out in order to evaluate the appropriateness of the tariff practiced by the insurance undertaking. In this context, the responsible actuary should take into consideration different hypotheses and different future scenarios that reflect not only the most likely developments, but also the more extreme and adverse developments in the financial position of the company, that may take place.</p> <p>The need to address specific risks associated with writing insurance contracts, namely the product design, pricing, underwriting, reserving, claims management and reinsurance is adequately addressed in the regulation. The policies, strategies and risk management and internal control procedures concerning these areas will, therefore, have to be documented. In practice, ISP's supervision in this field has been mainly based on the annual information submitted by insurance companies together with the responsible</p> |

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|                      | <p>actuary's annual report.</p> <p>Regarding the risk assessment, a review of the company's procedures is being included in the course of on-site inspections.</p> <p>Information on reinsurance treaties is annually submitted to ISP, which facilitates the ongoing supervision of the undertaking's reinsurance policy. ISP has, recently, significantly changed information requirements concerning reinsurance in order to allow a more in-depth analysis.</p> <p>ISP may decide to lower the reinsurance reduction factor considered for the calculation of solvency, whenever the nature or quality of an insurance company's reinsurance treaties have undergone significant changes since the previous financial year, or when there is no effective or significant transfer of risk to the reinsurer.</p> <p>Based on the global market analyses on the quality of the reinsurers used by Portuguese insurance companies, it is possible to conclude that most of the reinsurance business is done with high rating reinsurers.</p> <p>Regarding the proper accounting of the risk transfer instruments, the financial information must fulfill the rules and standards set by the PCES, approved by the Regulation of ISP 7/94-R, of 27April.</p> <p>The PCES defines that, with the exception of certain specific cases, no compensation among assets and liabilities, or between cost and income accounts, is allowed.</p> <p>Concerning reinsurance, the PCES states that liabilities may not be net accounted. Nonetheless, gross technical provisions may be partly covered by the reinsurer, but only up to the limit of the collateral set aside by the reinsurer.</p> |
| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 20.</b> | <p><b>Liabilities</b></p> <p>The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and make 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.</p>  |
| Description          | <p>According to article 69 of DL, of 17 April, insurance companies must have technical provisions that shall, at any time, be sufficient to enable the company to meet, to the extent that they are reasonably foreseeable, the commitments resulting from the insurance contracts.</p> <p>The legislation sets out what is to be included as a liability, which technical provisions shall be established and maintained by insurance companies and Regulation of ISP 19/94-R prescribes the methods, rules and principles to be taken into consideration in technical provisions calculations:</p> <ul style="list-style-type: none"> <li>• Provision for unearned premiums - shall include the part of gross premiums issued that can be attributed to one or more subsequent financial years.</li> <li>• Provision for unexpired risks - corresponds to the amount required to meet probable claims and charges that will arise after the year-end and exceed the value of contingent premiums and demandable premiums relating to contracts in force.</li> <li>• Claims outstanding - corresponds to the total cost estimated which the insurance company must support to regularize all of the claims which have occurred before the end of the year, whether notification has been received or not, following the</li> </ul>  |

