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Spain: IAIS Insurance Core Principles: Detailed Assessment of Observance

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

SPAIN

INSURANCE CORE PRINCIPLES

DETAILED ASSESSMENT OF OBSERVANCE

MAY 2012

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

Contents Page

Glossary 3

I. Executive Summary, Key Findings, and Recommendations 5
A. Introduction 6
B. Information and Methodology Used for Assessment 7
C. Institutional and Market Structure—Overview 7
Institutional framework and arrangements 7
Market structure and industry performance 8
D. Preconditions for Effective Insurance Supervision 18
Sound and sustainable macroeconomic and financial sector policies 18
A well-developed public infrastructure 18
Effective market discipline in financial markets 20
Mechanisms for providing an appropriate level of systemic protection (or public safety) 20
Efficient financial markets 20
E. Main Findings 20
F. Authorities' Response to the Assessment 34

II. Detailed Assessment 35

Tables
1. Market Size in Absolute Terms and Relative to the Economy 9
2. Number of Licensed Insurers 10
3. Number of Licensed Intermediaries 10
4. Distribution of New Business Premium by Channel in 2010 11
5. Distribution of Insurance Premium by Channel 11
6. Distribution of Gross New Premium Written 12
7. Assets Held by Insurers 13
8. Investments of Insurance Assets 14
9. Return on Equity of Insurers (2011) 14
10. Solvency Position 15
11. Impact of Solvency II on the Technical Provisions 16
12. Additional Capital Requirements Under QIS 5 17
13. Composition of the SCR in QIS 5 18
14. Summary of Observance of the Insurance Core Principles—Detailed Assessments 22
15. Recommendations to Improve Observance of ICPs 29
16. Detailed Assessment of Observance of the Insurance Core Principles 35
17. Recommendations from the 2006 FSAP and Their Implementation 80

Figures
1. Key Performance Indicators 15
2. Spain: Solvency Ratios Under Solvency II According to the QIS 5 Exercise 17

GLOSSARY

AGROSEGURO	Spanish Association of Insurers for Combined Crop Insurance
AML	Anti-Money Laundering
BdE	Bank of Spain (*Banco de España*)
CCS	Insurance Compensation Consortium (*Consorcio de Compensación de Seguros*)
CDD	Customer due diligence
CESFI	Financial Stability Committee (*Comité de Estabilidad Financiera*)
CFT	Combating the Financing of Terrorism
CNMV	Securities Market National Commission *(Comisión Nacional del Mercado de Valores)*
DGSFP	General Directorate of Insurance and Pension Funds (*Dirección General de Seguros y Fondos de Pensiones*)
ERD	Small Dimension Entities (*Entidades de Reducida Dimensión*)
EIOPA	European Insurance and Occupational Pensions Authority
ERM	Enterprise Risk Management
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSB	Financial Stability Board
FSAP	Financial Sector Assessment Program
IAE	Spanish Institute of Actuaries (Instituto de Actuarios Españoles)
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICAC	Accounting and Auditing Institute *(Instituto de Contabilidad y Auditoría de Cuentas)*
ICEA	Insurance Entities Cooperative Research (*Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones*)
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INE	National Statistics Institute (*Instituto Nacional de Estadística*)
IT	Information Technology
LCS	Insurance Contract Law (*Ley de Contrato de Seguro*)
LMSP	Private Insurance Intermediation Law (*Ley de Mediación de los Seguros Privados*)
MCR	Minimum Capital Requirement
MEC	Ministry of Economy and Competitiveness (*Ministerio de Economía y Competitividad*)
ML	Money Laundering
MMoU	IAIS Multilateral Memorandum of Understanding on Cooperation and Information Exchange
MoU	Memorandum of Understanding
PEP	Politically exposed person
QIS	Quantitative Impact Study
ROE	Return on Equity

ROSSP	Private Insurance Organization and Supervision Code (*Reglamento de Ordenación y Supervisión de los Seguros Privados*)
SCR	Sovlency Capital Requirement
SEPBLAC	Commission for the Prevention of Money Laundering and Monetary Offences (*Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias*)
SIFI	Systemically Important Financial Institutions
TF	Terrorism Financing
TRLOSSP	Private Insurance Organization and Supervision Law (*Texto Refundido Ley de Ordenación y Supervisión de los Seguros Privados*)
UNESPA	Spanish Association of Insurance and Reinsurance Institutions *(Unión Española de Entidades Aseguradoras y Reaseguradoras)*

I. Executive Summary, Key Findings, and Recommendations

1. **Spanish insurance market is well developed, with a comprehensive range of products offered by domestic and foreign insurers.** Life insurers accounted for about half of total gross premium written in 2010, and held approximately 80 percent of total industry assets. The majority of life products (including annuities) sold are guaranteed products. The main lines of non-life business are motor and property. The reinsurance market is relatively undeveloped for certain risks in Spain, due to the existence of the Insurance Compensation Consortium (CCS), which provides coverage for extraordinary natural and social-political perils through a compulsory surcharge based on sum insured. Thus, there is little need for insurers to seek catastrophic reinsurance.

2. **The Spanish insurers have weathered the financial crisis well.** Total written premiums increased in each of the past five years, except for a decline of 6 percent in 2010. Insurers remain profitable. The industry has maintained combined ratios below 100 percent in the last three years and the 2011first nine months' ROE is over 15 percent in non life and 13.5 in life. Under Solvency I the industry show on average a sound solvency margin of around 200 percent above the required capital in the life sector and 350 percent in the nonlife sector.

3. **The insurance sector is supervised under a sound regulatory framework.** Supervision is carried out by competent supervisors, adhering to the European Union (EU) Directives that are consistent with international standards. The Spanish authorities have made progress in addressing several recommendations arising from the previous Financial Sector Assessment Program (FSAP) in 2006, while recommendations on strengthening the autonomy of financial supervisors have not yet been taken up.

4. **The main vulnerabilities of the Spanish insurance supervisory framework are:**

- **Lack of sufficient resources to effectively carry out its supervisory objectives.** The State budget is likely to remain stagnant if not shrinking in the near future given the economic forecast. General Directorate of Insurance and Pension Funds (DGSFP)'s share of the State budget is not likely to increase. On the other hand, it is facing increasing demand on resources to implement new international prudential standards, and to provide ongoing cooperation and coordination in supervising cross-border insurance groups and financial conglomerates. The effectiveness of its supervision may be adversely affected given the competing demands on limited resources.

- **A third of the life insurance business carries guarantees backed by sovereign and corporate bonds.** While regulatory capital of life insurers appears sufficient under existing Solvency I methodology, adoption of Solvency II could result in additional capital requirements for some insurers. As the QIS 5 exercise showed a breadth of results, further calibration is needed. To this end, DGSFP has been working closely with the European Commission Working Groups and the European Insurance and

Occupational Pensions Authority (EIOPA) on the advanced design of Pillar 1 of Solvency II.

- **Product disclosure requirements for life insurance should be improved.** The Spanish Association of Insurance and Reinsurance Institutions (UNESPA) has issued voluntary guidelines on disclosure to customers. To promote fair treatment of customers, DGSFP should be empowered to standardize and formalize the disclosure requirements at the point of sale to ensure customers receive adequate and non-misleading information, as well as requiring ongoing disclosures to customers to keep them abreast of changes to policy values. DGSFP's cooperation with the Ministry of Justice in revamping the insurance contract law is a step in the positive direction.

A. Introduction

5. **This assessment provides an update on the significant regulatory and supervisory development in the Spanish insurance sector since 2006.** Spain undertook an initial FSAP in 2006, which included a formal assessment of Spain's observance with the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in 2003. Spain also volunteered to undertake a country peer review under the Financial Stability Board (FSB) Framework for Strengthening Adherence to International Standards in 2010.

6. **The Spanish authorities have taken steps to address a number of shortcomings identified in the 2006 FSAP** (Appendix I). Most notably, cooperation and coordination among the three sectoral supervisors have improved with the establishment of the Financial Stability Committee (CESFI)[1] in 2006, meeting at least twice a year. Several identified weaknesses (such as corporate governance, risk management and internal controls, investments, and suitability of key persons and professionals) will be addressed when the EU Directive 2009/138/EC (Solvency II) is fully implemented. The necessary legislative amendments are targeted for the end of 2012. The recommendation to improve the autonomy of the insurance supervisory body, was noted, however it has not been taken up for the moment, as the authorities concluded that it is impractical and undesirable from a policy perspective to do so at this stage.

7. The current assessment was conducted by Rodolfo Wehrhahn [staff of the International Monetary Fund (IMF)] and Mimi Ho (insurance supervision advisor contracted by the IMF) during February 1–21, 2012.

[1] Members of the CESFI are the State Secretary for Economic Affairs (acting as Chairperson), the Bank of Spain's Deputy Governor, the Securities Market National Commission's Vice-president, the Director General on Insurance and Pension Funds and the Secretary General on Treasury and Financial Policy (in charge of the Secretariat).

B. Information and Methodology Used for Assessment

8. **The current assessment is benchmarked against the revised ICPs issued by the IAIS in October 2011.** It takes into account of laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment, as well as market data provided by the authorities in the FSAP self-assessment questionnaire. Ongoing regulatory initiatives are noted by way of additional comments, in particular, the pending legislative amendments to implement Solvency II. The assessors also met a number of Spanish insurers, reinsurers, industry and professional associations, audit firms and rating agencies, who provided valuable input and insight to the assessment.

9. **The assessors are grateful to the authorities for their full cooperation,** thoughtful logistical arrangements and coordination of various meetings with industry participants. In-depth discussions with and briefings by officials from the DGSFP facilitated a robust and meaningful assessment of the Spanish regulatory and supervisory regime for the insurance sector.

C. Institutional and Market Structure—Overview

Institutional framework and arrangements

10. **Spanish financial markets are supervised by three separate sectoral supervisors:** banking by the Banco de España (BdE), securities by the Securities Market National Commission (CNMV) and insurance by DGSFP.

11. **The key insurance legislations are:**

- Private Insurance Organization and Supervision Law (TRLOSSP - Texto Refundido Ley de Odenación y Supervisión de los Seguros Privados),
- Private Insurance Intermediation Law (LMSP - *Ley de Mediación de los Seguros Privados*),
- Insurance Contract Law (LCS - *Ley de Contrato de Seguro*), and
- Private Insurance Organization and Supervision Code (ROSSP - *Reglamento de Ordenación y Supervisión de los Seguros Privados*).

12. **The Ministry of Economy and Competitiveness (MEC) is the agency empowered by the TRLOSSP to supervise insurance activities,** with the exception of mutual insurers that operate solely within an Autonomous Community[2] where the Autonomous Community

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[2] By law, these Autonomous Communities should consult DGSFP before granting a license. However, it is not always done in practice. As at the end of 2010, there were 159 such entities in seven Autonomous Communities with gross written premium of € 1.6 billion, or 2.7 percent of total Spanish insurance market in 2010. 87 percent of such entities by number (82 percent by premium volume) were in the Autonomous Community of the Basque Country.

has agreed to assume their supervision. By regulation, MEC has delegated the insurance supervisory responsibility to DGSFP, a department within MEC.

13. **DGSFP supervises only private insurance;** social insurances are not subject to DGSFP supervision. Social insurance is an integral part of the Spanish social security system, providing financial protection for disability, work injury, illness, maternity, unemployment, and old age (state pension).

14. **There are four levels of insurance legislation.** Insurance laws are initiated by the Government and legislated by the Parliament. Royal consents give effect to new laws. MEC, being the responsible ministry for insurance, has the power to issue insurance regulations, pursuant to power conferred by the primary insurance laws. MEC also has the power to issue administrative orders pursuant to power conferred by laws and regulations. Finally, DGSFP may issue rulings (*resolution*) which are binding on licensed institutions or individuals.

15. **DGSFP is a department within the MEC funded by State budget. This implies that is organically dependent on the MEC. As such, it does not have autonomy in setting its budget**. The organic dependency on the MEC entails additional drawbacks, affecting its organizational and operational autonomy, including the ability to hire the human resources needed to duly perform its tasks. The Director General of the DGSFP is directly appointed by the Minister of Economy. The DGSFP does not levy any fees on industry participants, except a one-time registration fee on intermediaries. Fees as well as administrative fines collected are passed over to the Treasury. DGSFP's 2011 operating budget was € 12.8 million, and it collected € 700,000 registration fees.

16. **Some of the largest insurers operating in Spain are insurance groups or belong to financial conglomerates.** To enhance collaboration among supervisory authorities, both domestically and internationally, DGSFP has signed Memorandum of Understanding (MoU) with BdE, CNMV, the Swiss Federal Office of Private Insurance, and three South American insurance supervisors to exchange information on issues relating to prudential supervision, market development, and technical cooperation. DGSFP participates in 23 supervisory colleges and is the group supervisor for two international groups.

Market structure and industry performance

17. **The insurance sector in Spain is well developed and mature.** It is the 6th largest in Europe, with gross premium income of € 58.5 billion (US$79.9 billion) in 2010, a 6 percent decrease from 2009 (see Table 1). There is room for market development as evidenced by an insurance density (premium per capital) of US$1,680 and an insurance penetration rate (premium as percentage of GDP) of 5.6 percent, as compared to the average of US$1,850.20 and 7.5 percent, respectively, for the whole of Europe.[3]

[3] Swiss Re: World Insurance in 2010, Sigma No. 2/2010.

Table 1. Spain: Market Size in Absolute Terms and Relative to the Economy (In USD millions)

	2006	2007	2008	2009	2010
Gross Written Premium (GWP)	**72,055**	**74,527**	**80,339**	**82,752**	**79,980**
GDP	**1,304,384**	**1,402,807**	**1,463,357**	**1,404,548**	**1,419,834**
GWP / GDP (in percent)	5.52	5.31	5.49	5.89	5.56
Premium / Population (USD)	1,611	1,649	1,743	1,743	1,680
GWP – life	31,351	31,779	36,676	39,859	36,612
GWP – life / GDP (in percent)	2.40	2.27	2.51	2.84	2.58
GWP / Population (USD)	701	703	796	840	779
GWP – non-life	40,703	42,748	43,797	42,893	42,368
GWP – non-life / GDP (in percent)	3.12	3.50	2.99	3.05	2.98
GWP / Population (USD)	910	946	950	903	901

Source: DGFSP.

18. **There are a significant number of players in the Spanish insurance market, with representation by most of the major international groups.** The number of life insurers has been slowly increasing, from 100 in 2007 to 113 in 2011. At the same time, there has been some consolidation in the non-life sector, with the total number of non-life insurers decreased from 195 in 2007 to 171 in 2011. (See Table 2). In addition, there were 653 companies authorized to write business in Spain in 2010, under the EU freedom of services arrangements.

19. **DGSFP set up an electronic register of intermediaries in 2007.** Many previously unregistered agents were captured with the enhanced system, leading to a surge in the number of intermediaries in 2008. Since 2008, the total number of agents has been on a yearly decline while the number of brokers has remained relatively unchanged (see Tables 2 and 3).

Table 2. Spain: Number of Licensed Insurers

As at end of:	2007	2008	2009	2010	2011
Domestic insurers					
Life insurance	100	105	108	112	113[4]
Non-life insurance	195	189	184	173	171
Reinsurance	2	2	2	2	2
	297	296	294	287	286
Foreign branches in Spain	60	66	67	69	77

Source: DGFSP.

Table 3. Spain: Number of Licensed Intermediaries

As at end of:	2007	2008	2009	2010	2011
Insurance intermediaries					
Agents (DGSFP)*	87,226	96,003	94,134	91,790	88,620
Brokers (DGSFP)*	3,011	3,013	3,015	3,006	3,029
Agents (CCAA)**	n/a	922	855	899	1,191
Brokers (CCAA)**	n/a	1,533	1,564	1,575	1,631
Agents (total)	**87,226**	**96,925**	**94,989**	**92,689**	**89,811**
Brokers (total)	**3,011**	**4,546**	**4,579**	**4,581**	**4,660**

Source: DGFSP.
* These are intermediaries registered with and supervised by the DGSFP.
** These are intermediaries registered with and supervised by the Autonomous Communities.

20. **The Spanish insurance market is characterized by the presence of many small insurers with a few large ones dominating the market.** In 2010, the top 5 life insurers commanded 37.5 percent of the market (by assets), the top 5 non-life insurers 50.9 percent (by premium), and the top 5 composite insurers 53.8 percent (by assets). The DGSFP classified 66 (23 percent) of the 286 insurers as Small Dimension Entities, (ERD, *Entidades de Reducida Dimensión*) which are subject to simplified inspection regime due to the smaller scale of their operations. The criteria to qualify as ERD are annual premium less than € 12 million, assets less than € 30 million, and life technical provisions less than € 25 million.

21. **Spanish market is concentrated, with foreign insurance groups having a prominent presence.** Five out of the top 10 insurance groups are foreign, making cross-border cooperation an important factor in DGSFP's supervisory approach. There are 70 insurance groups at the end of 2011. The top 10 groups had domestic premium volume of € 30.9 billion, or 52.8 percent of the market.

[4] Includes 27 composite insurers. DGSFP has stopped issuing composite licences since 1984.

22. **There is a diverse network of distribution channels, making use of virtually all established forms of insurance sales.** Bankassurance is the main distribution channel of insurance products with a market share of 38 percent, due to its dominance in the life insurance market. For individual life insurance products, the bank channel generated 75 percent of new business premium in 2010. On the other hand, non-life insurance policies were mainly (82 percent) sold through agents and brokers. The sale of group life insurance business is evenly spread between bankassurance (46 percent) and intermediaries (45 percent) (see Tables 4 and 5).

Table 4. Spain: Distribution of New Business Premium by Channel in 2010 (In percent)

Distribution Channel	Individual Life	Group Life	Non-Life
Banks	75.57	45.87	11.45
Agents	10.64	6.39	39.64
Brokers	5.45	16.08	42.47
Branch offices	5.92	28.70	5.37
Direct Sale (Internet)	0.01	0.00	0.05
Others	2.40	2.97	1.03

Source: DGFSP.

Table 5. Spain: Distribution of Insurance Premium by Channel

	2006		2007		2008		2009		2010	
	In millions of Euros	In In percent	In millions of Euros	In In percent	In millions of Euros	In In percent	In millions of Euros	In In percent	In millions of Euros	In In percent
Agents	15.0	29.6	13.2	27.7	15.1	25.1	15.3	24.9	14.5	24.7
Brokers	9.9	19.6	8.7	18.2	10.4	17.2	10.9	17.8	10.0	17.1
Banking	16.4	32.3	17.8	37.3	20.6	34.3	22.4	36.5	22.4	38.2
Direct sales	7.2	14.2	5.5	11.5	9.2	15.3	9.8	16.0	8.5	14.5
Direct Marketing (internet)	1.3	2.6	1.7	3.5	296.0	0.5	289.0	0.5	346.0	0.6
Other channels	862	1.7	824	1.7	4.5	7.5	2.6	4.3	2.9	5.0
Total	**50.7**	**100**	**47.8**	**100**	**60.1**	**100**	**61.3**	**100**	**58.7**	**100**

Source: DGFSP.

Insurance premium written has been relatively stable over the past three years. A mature and saturated market coupled with recent economic difficulties are key challenges for industry growth. There is a wide variety of life insurance products, distributed fairly evenly across participating, non-participating (including term), investment-linked and annuities. Annuity is the only clear growth product, with premium growth rate of 48 percent from 2008 to 2010. Majority of the annuities and unit-linked business sold are guaranteed investment products with little mortality or longevity risk to the insurers. The major non-life products are motor and property (about one-third each) and A&H (20 percent) (see Table 6).