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|  | <p>deduction of sums already paid out related to these accidents.</p> <ul style="list-style-type: none"> <li>• Provision for bonuses and rebates – corresponds to the payments to the insured or the beneficiaries of the contracts, under the participation of profits, provided that these payments have not already been distributed.</li> <li>• Provision for assurance and operations in the “Life” insurance – represents the value of the insurance company’s liabilities net of policyholders’ liabilities, in relation to all life assurances and operations. Namely, provisions should be established to cover the risks of mortality, installments guaranteed on the date they come due or the guaranteed redemption values, to cover guaranteed interest rates and to deal with the aggravation of risk inherent to the progression of the average age of the group insured.</li> <li>• Provision for ageing - corresponds to the estimated actuarial value of insurance company commitments less the actuarial value of future premiums.</li> <li>• Equalization provision - intended to meet exceptionally high claims in those classes of insurance which, by their nature, are expected to produce the greatest variations.</li> </ul> <p>The legislation also considers the possibility of other technical provisions being established by ISP.</p> <p>When assessing compliance with the regulations, the responsible actuary should justify the methods and the hypotheses on which he has based his analysis of the sufficiency of technical provisions.</p> <p>If any sensitivity test carried out describes a change in the results that may lead to an insufficiency in the solvency margin, the responsible actuary should also describe the tests carried out on the level of premiums, management costs and investment and provisions policies that, on a joint or isolated basis, may ensure the fulfillment of solvency requirements.</p> <p>A “Manual of Procedures on the Evaluation of Automobile Claims Outstanding” is at the disposal of supervisors. This manual contributes to more homogeneous and standardized procedures, not only in the analysis of information received from companies, but also for on-site inspections.</p> <p>The assessment of technical provisions has also, and to a great extent, been done in the course of on-site inspections. These inspections usually involve the evaluation of the internal control system of the company, the analysis of the claims management and provisioning procedures, and the gathering of individual claims process information for a case by case analysis.</p> <p>Any deficiencies detected in the course of on-site inspections are communicated to the company, either in writing or through a meeting with the board of directors.</p> <p>Concerning mathematical provision in life products, an ongoing evaluation is done based on the information provided to ISP. In the authorization processes, the adequacy of the actuarial principles and of the technical basis is considered.</p> <p>For each type of life insurance product and for each segregated fund, insurance companies should submit information about the discount rate and the mortality table used in the calculation of the respective mathematical provision. Furthermore, they should also submit information about premiums, claims, insured capitals and bonus participations. There is also information about the maturity of the commitments.</p> <p>The information concerning the discount rates and the mortality tables used in the calculation of the mathematical provisions is compared with the investment rate on</p> |
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|                      | <p>assets that back those liabilities and with the overall mortality behavior of the market. The analysis of all these sources of information allow the supervisor to focus on the situations that present more risk, namely the situations where the insurer calculates the mathematical provision of an old product using discount rates that are not aligned with the rates of return of the assets.</p> <p>Furthermore, in the course of on-site inspections the evaluation of the adequacy of mathematical provisions for specific contracts is also analyzed.</p> <p>In accordance with article 108-A of DL, whenever ISP deems that an insurance company is at risk of entering into an unsound financial position and that insured persons' and beneficiaries' rights are threatened, that company shall, on request and within the time limit set, submit a recovery plan based on a suitable business operations plan for ISP's approval.</p> <p>If ISP verifies that the technical provisions are inadequate or are incorrectly established or covered, the insurance company shall immediately rectify the situation in accordance with ISP's instructions.</p> <p>The non-acceptance of the above mentioned actions may give rise, if the ISP so decides, to the suspension of authorization to make new contracts or to the application of any other legal measures.</p> <p>In practice, and in sequence of the analysis done, some situations have been identified where an increase in technical provisions has been requested by ISP (namely claims outstanding provision). These situations have been considered together with the insurance company, namely with the board of directors and/or with the responsible actuary and outcomes have been agreed. ISP closely monitors the process of provision strengthening.</p> <p>Apart from technical provisions, insurance companies are required to establish other provisions (non-technical), to correct asset elements and to register other liabilities derived from specific risks (provisions for other risks and charges).</p> <p>The calculation methods for these non-technical provisions are described in ISP's regulations.</p> |
| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 21.</b> | <p><b>Investments</b></p> <p>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.</p>   |
| Description          | <p>Taking into consideration the importance of investments in the assets of an insurance company, the legislation and regulation on this issue is quite extensive in order to deal with the complexity of risks faced by insurance companies in the area of investment management.</p> <p>The legislation and regulation vary regarding the type of liabilities that the investments are covering, and the following different portfolios have to be identified:</p> <ul style="list-style-type: none"> <li>• Life assurance with profit sharing features and without autonomous investment;</li> <li>• Life assurance with profit sharing features, with autonomous investment – by means of an autonomous fund;</li> <li>• Life assurance in which the investment risk is borne by the policyholder – by autonomous fund;</li> </ul>   |

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|            | <ul style="list-style-type: none"> <li>• Life assurance without profit sharing features and capitalization operations, without autonomous investment;</li> <li>• Life assurance without profit sharing features and capitalization operations, with autonomous investment - by means of an autonomous fund;</li> <li>• Workers' compensation insurance;</li> <li>• Other Non-Life insurance.</li> </ul> <p>The Regulation of ISP 13/2003, of 17 July, establishes a set of rules regarding the covering of technical provisions, and mechanisms of definition, implementation and control of the investment policy, establishing the general principles to be taken into consideration in the definition of the investment policy, as well as some minimum requirements to be fulfilled.</p> <p>The principles to be considered in the implementation of insurance company's investment policy are related to an adequate diversification and dispersion of investments, avoiding an excessive dependence on any one asset, issuer or business sector. Moreover, the selection of investments should also be carried out with due consideration to their intrinsic risks and market risk, together with available credible information.</p> <p>The portfolio's investment composition and diversification is governed by Regulation of ISP 13/2003-R.</p> <p>Regarding the type of assets covering technical provisions, article 4 of the above mentioned ISP's regulation establishes a set of conditions for their admission. There are also limits or restrictions concerning credits.</p> <p>Assets covering technical provisions that can be deposited shall be deposited in appropriate accounts with credit institutions. Land and buildings may only be admitted as assets that cover technical provisions in the event that they are registered in the land registry office as property of the insurance undertaking.</p> <p>Regarding the limits established in the regulations, it is possible to overcome some of them, provided that the insurance undertaking demonstrates that the excess results from the application of an investment policy based on efficient joint asset-liability management that makes it possible to guarantee, with a high degree of probability, a suitable level of coverage of certain commitments. For that purpose, the insurance undertaking must submit to ISP the study of efficient asset-liability management that underlies the investment policy that it proposes to implement.</p> <p>The investment policies should be defined for each investment portfolio; it must be stated in writing and must be clearly identifiable.</p> <p>Insurance undertakings should maintain internal procedures, in writing, that establish the procedure according to which investment policies will be implemented and monitored. The procedures should, at least: identify the chain of responsibilities; define the procedure or recommendation, approval, implementation and monitoring of investment decisions; and define the frequency and format of the internal report.</p> <p>Supervision reports on investments, based on the details submitted by insurance companies and using information available from financial markets, have been prepared. The reports are structured by type of risk: market risk, credit risk and liquidity risk, and give also some information on the company's investment policy.</p> |
| Assessment | Observed  |
| Comments   | There is a significant amount of investments held in corporate bonds for which ratings  |

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|                      | are not available. It should be investigated why corporates avoid external ratings. Also, for exposure measurement purposes, insurance companies rely on provisional ratings provided by banks. Although, the reported write-offs have been insignificant, the absence of ratings is rather unusual.  |
| <b>Principle 22.</b> | <b>Derivatives and similar commitments</b><br>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          | <p>The article 2 of Regulation of ISP 13/2003-R, of 17 July, foresees that as part of the management of investments covering technical provisions, insurance undertakings may make use of suitable risk mitigation techniques and financial instruments, such as derivative products and similar commitments.</p> <p>On the other hand, the Administrative Order 299/99, of 30 April, establishes that derivative products, such as options, futures and swaps, related to assets covering technical provisions, may be used, but only to the extent that they contribute to a reduction of the investment risk in such assets or contribute to a more efficient management of the investment portfolio.</p> <p>The specific regulation on the use and accounting of derivative products and similar commitments was issued in 1998, and was subsequently changed by the Regulation of ISP 7/2002-R, of 7 May, and by the Regulation of ISP 9/2002-R, of 7 May.</p> <p>The supervisory principles underlying the drawing up of the regulations are, on one hand, the fact that derivative products may constitute a useful management instrument for investment portfolios, but, on the other hand, that the use of such instruments may cause large-scale losses, especially when used for speculative purposes or by non-specialized operators.</p> <p>The regulation defines the nature of the risk coverage operations that are permitted (coverage of the risk of variations in the price of the financial instruments held; guarantee of the acquisition cost of financial instruments; coverage of the risk of variability in earnings associated with the financial instruments held; coverage of the exchange risk rate associated with the securities held; and coverage of the credit risk related to the financial instruments held).</p> <p>The regulation also foresees the contracts and markets that are authorized and the limits to their use.</p> <p>Article 9 of Regulation of ISP 13/2003-R, that defines rules for investment management in general, establishes that each insurance undertaking must define investment policies based on rules and procedures that a reasonable, prudent and knowledgeable manager would apply in order to pursue a management policy in the exclusive interest of the insured and the beneficiaries, avoid an unsuitable risk of loss and obtain a suitable level of earnings given the risk incurred and the commitments assumed.</p> <p>Specifically as regards derivatives, the investment policies, which must be drawn up in writing, must clearly identify the possible use of derivative products and the reporting procedures, and must establish limits to the risk exposure. The investments that may be prohibited and other restrictions imposed must also be identified.</p> <p>Besides the definition of investment policies, it is also stated, in article 10 of Regulation of ISP 7/2002-R, that the board of directors of the insurance undertaking is responsible</p> |