Table 6. Spain: Distribution of Gross New Premium Written (€ millions)

Life Insurance				Non-Life Insurance			
Lines of Business	2008	2009	2010	Lines of Business	2008	2009	2010
Domestic risks:							
Participating	7,337	7,681	7,734	Motor	12,172	11,483	10,783
Non-participating	6,471	5,165	4,149	Property	11,781	11,704	11,401
Term	3,706	3,552	4,039	Liabilities	1,900	1,649	1,347
Annuities	4,503	8,453	6,682	A&H	6,935	7,190	6,741
Unit-linked	5,468	4,928	5,437	Others	1,560	1,660	1,694
Foreign risks	5	9	11		615	649	704
	27,492	29,787	28,052		34,962	34,334	32,670

Source: DGFSP.

23. **The reinsurance market in Spain is shaped by the participation of the CCS[5] in catastrophic insurance.** The number of reinsurers remains at two in the past five years. A unique feature of the Spanish market is the protection offered by the CCS on catastrophic risks, funded by compulsory premium surcharges on every policy issued. CCS has acted in situations where the private sector capacity is severely impaired, such as credit insurance during the recent crisis, after special authorization by the Parliament. On an ongoing basis, the CCS provides capacity to the multi-peril crop insurance sector through a reinsurance

[5] CCS is a public institution but not part of the government. It has its own legal status and full capacity to act. It is not supervised by the DGSFP, although it must comply with the requirements in insurance laws and regulations. It is funded through mandatory surcharges on each insurance policy issued. At the end of 2011, it has a reserve fund of € 7.8 billion. It has a staff strength of 353.

The Director General of DGSFP is the chairman of CCS. Besides the chairman, there are 14 board members appointed by the Minister for MEC: 7 members from the insurance sector and 7 members from the public sector. CCS has three main functions:

1. Permanent insurance functions—providing coverage for (a) extraordinary risks for natural (floods, storms, earthquakes and tsunamis, volcanic eruptions and falling of meteorites) and social-political (terrorism, rebellion, insurrection, riots and civil commotion, and actions of armed forces in peacetime) perils; (b) compulsory motor insurance for unaccepted or uninsured private vehicles and all official vehicles of government and public agencies; and (c) multi-peril crop insurance, working through AGROSEGURO.
2. Other insurance functions—as and when required by public interest and market circumstances. A 2/3 majority of board approval is needed for CCS to take on additional insurance functions.
3. Non-insurance functions—winding-up of insurers.

arrangement with the Spanish Association for Combined Insurers for Crop Insurance (AGROSEGURO).[6]

24. **Assets held by insurers as at end of 2010 totaled € 242.3 billion, or 22.8 percent of GDP**. The 27 composite insurers accounted for 53 percent of total industry assets. (Table 7).

Table 7. Spain: Assets Held by Insurers

(In € billions)	2008	2009	2010	% Share of Total
Life insurers	79.0	85.1	85.5	35.3
Non-life insurers	27.7	26.6	22.9	9.5
Composite insurers	119.1	126.3	129.0	53.2
Reinsurers	4.0	4.3	4.9	2.0
Total	229.9	242.3	242.3	100.0
Percent of nominal GDP[7]	21.1	23.0	22.8	--

Source: DGSFP.

25. **Investment of insurance assets is predominantly in fixed income instruments, while exposure to real estate is low.** Holdings in sovereign debts are around a quarter of the investment assets and around thirty percent in corporate debt. This investment strategy is aligned with the required matching of the long term liabilities that insurers, life and composite, have in their books. Exposure to sovereign debt and corporate debt is thus a significant risk for the industry through the credit risk. (Table 8).

26. **Related party investments may also be an important source of risk to the life industry, particularly the composite insurers.** While for capital requirements double counting and intra-group transactions are disallowed, the total intra-group and related company receivables are around five percent of the investments supporting the technical provisions. Furthermore, some insurers use deposits placed with their parent banks to provide the capital guarantee under the unit-linked business. Thus, intra-group exposure may be even higher than Table 8 indicates.

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[6] AGROSEGURO manages the agricultural insurance system under a co-insurance arrangement by private insurers in which CCS takes up 10 percent.

[7] GDP of € 1,088.1 bn, 1,053.9 bn, and 1,062.6 bn for 2008, 2009 and 2010, respectively. Source: World Economic Outlook Database, IMF.

Table 8. Spain: Investments of Insurance Assets

As at end of 2010	Life		Non-Life		Composite	
	€ bn	***% Total***	**€ bn**	***% Total***	€ bn	*% Total*
Intangible assets	0.06	*0.1*	0.3	*1.2*	1.4	*1.1*
Investments:						
Government securities	21.8	*25.5*	2.4	*10.5*	29.5	*22.9*
Corporate securities	30.3	*35.5*	4.5	*19.6*	41.0	*31.8*
Equities	3.9	*4.5*	3.3	*14.2*	9.2	*7.2*
Real estate and related	0.8	*0.9*	0.6	*2.6*	3.2	*2.5*
Investments supporting unit-linked	10.0	*11.7*	n.a.	*n.a.*	6.4	*5.0*
Receivables	1.6	*1.8*	2.6	*11.5*	5.1	*3.9*
Intra-group/related company receivables	2.4	*2.9*	0.4	*1.7*	6.6	*5.1*
Reinsurance recoverable	0.3	*0.4*	4.1	*18.0*	2.8	*2.2*
Other assets	14.4	*16.8*	4.8	*20.8*	23.8	*18.4*
Total	85.5	*100.0*	22.9	*100.0*	129.0	*100.0*

Source: DGFSP.

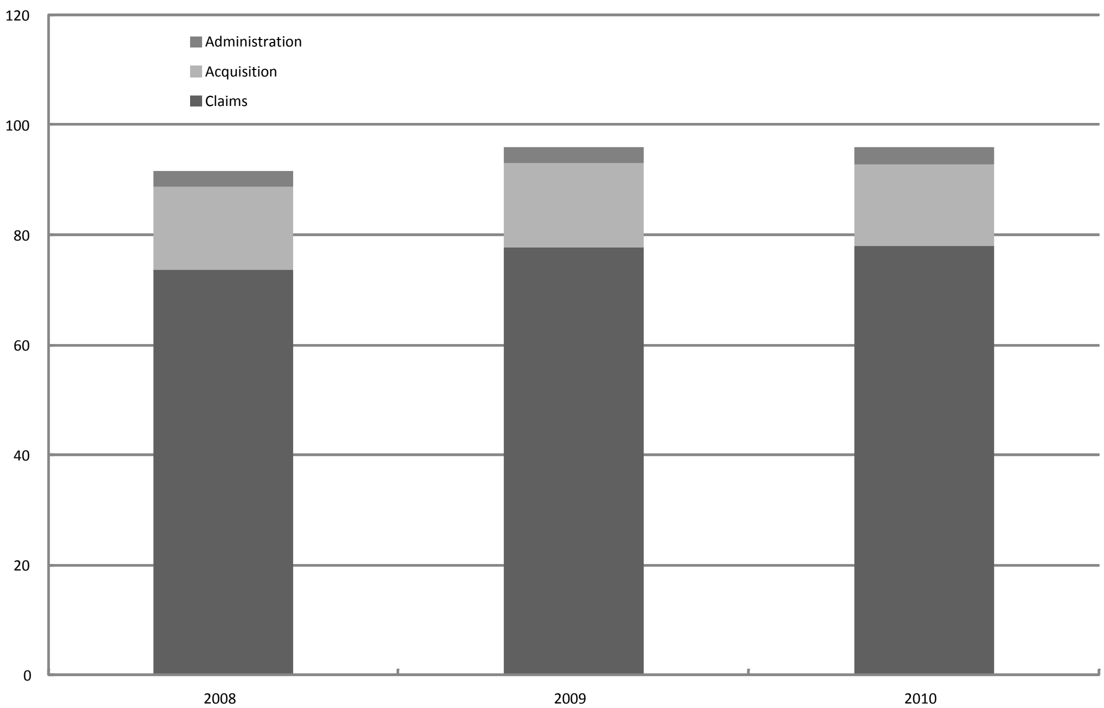
27. **Despite the stagnation of premium income, insurers remain profitable.** For the non-life business, catastrophic risks are covered by the CCS resulting in high retention of premium. For the life business, about 80 percent of life insurance (by new premium) is guaranteed return investment products with little mortality or longevity risks. Life insurers typically use asset/liability matching to manage interest rate risk. Nonetheless, the portfolio is subject to credit risks. The industry has maintain combined ratios below 100 percent in the last three years as indicated in Figure 2.The Institute of Insurance Entities Cooperation and Research (ICEA) data showed that the industry profitability as measured by return on equities has further improved in the first nine months of 2011 (Table 9).

Table 9. Spain: Return on Equity of Insurers (2011)

(in € billions)	Composite	Life Only	Non-Life Only	Total
Gross premium	30.3	16.6	11.6	58.5
Net premium	28.5	16.2	9.2	53.9
Assets	129.0	85.5	22.9	237.4
Liabilities	125.2	82.4	21.5	229.1
Excess of assets over liabilities	3.8	3.1	1.4	8.3
ROE (in percent)	15.1	13.5	15.8	--

Source: DGFSP.

Figure 1. Spain: Key Performance Indicators



Source: DGSFP, Seguros y Fondos de Pensiones, Informe 2010, pg 70

28. **Based on solvency requirements prescribed by the DGSFP, both life and non-life industries appear to be adequately capitalized.** Under Solvency I the industry show on average a sound solvency margin of around 200 percent above the required capital in the life sector and 350 percent in the nonlife sector (Table 10).

Table 10. Spain: Solvency Position

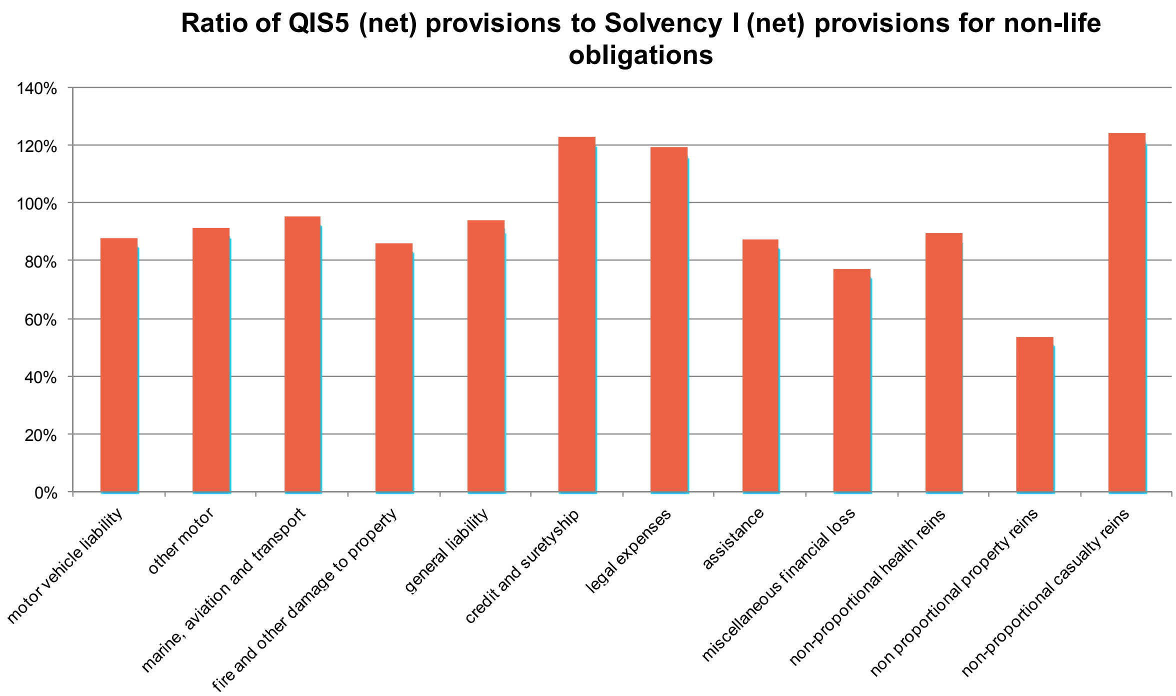
	2008	2009	2010
Available capital resources over minimum capital requirement:			
Life	540.13	576.38	499.30
Non-life	854.49	905.38	949.56
Available capital resources over prescribed capital requirement:			
Life	195.25	205.69	180.58
Non-life	316.95	339.34	357.43

Source: DGFSP.

29. **Spain is working closely with EIOPA to further fine-tune the calibration of the parameters under Solvency II.** A large part of the Spanish industry participated in the last Quantitative Impact Study (QIS) commanded by the European Commission in preparation

for the implementation of Solvency II. 138 Spanish entities participated in the recent QIS5 exercise, accounting for over 60 percent of the insurers that will be affected by Solvency II, representing a market share over 95 percent in life, 94 percent in non-life and 91 percent in health. The main output is an average increment of 10 percent of the own funds, due to a reduction of the technical provisions (except in life) and a valuation of the eligible assets. The average risk margin is 2.59 percent for total business, 5.93 percent in non-life and 2.02 percent in life. This is within the normal range (see Table 11).

Table 11. Spain: Impact of Solvency II on the Technical Provisions



Source: DGSFP.

30. **Under QIS 5 calibration the Spanish industry will require an average increment of 67 percent of capital.** The impact of QIS 5 is more severe on insurers underwriting long-term business. While half of the assets and liabilities of this type of business are matched either in duration or in cash flow, current proposed form of Solvency II does not recognize this immunization to market changes. Recent discussions at EIOPA level on the introduction of a matching premium are likely to significantly improve the capital position for asset/liability matched long-term business through the reduction of the affected liabilities (see Table 12).

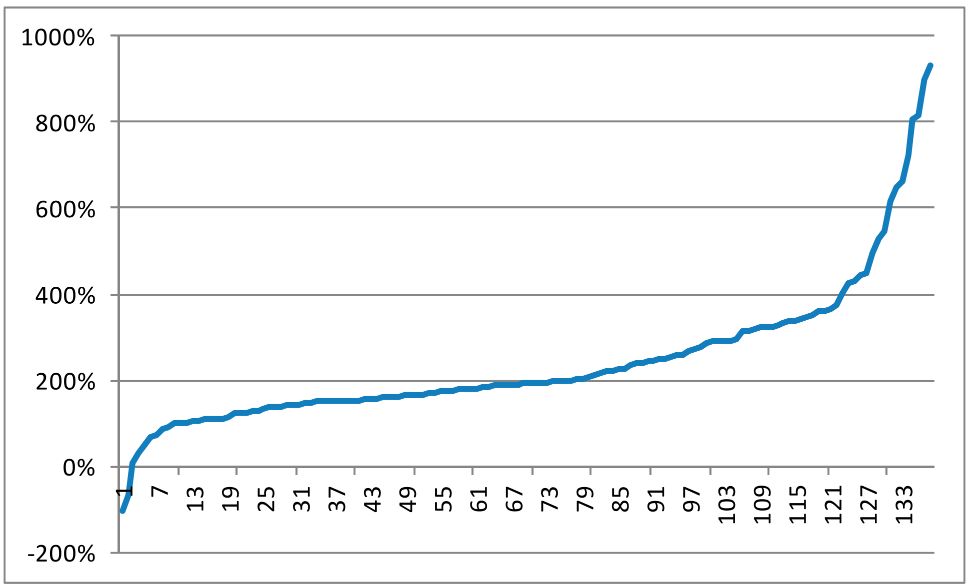
Table 12. Spain: Additional Capital Requirements Under QIS 5

	SCR (in € millions)	Solvency I Margin (in € millions)	SCR/Solvency I (%)
All insurers	17,205	10,278	167.40

Source: DGFSP.

31. **The Spanish insures show a high level of solvency under Solvency II regime as indicated by the QIS 5 exercise.** Only10 of the 138 participants will have deficient Solvency II ratios (see Figure 2). The solvency ratio on average remains sound at around 200 percent of SCR. The Minimal Capital requirement (MCR) is on average 37 percent of the SCR and only three companies had insufficient funds to cover the CR (see Table 13).

Figure 2. Spain: Solvency Ratios Under Solvency II According to the QIS 5 Exercise



Source: DGSFP.

32. **Market risk has the highest impact to Spanish insurer's solvency.** The underwriting discipline and conservatism of the sector, the protection of extraordinary risk by the CCS and the transfer mechanism of the investment risks to policyholders leave market risk the most important risk factor for the sector. On average 75 percent of the Solvency Capital Requirement (SCR) was related to market risk. The underwriting risk accounted for 42 percent in nonlife mainly due to the risk of insufficient reserving and 24 percent in life due to the risk of lapses. Effective diversification reduced the SCR by 36.5 percent. Tax and profit sharing as well as other mechanisms transferring the investment risk to policyholder reduced the SCR by another 37.6 percent.

Table 13. Spain: Composition of the SCR in QIS 5
(In percent of SCR)

	Total	Composite	Life	Non-Life
Market	75.46	91.00	93.7	45.24
Counterparty	11.68	9.79	13.48	13.24
Life	24.00	22.22	55.43	0.00
Health	7.17	4.78	0.44	16.82
Non-life	42.03	37.79	0.00	74.39
Occupational Risk	12.35	10.74	16.24	11.43
Intangible	1.38	2.42	0.15	1.26
Tax adjustment & profit sharing	-37.57	-37.80	-45.25	-29.75
Diversification	-36.50	-40.95	-34.20	-32.63

Source: DGSFP.

D. Preconditions for Effective Insurance Supervision

Sound and sustainable macroeconomic and financial sector policies

33. **The Spanish economy has shown to be resilient and policymakers responsive in the face of recent financial crisis.** It has undertaken a series of measures targeting the main economic problems, most importantly: fiscal consolidation, financial system reform, and labor market reform. These measures have helped to improve market confidence, although unemployment rate remains high.

A well-developed public infrastructure

34. **Spain has a clear legal system of business laws, an independent judiciary, complemented by well utilized alternative dispute resolution mechanisms, and well developed accounting and auditing standards consistent with international standards.** Extensive macroeconomic data and country statistics are provided by the BdE and the National Statistics Institute (INE) as well as other independent institutions.

35. **The legal system in Spain is based on continental Europe legal system.** It relies primarily on Act (laws and regulations) and to a lesser extent in judicial decisions and customs. Also, it is a complex legal structure, comprising of different legal systems that coexist through the autonomous territorial organization. The hierarchy of rules in Spanish laws is:

- Constitution.
- International treaties.
- The strict law or organic law which requires an absolute majority of Parliament, ordinary law and regulations with force of law (among which is the Royal Decree Law and the Royal Decree).

- Norms issued by the executive, within its own hierarchy based on the body that promulgates can be in the form of a Royal Decree, Decree, Ministerial Order, etc.

36. **Furthermore, the Spanish Constitution establishes the jurisdiction of the Autonomous Communities in the regulation of certain matters, and their ability to make rules with force of law through their own parliaments.** A joint process between the Autonomous Community parliament and the national parliament promulgated the Statute of Autonomy, which is constituted as a fundamental rule of an Autonomous Community. After this, priority will be the laws passed by the parliaments of the Autonomous Communities in matters within their competence; and related regulation will be issued by the executive bodies of the Autonomous Communities. Local Authorities have not been given legislative power but do have regulatory powers. The relationship between Autonomous Communities and State norms is competence, with the powers set out in the Constitution and the respective Statutes of Autonomy. The Constitutional Court of Spain is the body responsible for deciding whether a rule is unconstitutional as well as for resolving conflicts of jurisdiction between the State, Autonomous Communities and Local Authorities.

37. **The Accounting and Auditing Institute (ICAC) is the professional body that sets accounting and auditing standards in Spain under its separate Accounting Committee and Auditing Committee.** The DGSFP sits on the boards of both committees. The DGSFP also issues insurance accounting standards which are consistent with the International Financial Reporting Standards (IFRS). There are some differences in the accounting valuation of assets and the valuation of assets for solvency purposes, for instance real estate for accounting purposes is valued at historical cost but for solvency purposes it is valued at market value. Only ICAC-registered auditors may practice in Spain. At the end of 2011, ICAC had 5,493 registered practicing members.[8] To uphold professional standards, ICAC conducts education programs, inspection of its members and investigation of alleged poor quality of work.

38. **There are three actuarial associations in Spain organized by geographic regions.** The Spanish Institute of Actuaries (IAE) is the main one, covering all areas except Catalonia and the Autonomous Community of the Basque Country. The IAE has a membership of 1,500 which is approximately 75 percent of the total number of actuaries in Spain. Admission into IAE is based on the completion of a Master Degree in Actuarial and Financial Science in accepted universities. Foreign-trained actuaries may be admitted through a recognition program. The IAE has a professional code of conduct, and there is an established disciplinary process. DGSFP does not restrict the actuarial certification of technical matters to the members of any Spanish actuarial associations.

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[8] There were another 14,164 registered non-practitioners, who have not yet been qualified to practice.

Effective market discipline in financial markets

39. **CNMV has issued a Unified Good Governance Code for listed companies.** There is no equivalent corporate governance framework for the insurance sector, aside from the voluntary corporate governance guidelines issued by the UNESPA. The law is clear on the requirements for new market participants, mergers, takeovers, and acquisition of equity interests in insurers.

Mechanisms for providing an appropriate level of systemic protection (or public safety)

40. **CCS operates a guaranteed fund for extraordinary natural perils, terrorist risks and catastrophic loss of lives due to accidents.** CCS also takes over the management of insurers in the winding-up of insurers to ensure orderly exits and that insurance claimants are paid before unsecured creditors. The CCS is a part of the MEC and is funded by compulsory surcharges on insurance policies.

Efficient financial markets

41. **A variety of instruments and issuers operate in the Spanish financial market, in addition to the deep and sophisticated EU markets that serve Spain investors' needs.**

E. Main Findings

42. **Despite the lack of independence in the regulatory structure, there is no evidence to suggest that DGSFP is not independent in carrying out its duties.** However, the budgetary dependency appears to have limited DGSFP's ability to expand its resources to match its expanded responsibility, particularly in the area of group-wide supervision. The competing demands on limited resources have resulted in a "fire-fighting" modus operandi. Current urgencies (such as implementation of Solvency II and participation in international supervisory colleges) are managed at the expense of less visible but equally important tasks such as ongoing supervision.

43. **DGSFP is solely dependent on State budget.** Unlike CNMV, it does not collect any fees from market participants, other than the one-time registration fee from intermediaries. In 2011, it collected about € 700,000 of registration fees (which were turned over to the Treasury) as compared to its operating budget of € 12.8 million. As DGSFP is unlikely to receive more allocation from the State budget in the foreseeable future, it should explore other funding models to reduce its reliance on State budget.

44. **In the absence of additional budget, DGSFP should review its scope of work.** With limited resources, unless this changes, DGSFP should consider delegating important but less critical areas of supervision like complaint handling to have a stronger focus on offsite supervision and inspection. DGSFP currently deploys 31 staff to handle a large number of complaints from the public against insurers and insurance intermediaries. The public trusts DGSFP to be impartial in resolving their disputes with insurers. While handling

public complaint is an important function to promote fair-dealing with customers and is one of the early indications of emerging trend of poor business results, DGSFP may not be best placed to resolve disputes. DGSFP could explore other methods, such as an independent industry-wide ombudsman. The brunt of the cost should be borne by the insurers, although the complainant should bear some cost to discourage frivolous complaints.

45. **Supervision is handicapped by the lack of resources. This problem will presumably be exacerbated when the Solvency II Regime comes into force.** As an example, nowadays six analysts are responsible for the off-site monitoring of 280 insurers. As a result, there is a high dependency on system-generated ratios and ranking based on quantitative financial information. The consequence is that the analysis of internal control systems relies on an insurer's own disclosure on an annual basis in an internal control report and on on-site inspection. But resources for on-site supervision only allow for an inspection cycle of 4 to 5 years.

46. **A third of the life insurance business carries guarantees backed by sovereign and corporate bonds.** While capital appears sufficient under existing Solvency I methodology, adoption of Solvency II could result in additional capital requirements for some insurers. As QIS 5 exercise showed a breadth of results, further calibration is needed. To this end, DGSFP has been working closely with European Commission Working Groups and the EIOPA on the advanced design of Pillar 1 of Solvency II.

47. **Requirements on disclosures to customers should be strengthened to provide greater consumer protection.** Investment products with guarantees are one of the key life insurance products sold in Spain. Point-of-sale disclosure should include investment strategies so that customers may form an informed opinion on the security of the guarantee. On an ongoing basis, policyholders should be provided with information on the changes to the policy values at least annually.

48. **Shortcomings in suitability of persons, corporate governance, risk management and internal control will be addressed when Solvency II is implemented.** In the meantime, DGSFP should work with the industry on its preparedness. In the area of corporate governance, DGSFP should consider issuing a Code of Corporate Governance for insurers and reinsurers in line with the Unified Good Governance Code issued by the CNMV for the listed companies. Should Solvency II be further delayed DGSFP should address these deficiencies with high priority.

Table 14. Summary of Observance of the Insurance Core Principles—Detailed Assessments

Insurance Core Principle	Level	Overall Comments
1. Objectives, Powers and Responsibilities of the Supervisor	O	The primary insurance legislation clearly defines the objectives of insurance supervision and designates MEC as the insurance supervisor, who in turn delegates the day-to-day supervisory responsibility to DGSFP by regulation (Royal decree). The Minister for MEC is the ultimate decision-maker in the areas of market access and sanctions on very serious legal infringements. Legislation provides sufficient mandate and power to the authorities to fulfill their responsibilities. Autonomous Communities are in charge of the licensing and supervision of regional mutual insurers operating solely in their respective communities. In 2010, there were 159 such entities with gross written premium of € 1.6 billion (2.7 percent of Spanish insurance market). As the national insurance supervisor, DGSFP should monitor the development of these entities.
2. Supervisor	PO	DGSFP is a department within MEC, and is funded by the State budget. While it does not have administrative independence, it has clear objectives and operates in a transparent manner. There is no evidence to suggest that it suffers from undue political interference. DGSFP has full operational independence except in the areas of market access and administrative sanctions on very serious legal infringements where the Minister for MEC is the approving authority at the recommendation of the Director General of DGSFP. In practice, the prescriptive approach embedded in the insurance law makes it difficult for the Minister to deviate from legal provisions. Nonetheless, to enhance operational independence, such powers should be delegated to DGSFP. The increase in size and complexity of the supervised market demands new knowledge and skills for appropriate supervision and cross-border coordination, in particular with the eminent Solvency II preparedness. DGSFP did not have the additional resources needed for a more risk-focused supervisory approach. Furthermore, the lack of staff retention policy and succession planning exposes DGSFP to the risk of loss of critical staff when economy recovers and unemployment improves. DGSFP staff members are competent and qualified, but the headcount assigned to core supervisory functions needs to be increased to avoid supervisory gaps. There are no policies in place to guide DGSFP staff in conflict

Insurance Core Principle	Level	Overall Comments
		of interest situations. Such situations include family members working in supervised entities, or trading of securities of supervised entities.
3. Information Exchange and Confidentiality Requirements	O	The regulatory framework enables DGSFP to exchange confidential information with supervisors. In the case of non-EU supervisors, legislation also establishes the conditions for collaboration and exchange of information on the condition of reciprocity and confidentiality.
4. Licensing	O	The legislation clearly defines the activities that require licensing, and the process and criteria to obtain a licence. There are inadequacies in the assessment of (a) key individuals in control positions and (b) corporate framework during the licensing process. These are separately discussed and assessed under ICPs 5 and 7.
5. Suitability of Persons	LO	The suitability test is applied to “effective managers,” defined as board members, senior management and significant owners. The ongoing monitoring of the fitness and propriety of effective managers is indirect as it relies on the insurer’s initiative to report new appointments and removal of such individuals. In the absence of reporting requirements, DGSFP may not be aware of situations where an individual previously assessed to be fit-and-proper becomes unsuitable due to changes in circumstances.
6. Changes in Control and Portfolio Transfers	O	The Minister for MEC has the approving authority for changes in control, portfolio transfer and changes in legal structure of an insurer. The Minister must take into account policyholders’ interest and prudential considerations in granting approval. Acquisition of 10, 20, 30, or 50 percent or more of voting share or capital of an insurer is subject to DGSFP’s specific indication of no-objection. Additionally, there is a notification threshold at 5percent ownership of an insurer.
7. Corporate Governance	PO	The corporate governance requirement for insurers is limited to the requirement for the Board to be responsible for establishing adequate internal control processes including independent internal audit function and risk management systems consistent with the insurer’s risk management strategies. There are no comprehensive requirements on the role and accountability of the Board and Senior Management.
8. Risk Management and Internal Controls	PO	DGSFP has made important progress in the last few years with the introduction of the mandatory reporting of internal controls deficiencies, and the guidance on the checks of internal control in the inspection manual. However, more specific details on the scope of such internal controls and reporting duties should be provided.

Insurance Core Principle	Level	Overall Comments
9. Supervisory Review and Reporting	LO	Due to limited resources, off-site monitoring is heavily dependent on system-generated ratios and warning flags based primarily on financial information. The off-site analytical reports focus on worst-performing insurers in terms of financial results. The qualitative review of internal control deficiencies basically relies on the insurer's disclosure. There is a lack of a full integration of quantitative business results with qualitative indication of management of business to form a comprehensive view of the insurer's operation, or a risk-ranking based on impact/probability analysis. DGSFP conducts both full scale and focused on-site inspections. Its current resources only allow a 4- to 5-year inspection cycle, excluding 66 small insurers (ERD). The off-site supervisors visit the ERDs periodically for a day or two. The target is to cover all ERDs over a two- to three-year period. DGSFP conducted only 18 on-site inspections in 2011 (two thirds of which were full scale), compared to 48 in 2010, due to re-allocation of resources to Solvency II implementation. Some key elements of insurance operations are only reviewed during on-site inspections.
10. Preventive and Corrective Measures	O	DGSFP may require an insurer to put in place a financial recovery plan when it determines that the insurer's solvency position is in jeopardy or that policyholder's interest may be compromised. The financial recovery plan must, at a minimum, include a 3-year projection of (a) estimates of management expenses, (b) detailed estimates of revenues and expenses relating to direct business, reinsurance acceptances and cessions, (c) the balance sheet, (d) estimates of financial resources intended to cover the liabilities and the solvency margin, and (e) the overall reinsurance policy. DGSFP may also require the insurer to maintain a higher solvency margin, or engage a special audit of its accounts. If an insurer's situation worsens further, DGSFP may adopt one or more of the following escalating measures: • restriction of asset transfers, • short term financing, • injection of additional capital, • suspension of dividend payment to shareholders, • restriction to write new policies or to renew existing policies, • convening special board meetings, • temporarily replacing the board of directors, and • taking control of the insurer's operation. If special control measures fail to restore the insurer's financial standing, DGSFP may commence winding-up procedures.
11. Enforcement	O	Spanish insurance law adopts a prescriptive approach to

Insurance Core Principle	Level	Overall Comments
		supervisor's enforcement power. The situations under which sanctions may be imposed and the types of sanctions to be applied for each situation are clearly defined in the law. While this prescriptive approach at first glance restricts the supervisor's ability to take action, Article 38 of the law provides the supervisor a broad power to take action when a circumstance arises that jeopardizes the insurer's solvency or policyholders' interest. As such, DGSFP is not constrained in taking corrective action in situations not prescribed in law. (See also ICP 10).
12. Winding-up and Exit from the Market	O	Policyholders and beneficiaries have priority rights to the assets covering insurers' technical provisions in the event of winding-up. CCS is not a guarantee fund but manages winding-up and bankruptcy cases to ensure orderly exit from the market and timely payments to policyholders. Out of the 19 winding-up cases between 2007 and 2011, policyholders were paid 100 percent on all cases except two, where they were paid 52.4 percent and 84.1 percent, respectively.
13. Reinsurance and Other Forms of Risk Transfer	LO	The reinsurance regulation follows current EU Directives on reinsurance that requires insurers to adequately control and to transparently report their risk transfer programmes. Through the offsite reporting, the DGSFP has an indication of the level of risks reinsured. The onsite inspection reviews the sufficiency of risk transfer of the reinsurance contracts as well as their completeness and timely execution. However, there are no formal requirements to finalise the reinsurance contract in a timely fashion, nor a prohibition against reinsurance side letters that would add transparency to the contracts. Liquidity in general is supervised through the statutory reporting process, but there is no requirement to consider the payment pattern of reinsurance claims for the purpose of liquidity management of the insurer.
14. Valuation	PO	The current method of valuation follows the Solvency I rules. The valuation of assets and liabilities is undertaken on consistent bases in the general regime (Article 33.1) and for the immunized polices through the accounting mismatch reserve. However, for the business portfolios underwritten before 1999, assets are valued at fair value and liabilities at historical value, the latter of which is not an economic valuation. Furthermore, for non-life business, most future cash flows are not discounted. The pending adoption of Solvency II will address these discrepancies. Revaluation of real estate is every three years. The current method does not explicitly recognize best estimate of future cash flows, and a specific margin for adverse experience fluctuation. There is some conservatism implicitly

Insurance Core Principle	Level	Overall Comments
		incorporated in the technical provisions by under-estimating future cash inflows through the use of risk premiums instead of gross premium. On the other hand, the estimate of future cash outflows may be less conservative in some cases, in particular in the disregard of embedded options and for the legacy business issued prior to 1999.
15. Investment	O	The investment limits stated under current regulation do not hinder the ability of insurers to invest in a prudent and efficient way.
16. Enterprise Risk Management for Solvency Purposes	PO	While some insurers have adopted their groups' ERM systems, there is no regulatory requirement to adhere to comprehensive ERM systems other than the general requirement to have internal controls under Articles 110 and 110A of the ROSSP.
17. Capital Adequacy	PO	Spain is on the Solvency I regime. While waiting for the implementation of Solvency II, Spain has not established any enhancements to make the solvency regime more risk sensitive with the exception of detailed asset/liability matching requirements. Thus, shortcomings of the current solvency regime are hindering the compliance with this ICP as a total balance sheet approach and a risk-based assessment of the capital requirements is not incorporated into the legislation in force.
18. Intermediaries	PO	DGSFP registers insurance agents and brokers at both legal entity and natural person levels. In registering an intermediary, DGSFP takes into account the applicant's integrity, competence, and financial standing. DGSFP has the power to supervise and sanction intermediaries. However, in practice, due to limitation of resources, the supervision of exclusive agents is left to the insurers, and the level of supervision of multi-tied agents and brokers is inadequate with only 20 inspections of brokers and bankassurance operators in 2011. Bankassurance is a major distribution channel for life insurance. 75 percent of individual life and 45 percent of group life business were sold through banks in 2010. DGSFP maintains on its website a register of intermediaries, which is a mix of natural persons and legal entities. Sales staff (not inclusive of management board) of legal entity intermediaries are not individually registered, nor listed in the register. Intermediaries are required to disclose to customers their identity, licensed status, their relationship with the insurer, procedures to lodge complaints, and legal protection of confidential client data. The disclosure of remuneration is limited. A broker is only required to disclose his commission when he is paid both a fee by his client and a commission by

Insurance Core Principle	Level	Overall Comments
		the insurer. Multi-tied agents and brokers are required to carry professional liability insurance with coverage of up to € 1.68 million per year.
19. Conduct of Business	LO	The insurance laws and regulations establish requirements on disclosure to customers at the point of sale. In particular, in the case of life insurance where the policyholder bears the investment risk, a clear and precise statement about the fact that policy values is subject to market fluctuation, beyond the control of the insurer and that historical results do not indicate future results. However, investment strategies and policies are not part of the required disclosure. On an ongoing basis, insurers must inform the policyholder of any changes to the policy terms and conditions, and also on the status of their participation in profits. For investment products, there is no requirement to inform policyholders on the value of their policies. Life policies (except those where the policyholder bears the investment risk) may be cancelled within 30 days after receipt of policy document. DGSFP handles a high volume of customers' complaints against insurers and intermediaries.
20. Public Disclosure	LO	A substantial amount of financial information is available to the public about the insurer, including the basis for the preparation of annual statements, distribution of benefits and profits, asset and liability valuation methods and assumptions, information on different sections of the financial statements, specific technical information on the life and non-life segment of the business, coverage of technical provisions and solvency margin. While the disclosure requirements are comprehensive, the financial data can be very out-dated by the time the database is updated. The highly technical nature of the disclosures also makes it difficult for a member of the general public to comprehend the inherent risks.
21. Countering Fraud in Insurance	NO	Insurance frauds are criminal offences under the general criminal law. DGSFP does not explicitly require insurers to have in place procedures to deter, detect, prevent and remedy frauds. Nor does it monitor or analyze the overall market vulnerabilities to frauds. Counter-fraud measures are implemented voluntarily at the industry level, although it is limited by the legal protection of client data.
22. Anti-Money Laundering and Combating the Financing of Terrorism	O	DGSFP supports Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias (SEPBLAC), the designated Financial Intelligence Unit (FIU), in collecting data during on-site inspections. It understands the ML/TF risks in insurance business, and

Insurance Core Principle	Level	Overall Comments
		collaborates with other agencies in imposing sanctions on ML/TF offences.
23. Group-wide Supervision	O	DGSFP's supervision of an insurance group extends to all legal entities within the group, including non-regulated entities and any entity that DGSFP has good reasons to believe to be part of the insurance group. An insurance group is required to notify DGSFP of any change in its structure in a timely manner. DGSFP may deny or withdraw the insurance group's licence if the organization or group structure hinders effective supervision. DGSFP adopts the three levels of group wide supervision framework, which is in line with current EU Directives.
24. Macroprudential Surveillance and Insurance Supervision	PO	DGSFP collects and publishes a high volume of market statistics that are widely used by industry and academia for research purposes. However, it appears that DGSFP does not use the wealth of statistics for qualitative analysis beyond the generation of ratios. DGSFP is advised to develop a macroprudential surveillance system, including mandatory industry-wide stress tests to identify trends, potential risks and plausible future unfavourable scenarios, so that it may take early action to reduce the likelihood of systemic risk. The current 3-year projection of individual insurer's solvency position is a good start. DGSFP should include sensitivity and scenario testing to identify vulnerabilities at the insurer level and at the industry level. The Spanish insurance market has high participation by foreign insurers. Some of its insurers also have operations in other countries. DGSFP should also consider regional and global market development in its macroprudential analysis. It is noted that DGSFP is developing a new analytical tool with a view to build an early warning system. Through coordination by EIOPA, DGSFP contributes to and receives information from other supervisors on market conditions.
25. Supervisory Cooperation and Coordination	O	The engagement at EU and international level with relevant supervisors is high and collaborative. Supervisory colleges for the two international groups (where DGSFP is the designated group supervisor) have been established by the DGSFP and are under continuous improvement. DGSFP participates in another 21 Colleges as host supervisors.
26. Cross-border Cooperation and Coordination on Crisis Management	PO	DGSFP follows EIOPA and IAIS protocols on cooperation and coordination in cross-border crisis management. However, the colleges have not tested crisis simulations beyond EU. There are no resolution plans among cross-border supervisors. Work on determining Systemically Important Financial Institutions

Insurance Core Principle	Level	Overall Comments
		(SIFIs) is in early stages. A relatively minor weakness is that it does not require insurers to regularly test their contingency plans. It is advised that DGSFP should require it.
Aggregate Level: Observed (O), largely observed (LO), partly observed (PO), not observed (NO), not applicable (N/A).		