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|  | <p>for the definition of policies for the use of derivative and similar products.</p> <p>In fact, they must approve clear and precise written guidelines on the objectives and strategies to be used in derivatives, specifying the type of derivative contracts that may be carried out, for what purposes, under what conditions, in which markets and subjected to what limits. The underlying risk management principles must be also approved by the board of directors, and periodically re-evaluated, at least on an annual basis.</p> <p>Moreover, the board of directors must ensure that periodic reports are made concerning the compliance of their written guidelines and on the scale of the risk assumed. Those reports should be prepared by an internal or external entity, independent of the person(s) that execute(s), in practice, the investment policy.</p> <p>Any deviations from the adopted investment policies must, as foreseen in article 9 (8) of Regulation of ISP 13/2003-R, be described in a written internal report and whenever the deviations are of material relevance, they should be communicated to ISP, together with the measures that the undertaking proposes to implement in order to solve any detected situation.</p> <p>The insurance undertaking must also, as defined in article 17 of Regulation of ISP 7/2002-R, prepare and send to ISP, on an annual basis, and together with the elements related to the disclosure of the financial year, a report specifying:</p> <ul style="list-style-type: none"> <li>• a description of the guidelines issued by the board of directors on the use of derivatives;</li> <li>• a description of the systems that allow the closure of positions, in order to protect the company's solvency, and an individual and aggregated analysis of the risk assumed in the operations involving derivative products;</li> <li>• a description of the risk assessment models adopted;</li> <li>• all the information required for full clarification of the company's policies on derivatives.</li> </ul> <p>It is also foreseen that insurance undertakings must, quarterly, draw up a quantitative analysis on the derivative products used during each quarter. In this regard, standardized information should also be sent to ISP.</p> <p>As established in article 9 of Regulation of ISP 13/2003-R, insurance undertakings must ensure that investment policies are implemented by persons with a suitable level of knowledge and in a situation not likely to cause a conflict of interest, and must guarantee that persons other than those responsible for their implementation monitor the policies. Specifically, the board of directors should guarantee that the persons who are directly responsible for the implementation of the policy on the use of derivatives have sufficient experience and knowledge regarding these types of operations and its inherent associated risks [article 10 (d) of Regulation of ISP 7/2002-R].</p> <p>Lastly, regarding the disclosure requirements for derivative products and similar commitments, the annex of the annual accounts (note n. ° 45) must include information on the open derivative positions: by type of derivative; by the purpose for which they are intended (speculation/arbitrage or coverage); and by type of risk covered.</p> <p>The values related to gains and/or losses in derivative product operations should also be disclosed.</p> <p>The supervisory process encompasses the analysis of the use of derivatives, both off-site and on-site, and is supported by the use of a manual that assists supervisors to perform a more homogenous and harmonized analysis.</p> |
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| Assessment           | Observed   |
| Comments             | None   |
| <b>Principle 23.</b> | <b>Capital adequacy and solvency</b><br>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          | <p>The solvency margin requirements are established in accordance with EU Directives, in article 96 and following of DL.</p> <p>The legislation envisages the elimination of multiple uses of solvency margin elements as well as the elimination of the intra-group creation of capital in a group basis solvency calculation (insurance group) (Regulation of ISP 23/2002-R).</p> <p>Considering the complexity and risks of the operations, there are some specific adjustments to the solvency requirements as regards some risks. Namely:</p> <p>Non-life business:</p> <ul style="list-style-type: none"> <li>• In the case of insurance undertakings which essentially underwrite only one or more of the risks of credit, storm, hail or frost, the reference period for the average burden of claims is larger, considering the higher variation on claims profile (7 years instead of the 3 years applied to the other lines of business);</li> <li>• The premiums and claims regarding aircraft liability, liability for ships (sea, lake and river and canal vessels) and general liability, taking into account the significantly high claims ratio that this insurance may register, are increased by 50 percent;</li> </ul> <p>Life business:</p> <ul style="list-style-type: none"> <li>• The calculation of the required solvency margin is different for operations where the assurance undertaking bears the investment risk and for other operations as well as for life supplementary insurance where the calculation is done similarly to non-life business.</li> </ul> <p>When carrying out sensitivity tests on the solvency margin, the responsible actuary should, for the purpose of the reduction factor, take into consideration the quality of the reinsurer and the nature of the reinsurance contracts. The sensitivity analyses should consider different hypotheses and/or classes of evaluation models, and different future scenarios that reflect not only the most likely evolution, but also more extreme and adverse developments in the financial position of the insurance undertaking, that feasibly may take place.</p> <p>Whenever ISP deems that an insurance company is at risk of entering into an unsound financial position and policyholder's rights are threatened, that company shall, on request and within the time limit set, submit a recovery plan, based on a suitable business operations plan, for ISP's approval (article 108-A of DL).</p> <p>If, after adopting recovery measures, it is clear that recovery of the company is not possible, authorization to carry on its operations shall be withdrawn.</p> <p>The structure of the Portuguese solvency regime is in line with the EU regime, considering a 'minimum harmonization' principle.</p> |
| Assessment           | Observed   |
| Comments             | <p>The law does not set specific requirements regarding the matching of assets and liabilities, and capital adequacy requirements are not adequately sensitive to the risks of the insurer's operations. In anticipation of the Solvency II project, ISP should progressively introduce the methodologies envisaged in that new solvency regime (based</p>   |