Summary of Observance Level

Observed (O)	11
Largely observed (LO)	5
Partly observed (PO)	9
Not Observed (NO)	1
Total	**26**

Table 15. Recommendations to Improve Observance of ICPs

Insurance Core Principle	Recommendations
1. Objectives, Powers and Responsibilities of the Supervisor	DGSFP is advised to maintain updated information from the Autonomous Communities on the number and the size of the mutual insurers they license and supervise, consistent with its role as the national insurance supervisor.
2. Supervisor	a. Enhance operational independence, the power to control market access (licensing and mergers and acquisitions) and administrative sanctions on very serious legal infringements should be delegated to DGSFP. b. Increase resources to keep pace with rapid industry developments. The ideal outcome is for DGSFP to gain financial and human resource policy independence so that it may explore alternative funding models. In the absence of financial independence, DGSFP needs to review its workload to focus on its core functions and delegate certain important but less critical functions to entities that may perform such duties more competently and efficiently. For example, • The handling of public complaints consumes 31 of DGSFP's headcount. This function may be more competently carried out by an industry-wide independent ombudsman. • The implementation of Solvency II requires intense and highly technical attention. DGSFP could explore other avenues for resources, such as the CCS. c. Issue conflict of interest policies to complement the general Public Employees Code of Conduct.

Insurance Core Principle	Recommendations
	d. Update the LCS without delay.
3. Information Exchange and Confidentiality Requirements	Spain is not yet a signatory to the IAIS Multilateral Memorandum of Understanding (MMoU). It should reconsider its accession to the MMoU.
4. Licensing	Expand the fitness and propriety assessment to include key individuals in control positions (see ICP 5), and (b) assess an applicant's corporate governance framework (see ICP 7).
5. Suitability of Persons	a. Amend the definition of "effective manager" to include key individuals in control positions, with an attendant definition of "control positions." (See also ICP 8). b. Improve the ongoing monitoring of the fitness and propriety of effective managers by requiring insurers to report any changes in circumstances affecting their fitness and propriety.
6. Changes in Control and Portfolio Transfers	None
7. Corporate Governance	DGSFP should establish a comprehensive Code of Corporate Governance for insurers domiciled in Spain, in line with the Unified Good Governance Code issued by the CNMV for listed companies. The Code should contain specific requirements on: (a) the board structure, governance, and assessment of the effectiveness of the board; (b) roles and accountability of board members, senior management and key personas in control functions; (c) remuneration of board members and senior management; (d) timely and reliable financial reporting to the public; and (e) timely and effective communication with DGSFP and relevant stakeholders (including policyholders) on the governance structure of the insurer.
8. Risk Management and Internal Controls	a. DGSFP is advised to strengthen the existing regulation in the following areas: • Scope of internal controls—To be effective, internal controls should be comprehensive, covering the insurer's key business, information technology (IT) and financial processes. Key control functions must minimally include internal audit, risk management and actuarial. Each key control function should (a) be led by a person suitable for the position, (b) have sufficient independence from business units and adequate resources, (c) have sufficient resources, and (d) have access to the board and provide regular reports to the board. • Duties of key control functions: (a) Risk management should assess risks on an enterprise-wide basis. There should be defined risk appetite, documented approval process and authorities, established risk strategy, and escalation and reporting procedures. (b) Internal audit should assess the adequacy and effectiveness of the insurer's policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and

Insurance Core Principle	Recommendations
	integrity of management information. (c) Actuarial function is to advise on matters relating to technical provisions, pricing, investment policies, solvency position, reinsurance, recommendation of dividends to policyholders on participating policies, and risk modelling. (d) Compliance function is to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated in work processes. b. Many insurers have started to outsource high technical functions (such as IT and risk modelling). The existing regulation on outsourcing should be expanded to require: (i) board approval of outsourcing of material functions or activities, (ii) due care and diligence in selecting the outsourcing providers, (iii) written documentation of the outsourcing arrangements, and (iv) periodic review of such arrangements.
9. Supervisory Review and Reporting	DGSFP is advised to review the adequacy of resources for both on- and off-site supervision, and formulate a more robust risk-based supervision approach.
10. Preventive and Corrective Measures	See ICP 17.
11. Enforcement	None.
12. Winding-up and Exit from the Market	None.
13. Reinsurance and Other Forms of Risk Transfer	DGSFP should require insurers to: a) finalize the reinsurance contract in a timely fashion, and prohibit the use of reinsurance side letters. b) consider the payment pattern of reinsurance claims for the purpose of liquidity management.
14. Valuation	DGSFP should address a number of deficiencies in the current Solvency I methodology. For instance by implementation of the Solvency II regime. Specifically, the valuation of liabilities should explicitly recognize best estimate of future cash flows, and a specific margin for adverse experience fluctuation. Real estate should be re-valued every year.
15. Investment	None.
16. Enterprise Risk Management for Solvency Purposes	There is an urgent need to develop a comprehensive enterprise risk management regulatory framework.
17. Capital Adequacy	Pending Solvency II adoption, the DGSFP is advised to introduce regular scenario testing to determine the impact on insurer's solvency position. DGSFP should also formalize its practice of commencing discussions with an insurer at risk of breaching its solvency margin

<table>
<tr><th>Insurance Core Principle</th><th>Recommendations</th></tr>
<tr><td></td><td>so that there is sufficient time to take preventive measures.</td></tr>
<tr><td>18. Intermediaries</td><td>DGSFP is advised to:
• Improve the register of intermediaries to include all persons allowed to sell, for greater public disclosure and protection.
• Require intermediaries to disclose their financial interest in the sale of the products. For instance, an intermediary should point out which of the policies presented to the client bears the higher commission. Also the commission should be disclosed at least upon request.
• Require intermediaries to put in place additional safeguards to protect client’s money. For example, the use of bank accounts separate from the intermediaries’ own accounts to hold client’s money.
• Increase frequency of on-site inspections.</td></tr>
<tr><td>19. Conduct of Business</td><td>a. DGSFP is advised to improve the disclosure requirements to include:
• At the point of sale: description of investment strategies used to provide policy guarantee, so that the customers may form an informed conclusion on the security of the guarantee.
• Intermediaries selling products invested in complex investment instruments (e.g, derivatives, structured products) should have special training so that they can explain the risk, costs and benefits of the investments to customers clearly.
• On an ongoing basis: statements to customers of life insurance with investment elements at least annually, to inform them of the changes in policy values during the year.
b. DGSFP is advised to consider setting up an industry-wide independent ombudsman to handle public complaints.
c. Banks often offer packaged products for compulsory insurance. In such cases, the bankassurance operator should inform the customers that he is free to choose the product from another insurer. Furthermore, the cost for each component of the packaged product should be clearly identified.
TRLOSSP should give DGSFP the proper power to improve public disclosure.</td></tr>
<tr><td>20. Public Disclosure</td><td>DGSFP is advised to (a) improve the timeliness of public disclosure by using quarterly information submitted by insurers, and (b) require insurers to disclose their risk management and internal controls in a manner that can be understood by the public. (See also ICP 7 on corporate governance). TRLOSSP empower DGSFP to improve public disclosure.</td></tr>
<tr><td>21. Countering Fraud in Insurance</td><td>Regulation should explicitly require insurers and intermediaries to have effective policies and procedures to deter, prevent, detect, report and remedy fraud as part of their internal control processes.</td></tr>
<tr><td>22. Anti-Money Laundering</td><td>DGSFP should consider, in supporting SEPBLAC to further facilitate</td></tr>
</table>

Insurance Core Principle	Recommendations
and Combating the Financing of Terrorism (AML/CFT)	the industry's compliance with AML/CFT law, issuing guidelines on risk-based customer due diligence (CDD) procedures.
23. Group-wide Supervision	DGSFP is advised to consider the following improvements to its group-wide supervision framework: a. Given the large number of insurance groups in Spain, review its capacity (under level 1) to carry out effective group-wide supervision. b. In light of the recent financial crisis, consider improving the level 3 reporting requirements to include off-balance exposures, liquidity risks and possible contagion and reputation risks.
24. Macroprudential Surveillance and Insurance Supervision	DGSFP is advised to: a. Provide context to the comprehensive market statistics it publishes, by including more macroeconomic factors, such as level of interest rates, financial market indices, inflation, inter-connectedness with other financial market participants, catastrophes and pandemics that may impact insurers and insurance markets. b. Develop a macroprudential surveillance system, including mandatory industry-wide stress tests to identify trends, potential risks and plausible future unfavourable scenarios, so that it may take early action to reduce the likelihood of systemic risk. DGSFP should include sensitivity and scenario testing to identify vulnerabilities at the insurer level and at the industry level as well as to assess the potential systemic importance of insurers. c. Consider regional and global market development in its macroprudential analysis, recognizing the international dimension of its insurance market.
25. Supervisory Cooperation and Coordination	Due to the international operations of some Spanish insurance (groups), the degree of cross-border cooperation is highly intensive, and necessary. DGSFP is advised to allocate sufficient resources to the supervision of international groups to meet the growing requirements arising from its participation in 23 supervisory colleges.
26. Cross-border Cooperation and Coordination on Crisis Management	As part of its involvement in supervisory colleges, DGSFP should work with other group/involved supervisors to: • test the crisis simulations beyond EU; • establish resolution plans among cross-border supervisors; • identify SIFIs; • institute action plans in respect of SIFIs in case of a crisis; and • require insurers to regularly test their contingency plans.

F. Authorities' Response to the Assessment

49. The Spanish authorities want to express their gratitude towards the huge and valuable work developed by the IMF to assess the implementation of the supervisory and regulatory competences. The Financial Sector Assessment Program has been extremely useful in a critical moment where the experience and know-how of the IMF is received as precious benchmark to inspire and implement the improvements to come.

50. The assessment concludes that the sector is supervised under a sound regulatory framework. Notwithstanding this good evaluation, the Spanish authorities have an ambitious agenda to introduce new regulation and tools to keep improving the supervisory action, making it more efficient and adapted to the current economic environment.

51. As the FSAP rightfully points out, the main vulnerability of the supervisory framework is the lack of sufficient resources. The Spanish authorities are well aware of this weakness and will take measures to make the system cope with its demands. The Spanish insurance industry has repeatedly expressed their willingness to financially support the supervisor.

52. The FSAP recognizes that the strengthening of the autonomy of the supervisor is a pending issue. This statement, together with the previously mentioned assessment, is one of the issues that will be dealt by the Spanish authorities as soon as the economic crisis allows it.

The Spanish authorities have already taken steps to address a number of shortcomings identified in the FSAP. Furthermore, the ongoing works to transpose Solvency II will duly tackle some of the concerns raised in the assessment regarding product disclosure for life insurance and capital requirements linked to the risk taken by the insurance companies.

II. DETAILED ASSESSMENT

Table 16. Detailed Assessment of Observance of the Insurance Core Principles

ICP/Standard	Description
ICP 1	**Objectives, Powers and Responsibilities of the Supervisor** The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.
Legal authority	The TRLOSSP empowers MEC to supervise private insurance activities in Spain, on both legal-entity and group-wide basis, with the exception of mutual insurers that operate solely within an Autonomous Community where the Autonomous Community has agreed to assume the supervisory responsibility (Article 69). These small regional mutuals are licensed and supervised by the Autonomous Communities they operate in, in accordance with the provisions in the TRLOSSP. By law, these Autonomous Communities should consult DGSFP before granting a licence. However, it is not always done in practice. As at the end of 2010, there were 159 such entities in seven Autonomous Communities with gross written premium of € 1.6 billion, or 2.7 percent of total Spanish insurance market in 2010. In terms of the number of entities, 87 percent of such entities (82 percent by premium volume) are from the Autonomous Community of the Basque Country. MEC's supervisory power includes licensing and revocation of licence, establishing prudential requirements, conducting on-site inspections, imposing administrative sanctions over market misconduct and enforcement action against statutory breaches (Articles 5, 70–72). MEC delegates the bulk of its supervisory responsibility to DGSFP by regulation. However, the Minister for MEC retains the authority to issue and revoke insurer's licences, approve major corporate actions by insurers (such as acquiring controlling interest and portfolio transfers) and impose sanction on very serious infractions defined in law. Under the proposed new law implementing Solvency II, DGSFP will have the power over corporate actions. The primary insurance legislations permit the issuance of regulations where greater details are necessary. Insurance regulations are drafted by DGSFP and issued by the Government. There have not been any instances where MEC has not acted in accordance with DGSFP's recommendations. The MEC may issue Administrative Orders pursuant to powers conferred by insurance laws and regulations. The DGSFP may issue rulings (*resolution*). These rulings are binding but may be challenged in court.
Objectives and responsibilities	The TRLOSSP states that the objective of insurance supervision is to protect the rights of policyholders, providing transparency and development of the insurance market and encourage private insurance business. (Article 1). The TRLOSSP gives the authorities a wide range of supervisory power, including requiring insurers to submit information, remove directors and senior management when they become unsuitable for their positions, disallow insurers from writing new business or renewing existing business, and take effective control of an insurer in distress situations. DGSFP has exercised all such powers in the past to protect policyholders' interest.

ICP/Standard	Description
	DGSFP publishes its annual reports on its website, providing detail market statistics with a view to promote market transparency. The number and nature of complaints against insurers are also published annually. In 2011, DGSFP received a total of 9,415 complaints from the public, 304 of which were inquiries. Other than public reprimand, publication of sanctions against insurers and individuals is considered on a case-by-case basis. DGSFP fulfills its market development objective by raising public's awareness of insurance. This is mainly achieved through a consumer education portal on its website. The website provides information on insurance products, factors to consider when purchasing a policy, the process of buying a policy, rights and obligations of policyholders, how to make a claim, how and where to file a complaint, glossary of insurance terminology and DGSFP contact information. Consumers also have online access to insurers' financial information and register of licensed intermediaries.
Assessment	Observed
Comments	The primary insurance legislation clearly defines the objectives of insurance supervision and designates MEC as the insurance supervisor, who in turn delegates the day-to-day supervisory responsibility to DGSFP by regulation (*decreto real*). The Minister for MEC is the ultimate decision-maker in the areas of market access and sanctions on very serious legal infringements. Legislation provides sufficient mandate and power to the authorities to fulfill their responsibilities. Autonomous Communities are in charge of the supervision of regional mutual insurers operating solely in their respective communities. As the national insurance supervisor, DGSFP should have a complete picture of the insurance market in Spain. Therefore, DGSFP is advised to maintain updated information from the Autonomous Communities on the number and the size of the mutual insurers they supervise.
ICP 2	**Supervisor** The supervisor, in the exercise of its functions and powers: • is operationally independent, accountable and transparent; • protects confidential information; • has appropriate legal protection; • has adequate resources; and • meets high professional standards.
Governance structure	DGSFP is a department within MEC. The head of DGSFP, the Director General, reports to the Minister for MEC. DGSFP is organized into four sub-directorates reporting to the Director General: (a) legislative policy, (b) market structure, (c) inspection, and (d) pension funds. Two separate support units provide legal, IT, actuarial, financial and other dedicated technical support to all four sub-directorates. Other common support functions such as human resources and

ICP/Standard	Description
	procurement are provided by MEC. The legislative policy sub-directorate handles international relations and consumer complaints in addition to policy issues. The market structure sub-directorate is responsible for licensing and supervision of intermediaries. The inspection sub-directorate is responsible for ongoing supervision of insurers, both on- and off-site. DGSFP had 236 staff at the end of 2011, distributed as follows: • Legal policy (including consumer complaints): 71 • Insurance market structure (including licensing and supervision of intermediaries): 42 • Insurance supervision (both on- and off-site): 58 • Pension funds: 26 • Support (IT, actuarial and financial, and legal): 38 DGSFP is funded by the MEC from the State budget approved by the Parliament. Its operating budget was € 12.8 million in 2011. DGSFP collected about € 700,000 registration fees from insurance intermediaries and brokers in each of the past two years. Registration fees and any monetary fines collected are turned over to the Treasury. Being part of the government, DGSFP is bound by the pay scale and manpower allocation of the civil service. Under the current austerity measures, filling of vacancies is subject to ministerial review. DGSFP is subject to audit by the General Inspection of the Services, an independent government agency responsible for conducting internal audits of ministries and public agencies. There is no set frequency of such audits. The last full audit was conducted in 2008, and a data security audit in 2010.
Appointment & removal of head of agency	The process of appointing the Director General is specified in Law 6/1997 of April 14, governing the organization and functioning of the administration of the State. Article 18 of that law states that the Director General is nominated by the Minister for MEC, and appointed by the Council of Ministers (i.e., the Cabinet). In making the appointment, the Council of Ministers must take into account the professional competence and experience of the proposed candidate. There is no provision for public disclosure of the reasons of the removal of the Director General.
Free from political and industry interference	DGSFP is independent in setting its own operational goals and targets and has its own dedicated legal and technical support. Within the overall headcount constraint, DGSFP may allocate its manpower according to its supervisory plan. Director General has the final decision-making authority in supervisory matters, with certain exceptions. The Minister for MEC is the final decision-maker in the

ICP/Standard	Description
	areas of market access (i.e., issuance and revocation of licences, approval of acquisition of controlling interest in insurers, and portfolio transfers[9]), and sanctions on very serious offences as defined in the TRLOSSP. Insurance legislation provides avenues for appeals against DGSFP's supervisory decisions either through administrative review at the MEC level, or judicial review in courts. TRLOSSP gives DGSFP the power to direct an insurer to take actions or invalidate its actions (with the exception of filing appeal) when special control measures are invoked. Therefore, the existence of the appeal process does not inhibit DGSFP's timely intervention. Despite the inability of DGSFP to sign the IAIS multilateral MoU following the Foreign Affairs Ministry's recommendations, there is no evidence to suggest undue interference from industry or the government that would impede DGSFP from fulfilling its responsibilities.
Transparency & disclosure	Insurance laws, regulations, administrative orders and market statistics are published and updated. DGSFP identifies the need to update regulations during the course of carrying out its duties, but there is no scheduled interval of formal review of existing rules. Changes to laws and regulations are subject to lengthy legislative process. As an example, the update to the 30-year old LCS has been under the Ministry of Justice's review for three years.[10] DGSFP also publishes an Insurance Sector Annual Report, which provides a general description of its supervisory role and objectives and its supervisory program during the year. The Sector Annual Reports are published in May of the following year, using the unaudited 4th quarter reporting. However, the financial information for individual insurers is based on audited annual accounts, submitted six months after the close of the financial year. Thus, the publication of the annual report is many months later. Sometimes, the update of specific insurers can be as late as one year after the close of the financial year. Proposed insurance legislative changes are subject to consultation with a Consultative Group constituted by the DGSFP. Members of the Consultative Group include representatives from the insurance industry, labor union, and consumer groups. The Consultative Group has 15 days to consider the proposal and give response. DGSFP considers the Consultative Group's views, but is not obliged to abide by them. The proposal, the date of the meeting with the Consultative Group, and minutes of the meeting are published for transparency and opportunity for comments by the general public. After consultation, proposed legislative changes are sent to the relevant ministries and agencies for comments, before tabling at the Parliament by the Government.