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|                      | on a risk-based approach).  |
| <b>Principle 24.</b> | <b>Intermediaries</b><br>The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.   |
| Description          | <p>According to the Decree Law 388/91, of 10 October, in order to conduct an insurance mediation business, natural or legal persons must be authorized by the ISP. Distributing insurance products without this authorization is considered an administrative offence punishable with a fine and with the additional penalty of being prohibited from operating.</p> <p>The authorization is dependent on the fulfillment of professional requirements by the natural or legal person, such as appropriate knowledge and good repute.</p> <p>Collection of premiums by intermediaries takes place on behalf of the insurance company and releases customers from payment duties.</p> <p>The forthcoming implementation of the Directive 2002/92/EC on insurance mediation, will introduce the following enhancements in the framework of insurance mediation:</p> <ul style="list-style-type: none"> <li>• Widening of the scope of the activities qualified as insurance mediation and that are subject to its legal framework – such as ‘bancassurance’ operators. Therefore, all activities consisting of introducing, proposing or carrying out other work that is preparatory to the conclusion of insurance contracts, or of concluding or assisting in the administration and performance of such contracts, in particular in the event of a claim, are considered as insurance mediation;</li> <li>• Enhancement of the professional requirements that the intermediaries must comply with in order to be registered with the ISP, in particular regarding good repute, incompatibilities, professional indemnity insurance, financial guarantees and technical, commercial, administrative and accounting structures;</li> <li>• Creating a public electronic register with information about the insurance intermediaries, allowing quick and easy access to information from that register;</li> <li>• Strengthening consumer protection.</li> </ul> |
| Assessment           | Observed  |
| Comments             | <p>Although the large quantity of personalized intermediaries is an administrative burden to ISP, implementation of the new directive will result – in contrast to other European countries – in a slight reduction in ISP’s responsibilities. However, the number of applicants from other countries seeking to act as an intermediary in Portugal is considerable. ISP is strongly advised to investigate the possibility of charging an administration fee to those applicants, in order to ensure the appropriate sharing of the administrative burden.</p>   |
| <b>Principle 25.</b> | <b>Consumer protection</b><br>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          | <p>Customer protection and relationships between insurance undertakings and insurance intermediaries and their customers are subject to a legal framework, both general and</p>   |

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|                      | <p>specific to the insurance market. It comprises rules applicable to the content of the contracts, to publicity and commercial practices.</p> <p>The general legal framework includes the application of several provisions of the Civil Code, the Law on Consumer Protection, the Publicity Code, the Law on Personal Data Protection, the Law on Electronic Commerce, the Law on General Contractual Terms, the Law on Distance Selling and the Law on Digital Signature.</p> <p>Additionally, for some insurance products, special protection of the consumers is required. That occurs for unit linked products, where the legal framework seeks to guarantee that the policyholder has access to all relevant information in order to make an informed investment decision, i.e., with full awareness of the risks involved. In order to achieve that purpose, the general pre-contractual information obligations are supplemented by specific information that must be provided in a prospectus and special disclosure obligations are established.</p> <p>There are, however, some lapses regarding specific market conduct regulations that should be filled in, namely, concerning requirements related to the obtaining of information from consumers and the implementation of policies on how to treat consumers fairly and on dealing with claims and complaints.</p> <p>The new intermediation law will explicitly require insurance companies and intermediaries to have written policies on how to treat consumers fairly. It also addresses how to deal with claims and complaints and the suitable treatment of clients' personal information. This law will also explicitly require intermediaries to obtain from the client all the relevant information about his needs in order to advise him and to provide information regarding possible conflicts of interest. In the organization structure of the ISP there is an Assistance and Communications Department that was set up to assist the public on matters related to insurance and pension funds business.</p> <p>ISP has good and permanent relations with institutions that look after consumers' protection. Many complaints about insurers made to these institutions are forwarded to ISP.</p> <p>ISP has recently formed a new Supervisory Team (the Market Conduct Team) that will be specifically responsible for supervision of the insurance undertakings' compliance with the legal and regulatory framework to which they are subject while dealing with their clients.</p> |
| Assessment           | Largely Observed   |
| Comments             | <p>With the new legislation, which is in its final stage of approval, ISP has introduced adequate procedures to ensure that an appropriate level of consumer protection will be put in place. The "largely observed" assessment reflects the transitional period until the full implementation of the new legislation.</p> <p>ISP intends to introduce policies designed to ensure that (i) insurance undertakings treat consumers fairly, (ii) appropriate systems are in place, and (iii) training is available to strengthen the compliance of undertakings' employees and other sales persons with those policies.</p>   |
| <b>Principle 26.</b> | <p><b>Information, disclosure &amp; transparency towards the market</b></p> <p>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.</p>   |