[9] New legislation implementing Solvency II will transfer the power to approve major corporate actions to the Director General of DGSFP.

[10] The prolonged legislative process for LCS could be due to its complexity. The median duration of simpler legislative procedures is 9 months.

ICP/Standard	Description
Confidentiality, legal protection and integrity	Staff of DGSFP is members of the General Administration of the State. They are required by the TRLOSSP and the Public Employee Code of Conduct to protect the confidentiality of official information indefinitely. Breach of confidentiality is punished according to civil and criminal laws. Penalty is up to four years imprisonment. To ensure IT security, DGSFP engages external experts to conduct IT security audit every other year. DGSFP also engage “ethical hackers” to test the strength of its system firewalls on a regular basis. DGSFP staff does not have legal protection under the TRLOSSP. However, they are protected by a State legal protection scheme for public agencies and their staff. The scheme covers the legal costs and court awards (if any) in defending their actions in the course of carrying out their duties in good faith. Staff members of DGSFP must conduct themselves in accordance with the Public Employee Code, which is applicable to all government employees. There are no policies to address conflict of interest situations particular to insurance supervisors.
Competence of staff and adequacy of resources	Almost half of DGSFP staff members (97 out of 233) are qualified as “Inspectors,” a recognition as insurance supervision specialists. Only those who have obtained this qualification may conduct on-site inspections. The qualification is obtained after completing five examinations (four written and one oral) conducted by a tribunal consisting of representatives from the civil service, DGSFP, and academia. It takes an average of three years to complete the examination process. Annual training is provided to “Inspectors” to equip them with updated skills and knowledge in economic, financial, actuarial and regulatory matters. IT staff also receives training in electronic tools and technology. Other non-specialists also receive general training in the use of internal applications and general office skills. The allocated budget has not kept pace with the increase in DGSFP’s supervisory scope in recent years. The annual budged given to DGSFP has remained essentially the same in the past five years. DGSFP has found it challenging to meet its supervision objectives, recruit and retain skilled and experienced staff to supervise 280 entities, 97,000 intermediaries, and to handle over 9,000 complaints lodged in 2011 alone. There is basically a no-new-hires policy, and any vacancies created due to retirement or resignations are re-approved by the MEC and may be re-allocated to other departments within MEC. The inadequate resources has adversely affected the effectiveness of DGSFP’s performance. (See also ICP 9). DGSFP does not outsource any of its supervisory functions, as the TRLOSSP explicitly assigns core supervisory functions to only civil servants and insurance inspection to qualified inspectors.
Assessment	Partly Observed
Comments	DGSFP exercises supervision within the State budget framework and is subject to

ICP/Standard	Description
	clear accountability measures. The increase in size and complexity of the supervised market demands new knowledge and skills for effective supervision and cross-border coordination, in particular with the eminent Solvency II preparedness. The DGSFP did not have the additional resources needed for a more risk-focused supervisory approach. Furthermore, the lack of staff retention policy and succession planning exposes DGSFP to the risk of loss of critical staff when economy recovers and unemployment improves. DGSFP staff members are competent and qualified, but the headcount assigned to core supervisory functions needs to be increased to strengthen the intensity of on- and off-site supervision. To ensure effective supervision, it is important that DGSFP has financial independence so that it may explore alternative funding models and discretion in budgeting and allocating its human resources. In the absence of additional resources, DGSFP should consider delegate important but less critical areas like complaint handling to focus on offsite supervision and inspection For example, • The handling of public complaints consumes 31 of DGSFP's headcount. This function may be more competently carried out by an industry-wide independent ombudsman. • The implementation of Solvency II requires intense and highly technical attention. DGSFP could explore other avenues for resources, such as the CCS. While DGSFP does not have administrative independence, it operates in a transparent manner and there is no evidence to suggest that it suffers from undue political interference. Although the Minister for MEC retains the power to approve market access and administrative sanctions on very serious legal infringements at the recommendation of the Director General of DGSFP, the prescriptive approach embedded in the insurance law makes it difficult for the Minister to deviate from legal provisions. Nonetheless, to enhance operational independence, such powers should be delegated to DGSFP. DGSFP staff are bound by the code of conduct contained in the Basic Statute for Public Employees (Law 7/2007), which provides the guiding principles of avoiding conflict of interest situations and behaving in an ethical manner. DGSFP should issue additional policies to guide DGSFP staff in specific conflict of interest situations to complement the general Public Employees Code of Conduct. Such situations include family members working in supervised entities, or trading of securities of supervised entities. Spain should carry out the update of the insurance contract law without further undue delay.
ICP 3	**Information Exchange and Confidentiality Requirements** The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.

ICP/Standard	Description
Power to obtain information	DGSFP has power under the TRLOSSP (Article 72) and ROSSP (Article 67) to require insurers to submit information and to obtain information during on-site inspections, on entity and group-wide basis. DGSFP may also request financial information on any subsidiary of an insurance group, including its non-regulated entities.
Power to exchange information	The TRLOSSP (Articles 2.2, 75.3, and 77) establishes the general framework for the collaboration and exchange of information with other financial supervisors. Domestically, DGSFP has signed bilateral MoUs with BdE and CNMV to exchange information and collaborate on the supervision of the Spanish financial sector. Pursuant to these MoUs, DGSFP has exchanged information with the other sectoral supervisors on significant shareholders and market conduct matters. Joint cross-sector training programs were also conducted to heighten the awareness of cross-sectoral issues. Spain is not a signatory to the IAIS Multilareal MoU. Within EU, there is no requirement of a formal cooperation agreement for exchanging information. Outside of EU, DGSFP has signed MoUs with Switzerland, Mexico, El Salvador, and Uruguay to facilitate cross-border supervision of insurance groups. While a formal agreement is required to exchange information outside of EU, requests from jurisdictions outside of EU without a formal agreement are evaluated on a case-by-case basis subject to preconditions of reciprocity and confidentiality. DGSFP has accepted requests for information from supervisors outside the EU in the past. DGSFP participates in 23 supervisory colleges, acting as lead supervisor in two of the colleges. Members of the supervisor colleges consist of both EU and non-EU jurisdictions. Secure websites are used for some of the large colleges.
Use and onward transmission of information	DGSFP has procedures in place to ensure that the confidential information received from another supervisor is used only for the purposes specified in the request. Before using the information for another purpose, DGSFP obtains agreement of the originating supervisor. In the event that DGSFP is legally compelled to disclose confidential information it received from another supervisor, DGSFP has procedures to notify the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release.
Assessment	Observed
Comments	The regulatory framework enables DGSFP to exchange confidential information with supervisors. In the case of non-EU supervisors, legislation also establishes the conditions for collaboration and exchange of information on the condition of reciprocity and confidentiality. Spain should reconsider its accession to the IAIS Multilateral MoU.
ICP 4	**Licensing**

ICP/Standard	Description
	A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.
Activities requiring licensing	The TRLOSSP provides that only authorized (licensed) insurer may carry out life, non-life and reinsurance activities in Spain. The authorization is granted by the Minister for MEC, at the recommendation of DGSFP. The legal structure of the insurer may be a joint-stock company, a mutual, a cooperative or a mutual benefit society. Insurance activities are classified into 19 lines of business. Authorization is granted by lines of business. Additional authorization is required should the insurer wish to expand its activities into lines of business not covered by its existing authorization. TRLOSSP requires DGSFP to respond to a licence application within six months after receiving all necessary information for assessment. In assessing the application, DGSFP should consider factors such as meeting minimum capital requirement, having competent management members with good repute, and viability of its business plan (Article 5.2). A foreign insurer may operate in Spain either as a subsidiary or a branch. An EU insurer may conduct business in Spain through a cross-border arrangement without physical presence in Spain. DGSFP has established procedures to consult home supervisor before issuing a licence to a foreign insurer. DGSFP has stopped issuing composite insurance licence since 1984. Existing composite insurers are allowed to continue writing both classes of business. However, Article 49 of ROSSP requires composite insurers to segregate assets covering technical provisions for life and non-life classes of business. The solvency margin must also be calculated and maintained separately (Article 58.3 of ROSSP). A strict allocation of assets to the underlying liabilities is required for solvency accounting purposes, although the asset assignation has not been tested under liquidation. In 2011, DGSFP has licensed 3 new insurers, 6 foreign branches, and 10 additional lines of business to existing insurers.
Requirements for subsidiaries	For a subsidiary licence, an applicant must submit its business plan to DGSFP. The content of the business plan includes: organization structure, contemplated lines of business, reinsurance arrangement, distribution methods, and projected revenue and profits (Articles 24 and 25 of ROSSP). The applicant must meet the financial requirements specified in the TRLOSSP. The minimum capital required for a stock company is generally € 3 million, but a higher capital of € 9 million is required for life, guarantee, and credit insurance, and € 2 million for accident and health, legal, travel and funeral insurances. For a mutual insurer, the minimum mutual fund is half of the amount required of a stock company. At least 50 percent of the minimum capital must be paid-up. As part of the licensing process, DGSFP assesses the fitness and propriety of the applicant’s Board Members, Senior Management and Significant Owners. Board

ICP/Standard	Description
	Members and Senior Management must have sufficient knowledge and experience and be fit and proper to manage an insurer. However, the same fit-and-proper test does not generally extend to Key Persons in Control Functions. (See also ICP 5). In determining Significant Owners, DGSFP apply see-through to beneficial owners to the extent possible. Corporate governance is not a consideration in assessing licence application, as there is no corporate governance framework for insurers in general. (See also ICP7).
Requirements for branches	The establishment of branches in Spain by EU insurers is governed by Article 83 of the TRLOSSP and the General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the EU (Siena Protocol, March 2008). In accordance with the Siena Protocol, the intention of an EU insurer to establish a branch in Spain is communicated by its home supervisor to DGSFP who verifies that the notification contains, at the very least: proposed operations and the structure of the branch, name and address of the head office, address of the proposed branch, and name and powers of the general representative of the proposed branch. The establishment of branches by non-EU insurers is governed by Article 87 of the TRLOSSP which are more stringent compared to those for EU insurers. One of the requirements is to maintain localized capital in the same amount as required of subsidiaries. Only two non-EU insurers have established branch operations in Spain, in 1984 and 1996, respectively.
Power to reject or impose conditions	Article 5.6 of the TRLOSSP allows DGSFP to reject an application on grounds of failing to meet licensing criteria. Article 5.5 of the TRLOSSP provides that a license can be restricted in the scope of risks undertaken or by geographic coverage. DGSFP may also impose additional conditions to comply with the law and best industry practices, a practise that was used in the past. DGSFP has the general power to impose any additional requirements, conditions or restrictions during the first three years of a new licensed activity. If the licence is denied, conditional or restricted, DGSFP must provide the applicant an explanation.
Assessment	Observed
Comments	The legislation clearly defines the activities that require licensing, and the process and criteria to obtain a licence. It is recommended that DGSFP (a) expands the fitness and propriety assessment to include key individuals in control positions (see also ICP 5), and (b) assesses the applicant’s corporate governance framework (see also ICP 7). An “Observed” assessment is given to this ICP because the inadequacy in the scope of assessment of key individuals in control positions and corporate governance framework is considered and assessed in ICPs 5 and 7.

ICP/Standard	Description
ICP 5	**Suitability of Persons** The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.
Scope	Article 5.2(f) of the TRLOSSP requires an insurer to "be effectively managed by persons meeting the requirements of good repute and professional qualifications or experience." Articles 14 and 15 of the TRLOSSP specify the general fit and proper requirements for members of mutuals/cooperatives and "effective managers" of insurers. "Effective managers" refer to significant owners, board members, and senior management. It does not include key persons in control functions, such as risk management, audit or actuarial. Among other things, suitability takes into account the individual's integrity, financial soundness, professional knowledge and experience.
Ongoing basis	The suitability of effective managers is required at the initial licensing stage, and they are required to maintain their suitability on an on-going basis. Failure to meet the suitability test is ground for revocation of licence (Article 5.2 of TRLOSSP). To ensure continual meeting the fit-and-proper criteria, insurers report appointments and removal of "effective managers" to DGSFP. While DGSFP does not formally approve such appointments and removals, DGSFP assesses the new appointees. If the new appointees are found to be unsuitable, DGSFP requests the insurer to remove the person and propose an alternate candidate. DGSFP can remove, suspend or temporarily replace Board Members and Senior Management under exceptional circumstances (Articles 39 and 41 of TRLOSSP). There have been incidences in the past where DGSFP has removed the entire board of directors. The responsibility to assess the suitability of auditors and actuaries rests with the respective administrative and professional bodies, ICAC and Spanish Institute of Actuaries (IAE). DGSFP may request the professional associations to investigate the professional conduct of auditors and actuaries should it discover any issues during its on-site inspections.
Assessment	Largely Observed
Comments	Currently, the suitability test is applied to board members, senior management and significant owners only. DGSFP is advised to amend the definition of "effective manager" to include key individuals in control positions, with an attendant definition of "control positions." (See also ICP 8). When an insurer becomes aware of circumstances that may affect the fitness and propriety of effective managers, it is not legally required to notify DGSFP of the situation. DGSFP is advised to require insurers to report to DGSFP any changes in circumstances affecting the fitness and propriety of the effective managers. DGSFP has noted that adoption of Solvency II will improve the observance of this

ICP/Standard	Description
	ICP.
ICP 6	**Changes in Control and Portfolio Transfers** Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.
Approval and notification levels	Article 5 of the TRLOSSP requires DGSFP to indicate no-objection to acquisition of "significant ownership" of an insurer. Article 22 defines significant ownership as holding, directly or indirectly, 10, 20, 30, or 50 percent or more of voting share or capital. Article 22 of the TRLOSSP also specifies a notification thresholds at 5percent ownership of an insurer. Failure to notify DGSFP may nullify the acquisition. Disposal of significant holding must also be notified to DGSFP.
Evaluation	DGSFP requires insurers to provide the following information on their shareholder and any other person directly or indirectly exercising control: his identity, and his intentions, objectives and strategies associated with the proposed acquisition of significant interest in the insurer. After receiving the information, DGSFP evaluates the proposed acquisition of significant ownership of an insurer based on similar criteria for evaluating licence applications, comprising both financial and non-financial considerations. If the proposed acquisition results in controlling 50percent or more of the insurer, a business plan must be included in the notification. When the proposed acquisition of controlling interest in an insurer involves entities or beneficial owners of entities outside of Spain, DGSFP is required by law to coordinate with the corresponding foreign supervisors. This applies to both approval and notification levels of control. DGSFP identifies the ultimate beneficial owner(s) when assessing a proposed acquisition of controlling interest in an insurer. DGSFP can reject the proposed acquisition if it determines that the assessment criteria are not fully met. DGSFP has 60 days to complete the evaluation. The 60-day period can be extended by 20 days for insufficient information, or 30 days if foreign supervisors are involved.
Mutual/stock conversion and portfolio transfer	A change of a mutual company to a stock company is subject to the approval of the Minister for MEC (Article 24.6). The transfer of all or a part of an insurer's business is also subject to the approval by the Minister for MEC (Article 23). The Minister must be satisfied that policyholder's interest and rights will not be affected and that statutory prudential requirements will continue to be met after the proposed transformation or transfer.
Assessment	Observed

ICP/Standard	Description
Comments	The regulatory requirements for acquisition and changes in significant ownership of insurers, conversion of legal structure, and portfolio transfer are clearly set out under the TRLOSSP. Such changes will not be approved if the interest and rights of policyholders would be adversely affected.
ICP 7	**Corporate Governance** The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of policyholders.
Board's oversight	There is no mandatory corporate governance framework for insurers in Spain. There are two listed insurance companies that must comply with the Unified Good Governance Code issued by the CNMV for listed companies. The industry association UNESPA has issued a guideline on corporate governance for the voluntary compliance by its members. In this regard, 84 insurers representing 70 percent of market share have agreed to adhere to it. Board members of insurers must meet fit and proper criteria (ICP 5). ROSSP requires the Board of Directors to be ultimately responsible for the establishment of effective internal control processes, and the Senior Management responsible for implementing the processes following guidelines set by the Board. Internal control processes include internal audit and risk management. (See ICP 8).
Remuneration policy	While there is no formal requirement on remuneration policy for persons whose action may have material impact on the risk exposure of the insurer, DGSFP reviews payments to shareholders (via dividends), Board members and Senior Management against business results during on-site inspections, to ensure fair treatment of policyholders vis-à-vis shareholders and management. DGSFP has recommended remedial action when the payments to shareholders, directors and management were found to be out of line with business results. The insurer has followed DGSFP's recommendation even though DGSFP does not have legal authority over the insurer's remuneration policy.
Financial reporting	The Board's responsibility over the accuracy of financial information is not clearly stated, but is implied through the requirement for directors to sign-off on the annual financial information submitted to the DGSFP. Despite the lack of corporate governance requirements in the insurance regulatory framework, DGSFP has the power to sanction an insurer if it determines that the insurer's governance practice jeopardizes the insurer's solvency condition.
Assessment	Partly Observed
Comments	The corporate governance requirement for insurers is limited to the requirement for the Board to be responsible for establishing adequate internal control

ICP/Standard	Description
	processes including independent internal audit function and risk management systems consistent with the insurer's risk management strategies. There is room for improvement in the areas of: (a) the board structure, governance, and assessment of the effectiveness of the board; (b) roles and accountability of board members, senior management and key personas in control functions; (c) remuneration of board members and senior management; (d) duties of individual board members including acting in the best interests of the insurer and policyholders; (e) timely and reliable financial reporting to the public; and (f) timely and effective communication with DGSFP and relevant stakeholders (including policyholders) on the governance structure of the insurer. The UNESPA corporate governance guideline is for voluntary adoption by its members only. To ensure an adequate and consistent level of corporate governance, DGSFP should issue a Code of Corporate Governance for insurers domiciled in Spain in line with the Unified Good Governance Code issued by the CNMV for listed companies. The Code should more clearly define the role and accountability of the Board of Directors and Senior Management. It is noted that the introduction of Solvency II will address many of the requirements of this ICP.
ICP 8	**Risk Management and Internal Controls** The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.
Risk management	Article 110 of ROSSP requires insurers to establish and continuously maintain internal control processes that are adequate for their organizations. The Board of Directors is held responsible for maintaining and improving these internal controls, while the management is responsible for the implementation of internal controls following guidelines established by the Board. As part of internal control processes, insurers must establish risk strategies and the corresponding risk management systems that allow for the identification, measurement, and evaluation of internal and external risks to which the insurer is exposed. The insurer must develop contingency plan for adverse situations. Since 2007, insurers' Boards are required to submit an annual report to DGSFP on the effectiveness of its internal control processes, emphasizing any significant deficiencies detected, their implications and, if appropriate, proposing measures to overcome these deficiencies. DGSFP reviews the reports off-site and verifies the processes during on-site visits.
Compliance, actuarial and internal audit functions	DGSFP does not require insurers to have compliance functions to promote a culture of compliance and integrity. Nonetheless, many insurers have in-house compliance function following UNESPA's guidelines on internal controls. 104 insurers have signed the undertaking to abide by the UNESPA guidelines on internal controls.