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| Description          | <p>There are clearly defined legal extensive rights and duties for disclosing elements of the financial statements.</p> <p>A recent ISP Regulation (4/2005-R) requires, that either by publication in the Official Journal, or by making them accessible on its Internet site, insurance undertakings must disclose completely to the public their annual financial statements.</p> <p>The Insurance Undertakings Accounting Code stipulates that the financial statements should provide a true and fair view of the company's assets, liabilities, financial position and profit and loss. The information provided by the financial statements should be comprehensible and useful, relevant (have the necessary quality to influence decisions, help the assessment of past, present and future events, confirm or rectify previous assessments, which requires the information to be available on a timely basis and to be material), reliable (be free from material error or bias) and comparable.</p> <p>There is not complete alignment between existing disclosure requirements and those stated in the Guidance Paper on Public Disclosure by Insurers. However, it should be highlighted that, in the course of implementation of Pillar 3 of the Project Solvency II, the information to be disclosed is going to be expanded.</p> <p>Besides this, the disclosed elements just include partial information about the extent of the insurer's reliance on assets of a particular class or market sector, or from a particular counterpart. In fact, the disclosed information just identifies the extent of reliance on the different asset classes and on assets that are invested in companies of the same group or associated groups.</p> <p>On the other hand, segmental reporting by material business line and geographical area, including the technical accounts (gross and net of reinsurance) is provided.</p> <p>The Pensions/Savings Funds, Education/Savings Funds, and Education/Pensions-Savings Funds must include in their denomination the expression "shares", if they can invest more than 40 percent of their total assets in shares.</p> <p>The detailed composition of the amounts that constitute the assets of each autonomous fund of the "Life" assurance class, which functions as a support for a savings fund, must be published in the Stock Market Bulletin.</p> <p>For products in which the investment risk is borne by the policyholder and that are considered as non-standardized, the insurance undertaking must provide the policyholder, as pre-contractual information, with the detailed composition of the investment portfolio, specifying the specific risks associated therein.</p> |
| Assessment           | Observed   |
| Comments             | The scope of information disclosed could be enlarged and should be reviewed in the context of the outcome of Pillar III of Solvency II.  |
| <b>Principle 27.</b> | <p><b>Fraud</b></p> <p>The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.</p>  |
| Description          | <p>ISP's possesses adequate powers to regulate, inspect and supervise the business of insurance undertakings and insurance intermediaries. In the performance of its duties, the ISP issues binding instructions aimed at remedying any irregularities it is aware of among the undertakings subject to its supervision and takes all necessary actions.</p> <p>Although the measures adopted to prevent or remedy fraud can only bind entities subject to ISP's supervision, the ISP and its staff are obliged to report to the judicial authorities</p>  |

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|                      | <p>the facts that indicate that a fraud crime has been committed.</p> <p>The Portuguese law considers insurance fraud a crime, as set out in article 219 of the Criminal Code.</p> <p>To contribute to high standards of integrity in the insurance business, all members of governing bodies of insurance undertakings and of insurance intermediaries and, when natural persons, the insurance intermediaries, are subject to a test of fit and proper.</p> <p>There are some gaps in the requirements imposed by the ISP on the insurance undertakings and insurance intermediaries. The ISP has not yet established rules or guidance on market conduct regarding the problem of fraud.</p> <p>Regarding cooperation with other supervisory authorities for the countering of fraud, although that is possible under the applicable general law, there is no specific provision and as a result the practice has not been frequent.</p>   |
| Assessment           | Largely Observed  |
| Comments             | <p>The issue of insurance fraud it is not specifically addressed in the insurance business law. Consequently insurers and intermediaries are not required to allocate appropriate resources and implement effective procedures and controls to deter, detect, record and promptly report fraud to the appropriate authorities. Insurers and intermediaries should be required to provide counter-fraud training to management and staff and to exchange information with respect to fraud and those committing fraud.</p>   |
| <b>Principle 28.</b> | <p><b>Anti-money laundering, combating the financing of terrorism (AML/CFT)</b></p> <p>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).</p>   |
| Description          | <p>The Portuguese legislation on anti-money laundering (Law 11/2004, of 27 March) incorporated the Directives 2001/97/CE on prevention of the use of the financial system for the purpose of money laundering.</p> <p>The legal framework sets down several duties for financial institutions, in which the insurance undertakings that carry out “Life Insurance” activities are included, that are consistent with the FATF’s Recommendations, such as the following duties:</p> <ul style="list-style-type: none"> <li>• To require the identification of their customers, or of the person on whose behalf the customer is actually acting, by means of valid supporting evidence, when issuing insurance policies where the periodic amount or amounts to be paid in a given year exceeds € 1,000 or where a single premium exceeds € 2,500.</li> <li>• To require identification of clients in non-face to face transactions that are not connected with the provision of a service when the amount exceeds € 12,500.</li> <li>• To identify the customers, their representatives or any other person acting on their behalf, as well as the beneficiaries of an insurance policy or transaction, even where the amount of the transaction does not reach the above-mentioned amounts, when they consider as particularly likely – by its nature, complexity, unusual type having regard to the customer’s activities, amounts involved, frequency, economic and financial situation of the persons involved, payment means utilized –, to be related to money laundering.</li> <li>• To refrain from carrying out any transaction with a customer who does not identify</li> </ul> |

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|            | <p>himself or does not provide information to identify the person on whose behalf he is actually acting.</p> <p>Regulation 10/2005-R regulates in more detail the duties set out in the legal framework, in particular the measures that insurance undertakings have to adopt in order to avoid the risk of involvement in money laundering.</p> <p>ISP has adequate powers of supervision, enforcement and sanction in order to monitor and ensure compliance with AML requirements. ISP has the duty to monitor compliance with the law by the entities that they supervise. The supervisory authorities must inform the Republic Attorney-General whenever, in the course of an inspection or otherwise, they acquire knowledge or grounds for suspicion of some facts that indicate the possible commission of a money laundering crime.</p> <p>The ISP, as the insurance supervisory authority, possesses the powers and means to verify that the activities of the insurance and reinsurance undertakings under its supervision comply with the technical, financial, legal and tax requirements and to obtain detailed information about the insurance undertaking's position and their activities as a whole, particularly, through data collection, calls for documents relating to operations in the insurance business, and on-site inspections.</p> <p>The ISP is also responsible for the investigation and processing of the administrative offences regarding any infringement, by the insurance undertakings, related to the general legislation on the prevention of money laundering. The Minister of Finance is responsible for the application of the fines and additional penalties.</p> <p>Finally, the ISP has adequate powers to cooperate with the national financial intelligence unit and with other judicial authorities and financial supervisory authorities, both domestic and foreign.</p> <p>A Working Group with representatives of ISP, BdP and CMVM was created to discuss common issues and prepare joint proposals of a technical nature in matters related to money laundering.</p> <p>Regarding the AML prevention system, the level of communication of suspicious transactions has been low, and the number of on-site inspections of insurance undertakings has been increasing in recent years, with the aim of verifying their compliance with the legislation.</p> |
| Assessment | Observed   |
| Comments   | None   |

Table 5. Summary Observance of IAIS Insurance Core Principles

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

## V. RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE TO THE ASSESSMENT

27. The recommendations are summarized in the following table.

Table 6. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

| Reference Principle                  | Recommended Action  |
|--------------------------------------|---|
| <b>CP 2 – Supervisory objectives</b> | Although this principle was assessed as “observed,” the objectives for ISP should be adjusted to allow the disposal of tasks related to Guarantee funds and claims management. The current organizational structure would make it possible to separate responsibilities on a departmental basis.  |
| <b>CP3 – Supervisory authority</b>   | ISP needs approval for its budget from the Ministry of Finance. Although all expenses of the authority are covered by the fees of the supervised entities, ISP can be subject to interventions throughout the year, which could prevent ISP from achieving its goals. The charter should be amended to grant more independence in this respect. Moreover, ISP should be protected against inappropriate interference from executive branches and should be allowed to fully utilize its financial resources.<br>Furthermore, ISP should reassess the staff resources required to fully implement Solvency II. |
| <b>CP 7 – Suitability of persons</b> | The Law does not address fit and proper requirements for senior management and other key officers to a sufficient extent. There are no specific requirements of fit and proper regarding insurance undertakings' external auditors, and the supervisory authority does not have the power to disqualify an auditor that does not comply with fit and proper requirements. Also, the supervisory authority is not able to demand significant owners that no longer meet fit  |