ICP/Standard	Description
	The determination of insurance premiums must be based on actuarial principles (Article 25.3 of TRLOSSP and Articles 76 and 77 of ROSSP), and technical provisions must be based on prudent and reasonable assumptions (Article 16.2 of TRLOSSP). There are three actuarial associations in Spain organized by geographic regions. The IAE is for all areas except Cataluna and Basque Country. The IAE has a membership of 1,500 which is approximately 75 percent of the total number of actuaries in Spain. Admission into IAE is based on completion of a Master Degree in Actuarial and Financial Science in accepted universities. Foreign-trained actuaries may be admitted through a recognition program. The IAE has a professional code of conduct, and there is an established disciplinary process. DGSFP accepts actuarial certification of premiums and/or technical provisions from any qualified actuary in its assessment, not necessarily restricted to members of Spanish actuarial associations. Article 110.4 of ROSSP requires the insurer to have an independent internal audit function, carried out by staff with adequate knowledge and experience. The Board is responsible for ensuring that internal audit has adequate resources.
Outsourcing	Article 110.6 of ROSSP requires the insurer to apply its internal control processes to outsourced activities and clearly indicates that outsourcing arrangements do not lessen the accountability of the insurer over the outsourced activities.
Assessment	Partly Observed
Comments	DGSFP has made important progress in the last few years with the introduction of the mandatory reporting of internal controls deficiencies, and the guidance on the checks of internal control in the inspection manual. However, more specific details on the scope of such internal controls and reporting duties should be provided. DGSFP is advised to strengthen the existing regulation in the following areas: • Scope of internal controls—To be effective, internal controls should be comprehensive, covering the insurer's key business, IT and financial processes. Key control functions must minimally include internal audit, risk management and actuarial. Each key control function should (a) be led by a person suitable for the position, (b) have sufficient independence from business units and adequate resources, (c) have sufficient resources, and (d) have access to the board and provide regular reports to the board. • Duties of key control functions: (a) Risk management should assess risks on an enterprise-wide basis. There should be defined risk appetite, documented approval process and authorities, established risk strategy, and escalation and reporting procedures. (b) Internal audit should assess the adequacy and effectiveness of an insurer's policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and integrity of management information. (c) Actuarial function is to advise on matters relating to technical provisions,

ICP/Standard	Description
	pricing, investment policies, solvency position, reinsurance, recommendation of dividends to policyholders on participating policies, and risk modelling. (d) Compliance function is to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated in work processes. Many insurers have started to outsource high technical functions (such as IT and risk modelling). Outsourcing is a practical solution particularly for smaller insurers. The existing regulation on outsourcing should be expanded to require: (a) board approval of outsourcing of material functions or activities, (b) due care and diligence in selecting the outsourcing providers, (c) written documentation of the outsourcing arrangements, and (d) periodic review of such arrangements. DGSFP noted that the adoption of the Solvency II regime will address the above gaps in existing regulations.
ICP 9	**Supervisory Review and Reporting** The supervisor has an integrated, risk-based system of supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, the quality and effectiveness of its Board and Senior Management and compliance with legislation and requirements. The supervisor obtains the necessary supervisory information to conduct effective supervision of insurers and evaluate the insurance market.
Reporting and off-site monitoring	Insurance accounting standards in Spain are issued by the MEC, taking into account the ICAC report. They are largely in line with IFRS with some differences in the accounting valuation of assets and the valuation of assets for solvency purposes. For instance, real estate for accounting purpose is valued at historical cost but for solvency purposes at market value. Audit standards are issued by ICAC, an independent body attached to the MEC. Only auditors registered with ICAC are allowed to practice in Spain. There were 5,493 registered auditing practitioners at the end of 2011, with an estimate of around 600 insurance specialized auditors. One of ICAC's responsibilities is to inspect audit firms to ensure the upholding of audit standards. It has disciplined its members for failing to meet the standards. Sanctions are published. DGSFP requires all insurers to submit statistics on a quarterly and annual basis. Five supplemental reports are submitted annually: (a) audited annual accounts, (b) management report, (c) auditor's report, (d) internal control report, and (e) special audit report. Quarterly reporting is generally due two months after the end of the quarter, with an additional 15 days for the 2nd quarterly reporting to accommodate the traditional holiday period in August. Annual reporting is due 6 months after the close of the year. Only annual accounts are signed-off by Board Members, and audited by external auditors. Submitting inaccurate financial information to DGSFP is considered a very serious offence, and is ground for administrative sanction. Insurance groups are required to file consolidated financial statements, including

ICP/Standard	Description
	their non-regulated entities. Off-balance sheet items are reported. However, outsourced activities are not reported. Insures are also required to submit supplementary documents (such as external auditor's opinion on the insurer's financial position) on an annual basis. DGSFP has the power to require insurers to provide ad-hoc information necessary for it to carry out its supervisory objectives. (Article 71.4) DGSFP has developed an in-house database to facilitate efficient off-site supervision with minimal manpower. Currently, 6 analysts (including a supervisor) are responsible for data entry, conducting data consistency verification and generation of ratios and rankings of insurers. These analysts are responsible for other duties, such as participation in special projects, on-site visits to ERDs,[11] and preparation of sectoral statistical reports. Warning flags are raised based on pre-set parameters, e.g., cumulative losses exceeding 25 percent of capital, deficit in the guarantee fund, or assets below 90 percent of technical provisions. A list of the worst-performing insurers is tabled for discussion at a 3-member, cross-departmental committee each quarter, taking into account the number of public complaints and internal controls deficiencies reported by the insurers. If an on-site inspection is deemed necessary, the committee refers the insurer to the inspection unit for incorporation into its inspection schedule. DGSFP performs a three-year projection of solvency using the database to facilitate macroprudential surveillance. (See ICP 24).
On-site inspection	DGSFP has the power to inspect insurers on both legal entity and group-wide basis, to determine their legal, technical and financial positions, as well as the conditions under which they operate. (Articles 72.1 and 72.2 of TRLOSSP) Inspections may be full-scale, or focused in specific areas of concern. Inspections are conducted without advance notification to the entities. The number of inspectors going on-site is between one to three, depending on the size of the insurer, and the scope of inspection. An inspection may take between one to four months to complete. The supervisory intensity varies depending on size of the insurers to approximate their systematic risk. For example, the largest insurers applying for internal models are subject to continuous supervision, while the smallest insurers are subject to a simplified inspection protocol. DGSFP has an online inspection manual to facilitate the planning and execution of an inspection program. The manual is a compendium of rules (law, regulations, guidelines, public consultation, criteria), and a guide for verification of different areas, with reference to the tools available to perform calculations and projections. DGSFP inspectors have unfettered access to information, including

[11] At the end of 2011, there were 66 ERDs, determined on the basis of: (a) total gross written premium less than € 12 million, (b) life technical provisions less than € 25 million, (c) assets less than € 30 million, (d) not under Special Control Measures, and (e) not part of any insurance groups.

ICP/Standard	Description
	outsourced activities, but cannot visit the outsourced service providers on-site. One of the aims of the inspection is to detect weaknesses in insurers before they develop into major solvency issues. The TRLOSSP requires supervisory functions be carried out by civil servants having the qualification of "Inspectors"[12] (Article 72.3). While DGSFP may rely on external auditors, as a practice, DGSFP inspectors rely on their own data sampling to verify the valuation of assets and physical existence of the corresponding certificates. An inspection typically encompass a review of an insurer's operational and legal structure, board minutes, risk management and internal controls, verification of assets on a sampling basis, internal controls effectiveness, reinsurance contracts, selling practices, claims payments, technical provisions, product development, including their technical notes, policy terms, disclosure to policyholders, whistle-blowing protection, internal and external audit reports. Inspectors may also meet internal and external auditors. At the conclusion of an on-site inspection, the inspectors issue an inspection report, bearing the signature of both the insurer and the inspectors. The inspection report represents the inspectors' views and is not binding on the insurer at this stage. The insurer may submit response to the inspection findings in writing. The inspectors then prepare a management report, documenting their comments to the insurer's response. The Director General then issues a ruling (*resolution*) to the insurer on the final inspection findings and remedial actions required of the insurers. The ruling is presented and explained to the insurer in a meeting, during which the insurer may obtain a copy of DGSFP's management report. The ERDs are subject to a simplified inspection regime. They are paid a visit by the off-site supervisors for up to two days. The focus of the visit is on adherence to investment limits, internal control measures, and collecting additional accounting information. The targeted visit cycle for the ERDs is two to three years. DGSFP's target is to inspect non-ERD insurers once every four years. There are 35 inspectors responsible for 200+ insurers. Depending on the nature (full scope vs focused) and the size of the insurer, the inspection team may be up to three inspectors, for duration of 1 to 4 months. Due to constraint of resources, greater attention is paid to insurers that are more likely to be in financial trouble (e.g., the worst performing insurers identified during off-site monitoring) and large insurers that have greater market impact (e.g., three dedicated inspectors are assigned to one large insurer on a full time basis, plus three more on a part time basis). In 2010, DGSFP carried out 48 inspections, 75 percent of which were full scope. In 2011, it carried out 18 inspections, of which 65 percent were full scale. During 2011, a continuous supervision was in effect for 13 insurance groups with respect of their application for internal models to be used for Solvency II.

[12] See ICP 2 for a description of the process to become an "Inspector."

ICP/Standard	Description
Assessment	Largely Observed
Comments	Due to limited resources, off-site monitoring is heavily dependent on system-generated ratios and warning flags based primarily on financial information. The analytical report focuses on worst-performing insurers in terms of financial results. The qualitative review of internal control deficiencies basically relies on the insurer’s disclosure. There is a lack of a full integration of quantitative business results and qualitative indication of management of business to form a comprehensive view of the insurer’s operation, or a risk ranking based on impact/probability analysis. DGSFP conducts both full scale and focused inspections. Its current resources only allow a 4- to 5-year inspection cycle, excluding ERDs. Some key elements of insurance operations are only reviewed during on-site inspections. The inspection cycle may be too long for this purpose. DGSFP is advised to review the adequacy of resources for both on- and off-site supervision, and formulate a more robust risk-based supervision approach.
ICP 10	**Preventive and Corrective Measures** The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Power	DGSFP has comprehensive power to take preventive and corrective action if an insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements.
Escalation of action	DGSFP has the power to take action against entities and individuals that conduct insurance activities without the necessary licence. (Articles 4, 5, and 48). As part of ongoing supervision, DGSFP may require an insurer to put in place a financial recovery plan when it determines that the insurer’s solvency position is in jeopardy or that policyholder’s interest may be compromised. The financial recovery plan is subject to approval by DGSFP, and must at a minimum include a 3-year projection of (a) estimates of management expenses, (b) detailed estimates of revenues and expenses relating to direct business, reinsurance acceptances and cessions, (c) a balance sheet, (d) estimates of financial resources intended to cover the liabilities and the solvency margin, and (e) the overall reinsurance policy. DGSFP may also require the insurer to maintain a higher solvency margin. (Article 38). DGSFP may require an insurer to engage a special audit of its accounts. If an insurer’s situation worsens posing risks to policyholders’ interest, DGSFP may adopt one or more of the following special control measures: (Article 39) • restriction of asset transfers, • short term financing, • injection of additional capital, • suspension of dividend payment to shareholders, • restriction to write new policies or to renew existing policies,

ICP/Standard	Description
	• convening special board meetings, • temporarily replacing the board of directors, and • taking control of the insurer's operation. The circumstances under which DGSFP may take special control measures include: failing to meet solvency requirement, accumulated losses exceeding 25 percent of paid-up capital (or mutual fund), failing to meet its social objectives, the insurer's ability to meet future obligations is in doubt or accounting/management irregularities are detected. When DGSFP exercises its power of special control measures, the insurer is placed under the supervision of a separate unit. There are four insurers under special control measures at the time of this assessment. Once an insurer is placed under special control, banks and other European regulators are notified under condition of confidentiality. If special control measures fail to restore an insurer's financial standing, DGSFP may commence winding-up procedures.
Assessment	Observed
Comments	The primary legislation provides DGSFP with comprehensive power to take progressive escalation of preventive and corrective measures to address emerging supervisory concerns including the submission of a recovery plan. However, DGSFP should formalize a supervisory intervention ladder before the solvency margin drops below the minimum required level to allow sufficient time to put in place preventive measures. (See ICP 17).
ICP 11	**Enforcement** The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Power	The law specifies three categories of regulatory breaches: very serious, serious and slight (Article 40). The classification of the breach is based on factors such as intention, gravity of the consequence, and materiality to the business (Article 43). The approach is prescriptive: the law identifies 19 very serious breaches (such as withholding information from DGSFP), 21 serious breaches (such as accounting irregularities), and 4 slight breaches (such as understating technical provisions by less than 5 percent). The DGSFP has power to require the insurer to put in place a financial recovery plan if it believes the insurer's future solvency is in jeopardy or if there are circumstances that may pose a threat to the interests of policyholders. (Article 38) DGSFP is empowered to impose administrative sanction on insurers in the case of serious and slight breaches. The Minister for MEC imposes sanction for very serious breaches at the recommendation of DGSFP. (Article 46). The range of sanctions that the authorities may impose is prescribed in law: (Article 41).

ICP/Standard	Description
	• Very serious breaches—(a) revocation of licence, (b) suspension of operation in one or several lines of business for a period between 5 to 10 years, (c) publication of the breach, and (d) monetary fine from € 150,000 to € 300,000, or one percent of free capital of insurer, whichever is higher. • Serious breaches—(a) suspension of operation in one or several lines of business for a period of up to 5 years, (b) publication of the breach, and (c) monetary fine from € 30,000 to € 150,000. • Slight breaches—(a) reprimand, or (b) monetary fine up to € 30,000. DGSFP may also impose sanctions on Board Members and Senior Management (Article 42.4), including suspension of up to one year, monetary fine up to € 45,000 and private or public reprimand. To arrive at the quantum of monetary fines, DGSFP takes into consideration the size and scale of the insurer's operation. Publication of sanctions is determined on a case-by-case basis, as DGSFP views the publicity of sanction is a form of punishment in itself.
Management oversight	DGSFP has the power to require an insurer to suspend or replace Board Members and Senior Management. DGSFP also has the power to reject appointments to the Board or Senior Management positions. (See ICP 5). Where necessary and in extreme cases, DGSFP has the power to impose conservatorship over an insurer who s fails to meet prudential or other requirements. DGSFP also has the power to appoint one of its staff members with the "inspector" qualification to take control of a troubled insurer.
Assessment	Observed
Comments	Spanish insurance law adopts a prescriptive approach to supervisor's enforcement power. Nonetheless, Article 38 provides DGSFP broad power to take action when circumstances arise that jeopardizes the insurer's solvency or policyholders' interest. As such, DGSFP is not constrained in taking action in situations not currently prescribed in law. (See also ICP 10).
ICP 12	**Winding-up and Exit from the Market** The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimising disruption to provision of benefits to policyholders.
Exit from the market	DGSFP (with Minister's approval) may revoke an insurer's licence if it: (Article 26) • expressly surrenders the licence, • has not commenced business within a year,

ICP/Standard	Description
	• no longer meets licensing conditions, or • fails to take the required preventive and corrective measures. DGSFP may dissolve an insurer when: (Article 27) • the licence revocation affects its entire operation, • it has transferred all of its insurance business, • it is a mutual or a cooperative and its number of members has reduced to below the legal minimum, or • it no longer fulfill its objectives of being a mutual or cooperative. During winding-up, an insurer cannot issue new policies; existing non-life policies remain in force without option to renew.
Policyholder protection	The CCS assumes the full management responsibility for an insurer placed under winding-up, whether the insurer is solvent or insolvent. CCS does not provide any guarantee of policy values, although policyholders have priority claim on assets covering technical provisions. (Article 59). In the event that an insurer does not have adequate assets to cover all claims (e.g., due to inadequate technical provisions maintained) or where the assets noted on the investment register are lost (e.g., due to fraud), policyholders and beneficiaries would not be adequately protected by the priority ranking. Where the assets are inadequate to cover the full amount of a policyholder's claim, the balance of the claim is treated as a claim without any right of priority and would rank *pari passu* with other unsecured creditors. Recognizing this risk, the DGSFP reviews the adequacy of technical provisions and verifies titles to assets during on-site inspections. CCS is in charge of the winding-up proceedings in case of liquidation of an insurer, unless the winding-up is voluntary and solvent. In these cases, the goal is orderly winding-up of insurers and timely payments to policyholders. CCS acts as the administrator of processes on behalf of creditors in case of bankruptcy proceedings. To ensure timely payments to policyholder, CCS advances the claim payments based on its estimate of the probable recovery rate. Payments are generally made within four to five months. CCS bears the cost if it has over-estimated the eventual recovery rate, and makes additional payments if it has under-estimated the recovery rate. CCS also bears the costs of the winding-up proceeding. CCS has handled a total of 283 winding-up cases and 10 bankruptcy cases since its establishment in 1964. There are 22 winding-up cases in progress and five bankruptcy proceedings under way at the time of assessment. CCS collects 0.15 percent of non-life premiums to support this function. There is no levy on life premiums.
Assessment	Observed
Comments	The TRLOSSP provides for orderly exits of insurers from the market.

ICP/Standard	Description
	Policyholders and beneficiaries have priority rights to the assets covering insurers' technical provisions in the event of winding-up. CCS is not a guarantee fund but manages winding-up and bankruptcy cases to ensure orderly exit from the market and timely payments to policyholders. Out of 19 winding-up cases between 2007 and 2011, policyholders were paid 100 percent on all cases except two, where they were paid 52.4 percent and 84.1 percent respectively.
ICP 13	**Reinsurance and Other Forms of Risk Transfer** The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.
Description	The EU Reinsurance Directive 2005/68/EC was adopted into Spanish regulation in December 2007 to regulate the use of reinsurance. The TRLOSSP (Article 25.8) states that reinsurance strategy should take into account the nature, scale and complexity of the cedant's business in order to ensure adequate technical and financial balance of the entity. Risk retention by Spanish insurers is high. A large part of life insurance business is savings policies with little or no need for reinsurance. The catastrophic risks of non-life business are covered by the CCS, significantly reducing the need for reinsurance. CCS is a public entity established in 1964 to provide catastrophic coverage for extraordinary natural and social-political perils. Under its permanent insurance function, it provides coverage for: (a) extraordinary risks for floods, storms, earthquakes and tsunamis, volcanic eruptions, falling of meteorites, terrorism, rebellion, insurrection, riots and civil commotion, and actions of armed forces in peacetime; (b) compulsory motor insurance for unaccepted or uninsured private vehicles and all official vehicles of government and public agencies; and (c) multi-peril crop insurance, on co-insurance (10 percent of pool) and reinsurance basis. The coverage is funded through mandatory premium surcharges. Because of the existence of CCS, the need for catastrophic reinsurance is substantially reduced. DGSFP collects statistical information on reinsurance as part of its regular statutory reporting process. During an on-site inspection, DGSFP reviews the reinsurance arrangements to assess the economic impact, quality of the reinsurance agreements and compliance with risk transfer requirements. DGSFP's Insurance Inspection Handbook has an explicit protocol for analysis of reinsurance, including checks on individual contracts for their sufficient risk transfer character, the proper accounting of reinsurance for solvency purposes, any delayed payments of reinsurance accounts, and concentration of reinsurance.

ICP/Standard	Description
	Article 57.1 of TRLOSSP regulates those entities who can conduct reinsurance operations, including insurance and reinsurance entities from European Area, on a cross-border basis. The TRLOSSP (Articles 91 and 92) requires reinsurers to be licensed in order to operate in Spain, and the arrangements are not recognized for solvency purposes if the reinsurer's credit rating is below BBB. On a yearly basis and for the purpose of reinsurance credit for solvency requirements, Article 65.1.g) of ROSSP requires insurers to keep record of all reinsurance contracts, containing all relevant data as well as its economic impact. This reinsurance record is only checked during onsite inspections. No reinsurance credit is allowed if the contracts are not signed. The supervision of liquidity risk of cedants is mainly through the cash flow report that forms part of the annual accounts, according to the "Real Decreto 1317/2008, de 24 de julio del Plan de contabilidad de las entidades aseguradoras." There is an explicit regulation of special purpose vehicles (SPV) for the purpose of risk transfer to the capital markets. There has not been any risk transfers through the capital markets.
Assessment	Largely Observed
Comments	The reinsurance regulation follows current EU Directives on reinsurance that requires insurers to adequately control and to transparently report their risk transfer programmes. Through the offsite reporting, DGSFP has an indication of the level of risks reinsured. The onsite inspection reviews the sufficiency of risk transfer of the reinsurance contracts as well as their completeness and timely signature. However, there are no formal requirements to finalise the reinsurance contract in a timely fashion, nor a prohibition against reinsurance side letters that would add transparency to the contracts. Liquidity in general is supervised through the statutory reporting process, but there is no requirement to consider the payment pattern of reinsurance claims for the purpose of liquidity management of the insurer.
ICP 14	**Valuation** The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.
Valuation of assets	<u>A. Financial Reporting</u> General Rule: Historical cost. For properties, insurers may opt to revaluate to fair value at the end of 2008. Valuation of real estate is on a triennial basis based on the ministerial order ECO/805/2003. Financial instruments: Amortized cost or fair value depending on the category in which they have been classified.

<table>
<tr><th>ICP/Standard</th><th>Description</th></tr>
<tr><td></td><td><u>B. Solvency</u>

General rule: All assets that cover technical provisions are values at fair value.

Exception: Assets backing immunized policies are valued at amortized cost or historical cost depending on the category in which they are classified.</td></tr>
<tr><td>Valuation of liabilities</td><td><u>A. Financial Reporting</u>

Same criteria as in Solvency requirements as indicated above

<u>B. Solvency</u>

B1. Life.

B.1.1 Discount rate:

There are three cases:

- General rule (Article 33.1 of ROSSP): the future cash flows are discounted using: -
o A discount rate that reflects the time value of the money (60 percent of the average interest rates of the Spanish Bonds if the obligation is in Euros. The interest rate is published in an Administrative Order in January each year. For 2012 the technical interest is 3.37 percent; or
o A discount rate that corresponds to the one published by DGSFP at the effective date of the policy. (Only if the estimated financial duration of the assets allocated to the contract is greater or equal to the financial duration of the payments under the same basis); or
o A discount rate equal to the guaranteed interest rate under the policy if the guarantee is for a period shorter than a year. Notwithstanding, if the actual return from the investments specifically allocated is less than the average discount rate used, the actual rate of return will be used to discount cash flows.

- Immunized policies: Insurers may immunize a block of business through either cash flow matching (Article 33.2 a), or duration matching (Article 33.2.b). In these cases the discount rate is fixed at the start of the contract. Assets backing these contracts must be identified and be rated not lower than BBB. Lapse assumptions are not considered in the determination of technical provisions; however, the technical provisions shall not be less than the surrender value.

- Transitional rule: For contracts with inception date before January 1, 1999 (disposición transitoria 2) the discount rate is the lower of (i) the rate used in premium calculation, or (ii) the actual rate of return from the investments allocated to the portfolio.</td></tr>
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<tr><th>ICP/Standard</th><th>Description</th></tr>
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Portfolio	Assets 2010 Accounting Value (millions €)	Assets 2010 Profitability (%)	Assets 2010 Duration (years)	Liabilities 2010 Technical Provision (millions €)	Liabilities 2010 Profitability (%)	Liabilities 2010 Duration (years)
Article 33.2 a) (Cash Flow Matching)	55.37	4.64	8.67	54.73	4.09	9.98
Article 33.2 b) (Duration)	9.02	4.97	8.05	8.64	3.85	8.15
Transitional Provision 2	31.14	5.85	7.60	29.49	5.07	9.77
Article 33.1	30.02	4.04	6.13	28.93	2.52	11.19
Total	**125.55**	**4.82**	**7.75**	**121.79**	**3.94**	**10.09**

B.1.2 Mortality and survival assumptions are given by the mortality and survival tables: GKM-95, GKF-95, GRM-95, GMF-95, and Perm 2000 can be used.

B.1.3. Expenses assumptions: Expenses assumptions for premium calculations should be used if they are equal or higher than current actual expense. Inflation on future expenses not required.

B.2.- Non life: There is an unearned premium provision, an unexpired risks provision, and a claims and expenses provision where cash flows are not discounted and a stabilization provision for catastrophic risks.
</td></tr>
<tr><td>Accounting mismatch</td><td>
In situations where assets are valued for financial reporting purposes at fair value and the insurance liability value does not change in the same quantity or in the same way or both, an accounting adjustment provision to eliminate the mismatching is required. This mismatch provision is reflected in the solvency position of the undertaking. The cases where accounting mismatching could exist are:

- Life insurance business using financial immunization techniques;
- Insurance operations that reference the surrender value of the policy as equal to the value of assets assigned to them;
- Insurance operations that recognize participation features, where there is a clear identification of assets that are used to calculate that participation amount; and
- Insurance operations in which the policyholder assumes the investment risk or similar (unit linked).

Technical provisions are calculated ignoring any reinsurance cessions. The reinsurance credit is taken into consideration in the form of assets in the balance sheet.

The value of technical provisions and other liabilities do not reflect the insurer's own credit standing.

The valuation of the liabilities does not include any provisions for embedded options.
</td></tr>
<tr><td>Assessment</td><td>Partly Observed</td></tr>
</table>

ICP/Standard	Description
Comments	The current method of valuation follows the Solvency I rules. The valuation of assets and liabilities is undertaken on consistent bases in the general regime (Article 33.1) and for the immunized polices through the accounting mismatch reserve. However, for the business underwritten before 1999, assets are valued at fair value and liabilities at the value stated in the contract, the latter of which is not an economic valuation. Furthermore, for non-life most future cash flows are not discounted. The pending adoption of Solvency will address these discrepancies. Revaluation of real estate every three years is too long and consideration should be made to require an annual valuation of this type of assets. The current method does not explicitly recognize risk-adjusted present values of future cash flows. There is also no margin over the current best estimate of technical provisions to cover inherent uncertainties of insurance obligations. For life insurance, there is some conservatism implicitly incorporated in the technical provisions by under-estimating future cash inflows through the use of risk premiums instead of gross premium. On the other hand, the estimate of future cash outflows may be less conservative in some cases, in particular in the disregard of embedded options and for the legacy business issued prior to 1999.
ICP 15	**Investment** The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.
	The TRLOSSP and ROSSP establish requirements for solvency purposes on the investment activities of insurers. Article 16 of the TRLOSSP requires technical provisions to be covered by investments that are liquid, diversified, and appropriate to the risk of the policies. Articles 49 to 56 of ROSSP provide the specific regulatory requirements on the appropriateness of these assets, including: types of investments, concentration limits per class of assets and per issuer, liquidity, duration and currency matching and minimal credit ratings for certain type of structured instruments. Minimum credit rating of assets is not a requirement, except for structured assets and derivatives and for assets backing up the technical provision for immunized policies. For the assets backing up the other policies, the fair valuation of assets would reflect the credit rating. Article 110A of ROSSP requires an insurer to invest only in assets whose risks it can properly assess and manage. The board of directors is required to establish an investment policy that spells out the risk appetite, asset-liability management, and liquidity under different scenarios. The use of derivatives and structure financial instruments should be clearly defined in the investment policy establishing limits, minimal credit rating and liquidity requirements. The investment policy approved by the board of directors requires the investment personnel to have the ability to understand and price any of those instruments including the availability of internal models for this purpose.
Assessment	Observed

ICP/Standard	Description
Comments	The limits stated under current regulation do not hinder the ability of insurers to invest in a prudent and efficient way.
ICP 16	**Enterprise Risk Management for Solvency Purposes** The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.
Description	Article 110 of ROSSP requires insurers to set up, maintain, document and monitor internal controls appropriate to the nature of their operations. The internal controls should include the function of internal audit and establish a risk management system. This responsibility is assigned to the board. Sufficient resources, knowledge and independence are also required for the functioning of these operations. The DGSFP has put a strong focus in insurers' compliance with proper internal controls and several sanctions have been issued to enforce compliance. The risk management systems are required to be adequate to an insurer's business to allow for identification, evaluation, regular monitoring of all risks internal and external to which an insurer is exposed in the course of its activities. The risk identification should provide adequate measure of the frequency and impact of those risks. Contingency planning is also required. Asset-liability management requirements are well developed. On an annual basis the board is required to provide a written report to DGSFP on the effectiveness of the internal control function including the risk management system operations.
Assessment	Partly Observed
Comments	While some insurers have adopted their groups' enterprise risk management (ERM) systems, there is no regulatory requirement to implement comprehensive ERM systems other than the general requirement to have internal controls under Articles 110 and 110A of ROSSP. There is an urgent need to develop a comprehensive enterprise risk management regulatory framework in line with standards established under ICP 16.
ICP 17	**Capital Adequacy** The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention
Description of current practice	The current solvency regime in Spain is based on EU Solvency I; Pending the implementation of Solvency II, Spain has not established any enhancements to make the solvency regime more risk sensitive with the exception of detailed asset/liability matching requirements. This regime does not take into account all key risks of insurers nor does it recognize the interdependence between assets, liabilities, regulatory capital requirements and capital resources. Spain's preparation for the adoption of Solvency II is on track and the industry

ICP/Standard	Description
	engagement in the QIS exercises has been high with 138 entities, representing 63 percent of the entities to which Solvency II will apply. The 138 companies account for over 90 percent of market share. The results of the QIS 5 exercises indicate an average increment of around 10 percent of the own funds, basically due to the higher valuation of assets and a reduction of the technical provisions. The required capital under Solvency II under QIS 5 calibration would call for an increment of 60 percent of the current capital requirements or around € 17 billion for all the participating insurers. Article 13 of the TRLOSSP requires a incorporated insurer to have a minimum capital of € 3 million, and higher capital of € 9 million for life, guarantee, and credit insurance, and € 2 million for accident and health, legal, travel and funeral insurances. The amounts are halved for a mutual insurer. At least 50 percent of the capital must be paid-up. Articles 17 and 18 of the TRLOSSP and Articles 58–63 of ROSSP require insurers to maintain a "guarantee fund" equal to at least one third of the solvency margin requirement, subject to a minimum of € 2.3 million, increased to € 3.5 million for insurers carrying life, surety, credit or liability risks. The capital requirements apply both on a solo as well as group basis where double counting and intra-group transactions are disallowed. DGSFP established rules for the assets that are admitted for computing the solvency requirements and more stringent ones for the own funds that are allowed to cover the guarantee fund. The most important suitable forms of assets to cover solvency requirements listed in Articles 59 and 60 of ROSSP for solo and group entities respectively include: paid-up capital; 50 percent of the unpaid capital; reserves not assigned to cover other liabilities; undistributed profit; subordinated debt that satisfy certain conditions up to 50 percent. Under Solvency I, the solvency requirement for life insurers is computed generally as a percentage of technical provision or risk capital. For non-life insurers, minimum solvency is computed as a percentage (based on average retained claims) applied to the higher of a specified percentage of: (a) booked/earned premiums plus policy costs; and (b) average claims booked and addition to claims provision. Besides the participation in the recent EIOPA stress tests, insurers are not required to perform sensitivity tests to calculate the impact on assets, technical provisions, other liabilities and own funds. Reinsurance is taken into consideration for solvency purposes in the form of an asset while the technical provisions are calculated gross of reinsurance. Only up to 50 percent of the solvency requirement can be covered by reinsurance arrangements. The solvency regime applies also to foreign insurers outside the EU that have established a branch in Spain. The TRLOSSP requires premiums and technical provisions being determined based on actuarial principles. However, there is no formal requirement that an actuary should form an opinion on the adequacy of assumptions. The current rules also contemplate two solvency control levels: the solvency requirement proper, and the guarantee fund (*fondo de garantia*), which trigger

ICP/Standard	Description
	different degrees of intervention by the DGSPF. DGSFP may invoke a range of special control measures when an insurer: (Article 39.1). a) has s a deficit of more than five percent in any individual technical provision, except in the technical provision of benefits, where the deficit needs to be 15 percent; or a deficit of more than 10 percent in the technical provisions taken as a whole. b) Fail to meet the solvency margin. c) has solvency margin that is below the guarantee fund. d) has accumulated losses in quantity superior to the 25 percent of its share capital or mutual fund in case of a mutual company. e) faces financial or liquidity difficulties that have delayed or breached its payments' obligations. f) Manifested impossibility to realize the social aim or impossibility to continue operations. DGSFP may impose sanctions on the following "serious infractions": (Article 40.4c and d). a) The deficiency in the solvency margin is more than five percent. b) The deficiency in the calculation or the insufficiency of the investments to cover the technical provisions is between 5 to 10 percent. DGSFP may impose sanctions on the following "very serious infractions": (Article 40.2c and d). a) The deficiency in the solvency margin is more than five percent. b) The deficiency in the investments for cover the technical provisions is more than 10 percent. The use of internal models for regulatory purpose is not allowed under the current regulation.
Assessment	Partly Observed
Comments	Spain is on the EU Solvency I regime. Pending the implementation of Solvency II, Spain has not established any enhancements to make the solvency regime more risk sensitive with the exception of detailed asset/liability matching requirements. The shortcomings in the current regime are hindering the compliance with ICP 17 which requires a total balance sheet approach and a risk-based assessment of the capital requirements. At a minimum, DGSFP is advised to introduce regular scenario testing to determine the impact on insurer's solvency position. DGSFP should also formalize its practice of commencing discussions with an insurer at risk of breaching its solvency margin requirements.
ICP 18	**Intermediaries**

ICP/Standard	Description
	The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.
Licensing	LMSP requires an individual conducting insurance and reinsurance intermediation to be registered with DGSFP. An intermediary may be a natural person or a legal person, acting in the capacity as an agent or a broker. Employees of insurers involved in direct sales activities are not considered intermediaries and therefore not required to be registered. A broker must be able to place business with at least 3 insurers. An agent may be either exclusive (who sells products from his principal only or from two insurers in different lines of business) or multi-tied (who sells products from two or more principals). Bank assurance operators also act as either exclusive or multi-tied agents. There are three classes of training for intermediaries: Group A – Those in management positions of a broking firm, multi-tied agents or multi-tied bankassurance and technical directors. Group B – Exclusive agents or exclusive bankassurance operators and technical directors. Also auxiliary employees of these intermediaries, advisors to assist in the management, implementation and formalization of contracts of insurance or in case of disaster, people who make up the distribution network of bankassurance, and employees of brokers who provide advice and assistance to customers and directly involved in the mediation of insurance or reinsurance. Group C – Support staff of agents and brokers or reinsurance brokers who are not involved in finalizing sales. An intermediary must complete 500, 200, or 50 hours of training on insurance and financial matters for Group A, B, and C registration, respectively. They must also pass an aptitude test before registration. The training and examinations are conducted by independent institutions approved by DGSFP based on DGSFP-approved content. After successful registration, intermediaries must fulfill at least 60 hours of continuous training every three years. For multi-tied intermediaries and brokers that are legal entities, at least 50 percent of the management body must meet the Group A competence requirements. For exclusive intermediaries that are legal entities, at least 50 percent of the management body must meet the Group B competence requirements. An insurer must submit a list of new agents it wishes to contract to DGSFP for registration on a monthly basis. Insurers must demonstrate compliance with the competence requirements, and pay a registration fee for each agent. The agents may commence selling activities once their names appear in the register. Sales staff (other than management) of agencies and broking firms are not individually registered. The registration fee paid for a natural person intermediary is € 11, and € 161 for a legal entity intermediary, regardless of the number of sales staff it has. The individual sales staff's names do not appear in the register that DGSFP maintains on the website.