| Reference Principle                | Recommended Action   |
|------------------------------------|--|
|                                    | <p>and proper requirements to dispose of their interest in the insurance undertaking.</p> <p>In the course of the next year, ISP should, as planned, propose amendments to the law that lays down the conditions governing the conduct of the insurance business, in order to:</p> <ul style="list-style-type: none"> <li>• Set specific requirements of fit and proper regarding external auditors and senior management;</li> <li>• Confer on the supervisory authority the necessary powers to: <ul style="list-style-type: none"> <li>○ disqualify an external auditor or senior manager that does not comply with fit and proper requirements;</li> <li>○ demand significant owners that no longer meet fit and proper requirements to dispose of their interests in the insurance undertaking.</li> </ul> </li> </ul>  |
| <b>CP 9 – Corporate governance</b> | <p>There is a low percentage of non-executive directors in the governing body of insurance companies. The law does not expressly address some issues that relate to specific responsibilities of the governing body, such as:</p> <ul style="list-style-type: none"> <li>• the establishment and monitoring of compliance with standards of business conduct and ethical behavior for directors, senior management and other personnel;</li> <li>• the establishment and regular review of the policies that deal with conflicts of interest, fair treatment of customers and information sharing with stakeholders.</li> </ul> <p>There are a significant number of insurance undertakings that do not have audit committees.</p> <p>The responsible actuary is not granted direct access to the governing body nor is his independence from insufficient orders of the insurer completely assured.</p> <p>In 2005, ISP conducted an inquiry in order to collect relevant data on insurance undertakings' governance structure and mechanisms (including internal control and risk management systems). In 2006, ISP will propose amendments to the law that lays down the conditions governing the conduct of the insurance business, in order to (i) establish the main and specific responsibilities of the insurance undertaking's governing body, and (ii) require insurance undertakings to approve and monitor compliance with the standards of business conduct and ethical behavior for directors, senior management and other personnel.</p> <p>The remaining weaknesses related to the statutory audit will be addressed when the Directive on statutory audit of annual accounts and consolidated accounts is transposed into national law.</p> |
| <b>CP 10 – Internal control</b>    | <p>With the new regulation already approved and under implementation, ISP has ensured sufficiently that by 2007</p>  |

| Reference Principle  | Recommended Action  |
|--|---|
|  | all procedures for internal control will be in force. The “largely observed” assessment reflects the transitional period until full implementation.   |
| <b>CP 21 – Investments</b>   | Although this principle was assessed as “observed,” there is a significant amount of investments held in corporate bonds for which ratings are not available. It should be investigated why corporates avoid external ratings. Also, for exposure measurement purposes, insurance companies rely on provisional ratings provided by banks. Although, the reported write-offs have been insignificant, the absence of ratings is rather unusual.   |
| <b>CP 23 – Capital adequacy and solvency</b>                                 | Although this principle was assessed as “observed,” the law does not set specific requirements regarding the matching of assets and liabilities, and capital adequacy requirements are not adequately sensitive to the risks of the insurer’s operations. In anticipation of the Solvency II project, ISP should progressively introduce the methodologies envisaged in that new solvency regime (based on a risk-based approach).  |
| <b>CP 24 – Intermediaries</b>  | Although this principle was assessed as “observed,” the large quantity of personalized intermediaries is an administrative burden to ISP. Implementation of the new directive will result – in contrast to other European countries – in a slight reduction in ISP’s responsibilities. However, the number of applicants from other countries seeking to act as an intermediary in Portugal is considerable. ISP is strongly advised to investigate the possibility of charging some form of administration fee to those applicants, in order to ensure the appropriate sharing of the administrative burden. |
| <b>CP 25 – Consumer protection</b>   | With the new legislation, which is in its final stage of approval, ISP has introduced adequate procedures to ensure that an appropriate level of consumer protection will be put in place. The assessment “largely observed” reflects the transitional period until full implementation. ISP intends to introduce policies designed to ensure that (i) insurance undertakings treat consumers fairly, (ii) appropriate systems are in place, and (iii) training is available to strengthen the compliance of undertakings’ employees and other sales persons with those policies.                             |
| <b>CP 26 – Information, disclosure &amp; transparency towards the market</b> | Notwithstanding the overall “observed” compliance rating for this principle, the scope of information disclosed could be enlarged and should be reviewed in the context of the outcome of Pillar III of Solvency II.  |
| <b>CP 27 – Insurance fraud</b>   | The issue of insurance fraud it is not specifically addressed in the insurance business law. Consequently insurers and intermediaries are not required to allocate appropriate resources and implement effective procedures and controls  |

| Reference Principle | Recommended Action  |
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|                     | to deter, detect, record and promptly report fraud to the appropriate authorities. Insurers and intermediaries should be required to provide counter-fraud training to management and staff and to exchange information with respect to fraud and those committing fraud. |

### **Authorities' response to the assessment**

28. ISP acknowledged the fruitful discussions during the assessment process within the FSAP, and the recommendations received, which will help improve the effectiveness of insurance supervision in Portugal. ISP appreciated the appraisal of the efforts undertaken to strengthen insurance supervision on the basis of a forward-looking and risk-based approach, and to increase the standards related to insurance undertakings' risk management and internal controls, in line with the development of the Solvency II Project. Furthermore, ISP welcomed the FSAP's recognition of the efforts made to promote and reinforce the transparency of the supervisory authority's activities and processes according to international best practices.

29. ISP has carefully considered all the FSAP recommendations and will continue to work towards their progressive implementation, both by drawing up regulatory measures and by preparing proposals for the amendment of existing laws.