ICP/Standard	Description
	Registration criteria include personal character, professional competence and financial standing. A person will be denied registration as an intermediary or as manager of a brokerage if he is an undischarged bankrupt or has criminal records for crimes involving dishonesty, violation of data protection law, embezzlement of public assets and any other financial crimes. The same applies to anyone who has been disqualified from holding public office or administrative or management in financial institutions, or has been previously sanctioned under LMSP. Tied agents and brokers must carry professional liability insurance, and have a bank guarantee (or insurance) for at least 4 percent of annual premiums handled in the previous year, subject to a minimum of € 16,803. [Article 27.1(f)]. The professional liability coverage is up to € 1,120,200 per event, subject to an annual limit of € 1,680,300. As sales staff of agencies and broking firms are not individually registered, the intermediary register is not a complete listing of all individuals qualified to sell insurance. According to UNESPA, there are 150,000 individuals working as agents, compared to the 92,000 registered-agents shown in DGSFP's statistics. Corporate intermediaries submit a list of their sales staff to DGSFP every 6 months, detailing their competence level.
Supervision	There are several intermediaries associations, some operating only on a regional basis. The largest ones include ADECOSE (Spanish Insurance Brokers' Association) representing the largest brokers in Spain, and General Council of Colleges of Insurance Intermediaries, representing both agents and brokers. The latter is a member of the Consultative Group to DGSFP. Both associations issue code of conduct for their members; have internal ethics committee to deal with alleged misconduct of their members. Being voluntary industry associations, their sanctioning power is limited. Any disciplinary cases are referred to DGSFP for sanctions under the TRLOSSP. In 2011, DGSFP imposed sanctions on about 50 cases for late filing of requisite reports. There have been no sanctions for misconduct. Supervision of exclusive agents is through the insurers. Supervision of multi-tied agents (other than bankassurance operators) is limited to off-site review of annual and semi-annual reports on the number, and training. Supervision of brokers and bankassurance operators includes both off-site review of annual and semi-annual reports, as well as on-site inspection. During 2011, DGSFP carried out 20 inspections of brokers and bankassurance operators, covering areas of annual accounts, verification of having minimum three insurers, commission structure, customer complaints, disclosure to customers, and competence of representatives. It also conducted inspections on unregistered intermediaries. Article 55 of LMSP lists 22 behaviours that are considered very serious regulatory breaches (e.g., conducting business without a licence), and 9 serious breaches (e.g., occasional or isolated unlawful transactions). Article 56 provides a list of disciplinary actions that DGSFP may take depending on the severity of the breaches, ranging from fines, public reprimand, to de-registration. DGSFP has imposed sanctions on intermediaries in 2011 mainly for non-submission or late submission of reports. There were 2 or 3 open cases of suspected non-authorized

ICP/Standard	Description
	activities.
Disclosure to customers	Article 42.1 of LMSP specifies that the intermediary must disclose: (Article 42.1) a) His identity and address. b) The register in which he is listed, and the means to verify the registration. c) If he has a direct or indirect holding of more than 10 percent in the shares or voting rights in a particular insurer. d) If a particular insurer or a parent insurer of an entity has a direct or indirect holding of more than 10 percent of the voting rights or shares of the insurance intermediary. e) The procedures by which a customer may lodge a complaint and, where appropriate, resolution of dispute in court. f) The legal protection of the customer personal data. Article 43 requires such communication to be in writing, clear and transparent. A broker is required to disclose commission to his client only if he receives both a fee from a client and a commission from the insurer. Otherwise, the broker is not obliged to disclose his remuneration. There is currently no requirement for agents to disclose commission. A new EU Directive will require all intermediaries to disclose commission upon request. There are no requirements for intermediaries to perform needs analysis to determine the suitability of life insurance policies. Insurers and intermediaries are required by law to protect confidential information regarding their customers.
Assessment	Partly Observed
Comments	DGSFP registers insurance agents and brokers at both legal entity and natural person levels. In registering an intermediary, DGSFP takes into account the applicant's integrity, competence, and financial standing. DGSFP has the power to supervise and sanction intermediaries. However, in practice, due to limitation of resources, the supervision of exclusive agents is left to insurers, and the level of supervision of multi-tied agents and brokers is inadequate with only 20 inspections of brokers and bank assurance operators in 2011. Employees of insurers involved in direct sales activities are not considered intermediaries and therefore not subject to the requirements imposed on intermediaries. Nonetheless, DGSFP should require insurers to ensure that these direct sales staff are competent and meet similar training requirements. Banks establish subsidiaries apart from its banking activities to distribute insurance products. Bankassurance is an important distribution channel for life insurance. In 2010, 75 percent of individual life and 45 percent of group life were sold through banks. The register of agents is a mix of natural persons and legal entities. Sales staff

ICP/Standard	Description
	(other than management) of legal entity intermediaries are not individually registered nor listed in the register. Since the purpose of the register is to enable consumers to verify an intermediary's capacity to act, the register should include all sales staff of legal-entity intermediaries and their capacity, i.e., Group B (allowed to sell) or Group C (not allowed to sell). Intermediaries are required to disclose to customers their identity, licensed status, their relationship with the insurer, procedures to lodge complaints, and legal protection of confidential client data, but the disclosure of remuneration is limited. Information on charging structures can be important information to customers. For example, for insurance products with investment elements, information on any fees or other costs deducted from the initial amount invested, as well as on fees or commissions deducted from the investment thereafter will be important. For non-life insurance and pure life insurance products, where fees are not paid directly by the customer, such information may have less of a direct impact but may have a bearing on the independence of any advice that is provided. While multi-tied agents and brokers are required to carry professional insurance, the coverage is modest relative to the potential liabilities arising from professional misconduct. In the case where an intermediary handles client's money, it is prudent for the supervisor to require the intermediary to have safeguards. One example is to require separate bank accounts distinguishable from the intermediary's own bank accounts for client's money. DGSFP is advised to: • Improve the register of intermediaries to include all sales staff of legal-entity intermediaries. • Require intermediaries to apply appropriate corporate governance. • Require intermediaries to disclose their financial interest in the sale of the products. For instance, an intermediary should point out which of the policies presented to the client bears the higher commission. The commission should also be disclosed at least upon request. • Require intermediaries to put in place additional safeguards to protect client's money. For example, the use of bank accounts separate from the intermediaries' own accounts to hold client's money. • Increase frequency of on-site inspections.
ICP 19	**Conduct of Business** The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.
Pre-sale disclosure	The LCS was enacted in 1980. Collaborating with the Ministry of Justice, DGSFP is in the process of amending it. The TRLOSSP requires insurers to have policy terms consistent with the provisions in the LCS. This includes statements of policyholder's rights in policy documents. Insurers must set premium rates at a level sufficient to cover future policy obligations based on reasonable actuarial principles (Article 25). At the point of sale, an insurer is required to provide to a customer a clear statement on:

ICP/Standard	Description
	(Article 60). a) The jurisdiction in which the insurer is supervised. b) The law applicable to the contract, the provisions relating to claims that may be made. c) For life insurance where the policyholder bears the investment risk, a clear and precise statement about the fact that policy values is subject to market fluctuation, beyond the control of the insurer and that historical results do not indicate future results. Moreover, throughout the duration of a life insurance policy, an insurer shall inform the policyholder of any changes to the policy terms and conditions, and also on the status of their participation in profits. ROSSP further requires an insurer to disclose: (Article 105). a) Definition of guarantees and options. b) Duration of the contract. c) Conditions for its rescission. d) Conditions, terms and maturity of the premiums. e) In the case where the policyholder assumes the risk of the investment, the amount, basis of calculation and regularity of all the inherent expenses. f) Method of calculation and allocation of participation in profits. g) Indication of the policy surrender values and nature of any guarantees, In the event these cannot be established at the time of sale, indication of the methods of calculation as well as of the minimum values. h) Premiums for each guarantee. i) Premiums for each benefit, main or supplementary, where deemed necessary. j) Procedures and deadlines for exercising the right to cancel. k) General indication of tax treatment. Life policies (except those where the policyholder bears the investment risk) may be cancelled within 30 days after receipt of policy document.
Fair treatment of customers	DGSFP does not approve or review new products. However, DGSFP monitors complaints on policy terms and reviews technical product details during on-site inspections. LCS requires claims be paid within 40 days. Penalty applies if claims are not paid after 3 months. The amount of penalty progressively increases to 20 percent of the amount of claims if unpaid after two years. (Articles 18 and 20). Every insurer is required to have a customer service department, which is the first line of defence when a customer complaint arises. The common areas of complaints include: valuation of damages, increases in premium for health

ICP/Standard	Description
	policies, and risk declaration for life policies. An insurer has to respond to a complaint within two months. It may refer the complaint to an internal ombudsman committee. If the complainant is not satisfied with the insurer's response, he may lodge the complaint with DGSFP. DGSFP has 31 staff dedicated to public complaints, who handled over 9,000 new complaints in 2011. After receiving comments from both sides, DGSFP aims to give a response within four months. DGSFP's decision is not binding on either party. If he is still not satisfied, the complainant may take his case to the court. DGSFP publishes a report each year, analyzing the sources of complaints by insurer and by line of business. The large number of complaints is in part a reflection of the success of DGSFP's public education effort. It publishes substantial amount of information for consumers on its website, including the channels to lodge complaints.
Marketing	ROSSP requires the marketing materials to provide accurate and sufficient information on the essential characteristics of the insurance operation, service or insurance product. The minimum criteria are: (a) Identification of the insurance coverage that assumes the risks or commitments, sufficiently prominent by trade names or trademarks, unless they can be misleading, in which case it will use the name. (b) Indicate the type of insurance contract that is offered. DGSFP has acted in the past to require insurers to modify its advertisements.
Assessment	Largely Observed
Comments	The insurance laws and regulations have requirements on disclosure to customers at the point of sale. However, given the high proportion of guaranteed investment products sold in Spain, the disclosure requirements should be strengthened to include description of investment strategies used to provide the guarantee, so that the customers may form an informed conclusion on the security of the guarantee. This is particularly pertinent in the case of unit linked business where the customers bear the full investment risks. In this regard, intermediaries selling products backed by complex investment instruments should have special training so that they can explain the investments clearly to customers. For investment products, there is no requirement on ongoing disclosure to policyholders on the value of their policies. As market value adjustment is prevalent on guaranteed products, the insurer should provide a statement to policyholders on the changes to their policy values at least on an annual basis. DGSFP devotes a large portion of its resources (31 out of its 236 headcounts) to handle public complaints. It publishes an annual report detailing the number and types of complaints and the institutions that were complained against. DGSFP also uses public complaints as one of factors in prioritizing on-site inspections. While public complaints provide valuable insights into insurers' conduct of business, given current resource constraints, DGSFP is advised to consider

ICP/Standard	Description
	setting up an industry-wide independent ombudsman to take over this function, so that it may focus on its critical supervisory functions. Banks often offer packaged products combining loans and insurance. For example, a bank packages property insurance with its mortgage loans. In such cases, the bankassurance operator should disclose to the customers that he is free to choose the product from another insurer. Furthermore, the cost for each component of the packaged product should be clearly identified. TRLOSSP should give DGSFP the proper power to improve public disclosure if such power does not currently exist.
ICP 20	**Public Disclosure** The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.
Reporting requirements	All incorporated entities and mutual societies are required to submit audited annual accounts and management report to a central commercial registrar ("Registrar" - *Registro Mercantil Centro*) six months after the close of the financial year. In addition, DGSFP requires all insurers to submit statistics on a quarterly and annual basis. Five supplemental written reports are submitted annually: (a) audited annual accounts, (b) management report, (c) auditor's report, (d) internal control report, and (e) special audit report. The first three reports are the same as those filed with the Registrar and thus are consider public information. The latter two reports are for DGSFP's internal use only. Notes to the annual accounts include a discussion on: a) Solvency and capital: information on components of technical provisions, assumptions with regard future cash flow, discount rate, the extent of asset/liability management, and capital adequacy to cover asset/liability mismatches. b) Financial performance: financial performance in total and by business segments, investment returns in total and by components. (Claims statistics and pricing adequacy are not disclosed). c) Investments: investment objectives, investment policies and processes, methods and assumptions used to value investments, and an explanation of the differences between the methods and assumptions used for financial reporting and solvency purposes. d) Risk management: information about the nature of risks, description of risk concentration, and the use of reinsurance or other forms of risk transfers. (Interaction between capital adequacy and risk is not disclosed). The management report contains (a) description of company profile, key products, business environment, business objectives and strategies, and corporate

ICP/Standard	Description
	governance framework; (b) discussions of the risks and uncertainties facing the entity, analysis of business development and results, human resource policy, research and development activities, buy-back of stocks, investment policies and significant events that occurred after the close of the financial year. A member of the public may request a copy of the information filed with the Registrar by paying a fee. The request may be made in person or via internet. Listed companies are required to make such information available on their websites or in printed annual reports to shareholders. (There are two listed insurance companies). Another public source of access to information is DGSFP's website. It allows the public to view an insurer's licensed activities, balance sheet, profit and loss account, board composition, solvency margin and technical provision. Universities, associations, and other research facilities also talk to DGSFP on the phone to obtain data. Only full year financial information is available on DGSFP's website. Since the annual accounts are filed with DGSFP six months after the close of the year, the information is out-dated by the time DGSFP updates its database for public consumption but with large delays. For example, DGSFP has just updated the 2010 accounts, one year after the close of the year. The ICEA is a private not-for-profit research and training institutions, funded by membership dues and ad hoc consulting assignments. While ICEA's research and publication is mainly for its members, some of its market data are made available to the public.
Assessment	Largely Observed
Comments	A substantial amount of financial information is available to the public about the insurer, the basis for the preparation of annual statements, distribution of benefits and profits, asset and liability valuation methods and assumptions, information on different sections of the financial statements, specific technical information on the life and non-life sections of the business, coverage of technical provisions and solvency margin. The purpose of disclosure is to enable market participants to have a good understanding of how an insurer manages its risks, to order to reach an opinion about its solvency and capital adequacy. Timeliness and clarity of information are two important factors. While the disclosure requirements are comprehensive, the financial data can be very out-dated by the time the database is updated. The highly technical nature of the disclosures also makes it difficult for a general member of the public to comprehend the inherent risks. DGSFP is advised to (a) improve the timeliness of public disclosure by using relevant quarterly information submitted by insurers, and (b) require insurers to disclose their risk management and internal controls in a manner that can be understood by the public as part of the corporate governance framework. (See also ICP 7). TRLOSSP should give DGSFP the proper power to improve public disclosure if such power does not currently exist.

ICP/Standard	Description
ICP 21	**Countering Fraud in Insurance** The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.
Description of current practice	Insurance frauds are criminal offences under the general criminal law. While DGSFP does not have the legal authority to investigate insurance frauds, it may report frauds to the relevant authorities and cooperate with other local and foreign authorities. DGSFP does not monitor or analyze the insurer's fraud prevention procedures. Nor does it analyze overall market vulnerabilities to frauds. It sees its role as a passive one in raising public awareness through publicity of committed frauds. Any counter-fraud measures are through informal data exchange at the industry level. For example, UNESPA maintains a list of convicted fraudsters, and the number of auto accidents and amount of damages by the insureds. Another industry initiative by ICEA is to conduct an annual award of best fraud investigation for the insurance industry. A panel of judges comprising of representatives from DGSFP, judges, claims adjustors, police, ICEA and UNESPA review cases entered by the insurers and choose a winning case.
Assessment	Not Observed
Comments	Currently, DGSFP does not explicitly require insurers to have in place procedures to deter, detect, prevent and remedy frauds. Counter-fraud measures are implemented voluntarily at the industry level, although it is limited by the legal protection of client data. Insurance frauds result in financial losses to both investors and policyholders, and reputational damage to the insurer(s) concerned and the industry. The increased level of cross-border activities has added an international dimension to anti-fraud measures. Insurers and intermediaries need to understand and take steps to minimize their vulnerability to fraud. Therefore, DGSFP should require insurers and intermediaries to have effective policies and procedures to deter, prevent, detect, report and remedy fraud as part of their internal control process.
ICP 22	**Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT)** The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.
Description of current practice	Spain was evaluated by Financial Action Task Force (FATF) in 2006 and was placed into regular follow-up. Since then, Spain has been taking action to enhance its AML/CFT regime in line with the recommendations in the FATF Mutual Evaluation Reports. In recognition of the significant improvements made, Spain was removed from the regular follow-up list in 2010 after four rounds of mutual evaluation. Spain is expected to present its first biennial update to FATF in

ICP/Standard	Description
	October 2012. A Spanish AML-CFT legislation was enacted on April 30, 2010, which transposes the European Directive 2005/60/EC (the Third Money Laundering Directive). The designated FIU is SEPBLAC, formerly a unit within BdE, and now a part of an inter-ministerial body under the new law. The AML/CFT sanctioning power rests with MEC. According to the Fourth Follow-up Report issued in October 2010, Spain still needs to improve in several areas, including CDD and politically exposed persons (PEPs).[13] For the insurance industry, the AML/CFT requirements are applicable only to high-value life insurance policies. As part of the licensing process, insurers must submit their AML/CFT procedures. DGSFP consults SEPBLAC on the adequacy of such procedures. A licence is issued only after SEPBLAC is satisfied with the procedures. On an ongoing basis, DGSFP provides its inspection plan to SEPBLAC for its input on the information it needs DGSFP to obtain on-site. After receiving the information from DGSFP, SEPBLAC makes its decision whether or not to visit the insurer for more in-depth discussions. SEPBLAC has the power to visit the insurer without DGSFP's accompaniment. DGSFP has also conducted joint inspections with SEPBLAC in the past. There is a 15-member committee comprising representatives from BdE, CNMV, DGSFP, police and other relevant agencies to review AML/CFT offences and to decide on the appropriate sanctions in the form of monetary fines. This committee meets every 6 months. The fines are quite substantial, at € 150,000 per offence. The committee's decision may be challenged in court, in which case the sanction becomes public knowledge. Otherwise, the sanctions are not published. DGSFP expects insurers to obtain UN sanction lists from private sources, such as FATIVA and WorldCheck.
Assessment	Observed
Comments	DGSFP supports SEBLAC, the designed FIU, in collecting data during on-site inspections. It understands the ML/TF risks in insurance business, and

[13] Spain has been evaluated as non-compliant in Recommendation 6 (PEPs), R.7 (correspondent banking) and R. 24 (DNFBP – Regulation, supervision & monitoring), as well as partially-compliant in R. 5 (CDD), R. 23 (regulation, supervision & monitoring), SR I (implementation of UN instruments), R. 8 (new technologies & non face-to-face business), R. 12 & R. 16 (designated non-financial businesses & professions [DNFBP]), R. 18 (shell banks), R. 25 (guidelines & feedback), R. 29 (supervisors), R. 30 (resources, integrity & training), R. 32 (statistics), and R. 33 (legal persons).

ICP/Standard	Description
	collaborates with other agencies in imposing sanctions on ML/TF offences. Nonetheless, DGSFP should consider, in supporting SEPBLAC to further facilitate the industry's compliance with AML/CFT law, issuing guidelines on risk-based CDD procedures.
ICP 23	**Group-wide Supervision** The supervisor supervises insurers on a legal entity and group-wide basis.
Supervisory scope	The insurance law and the financial conglomerate law define what constitutes an insurance group and a financial conglomerate in order to determine the scope of supervision. DGSFP's supervision of an insurance group extends to all legal entities within the group, including non-regulated entities and any entity that DGSFP has good reasons to believe to be part of the insurance group. An insurance group is required to notify DGSFP of any change in its structure in a timely manner. DGSFP may deny or withdraw the insurance group's licence if the organization or group structure hinders effective supervision. A financial conglomerate who is headed by an insurer is required to submit information to DGSFP with respect to capital adequacy, risk concentration, intra-group transactions and internal control mechanisms. DGSFP has bilateral cooperative agreements with BdE and CNMV to exchange supervisory information. DGSFP has been conducting inspections on group-wide basis since 2006. There are over 70 insurance groups in Spain at the end of 2011. Many of them are simple in structure, such as an insurer owning an auto repair shop. There are currently no financial conglomerates headed by insurers in Spain.
Cross-border coordination	Supervisors within the EU collaborate and coordinate the supervision of insurance groups pursuant to the Helsinki Protocol. Spain has been attending the Coordination Committee Meetings of several groups since 2001. EIOPA has published annual Action Plan for the colleges of supervisors from 2010.
Supervisory framework	A dedicated (not full-time) on-site inspection team is assigned to each insurance group that has applied for internal models, taking in consideration the nature, scale and complexity of the group. On site-inspection plans are conducted on both legal entity and group-wide basis. Although the Solvency II Directive is not yet into force, the supervisory collegues has been very active. DGSFP is a member of 23 supervisory colleges, acting as the designated group-wide supervisor in 2 of them. DGSFP adopts a three-level group wide supervision framework. Level 1 - Preconditions for group-wide supervision: DGSFP has the legal authority and capabilities to conduct group-wide supervision, although it is not clear that there is sufficient capacity. DGSFP has the ability and willingness to cooperate with other supervisors. There is clear definition of insurance groups and financial

ICP/Standard	Description
	conglomerates. Level 2 - Regulatory requirements: Solvency and market conduct requirements applicable to legal entities are extended to the group level. Currently there is no corporate governance framework at the entity and group level. The regulatory environment is conducive to group-wide supervision, supported by clarity in definition of insurance groups and financial conglomerates, and comprehensive network of cross-border cooperation. Level 3 - Supervisory review and reporting: Insurance groups are required to submit consolidated statistical and accounting information to the DGSFP on an annual and semi-annual basis, including (a) group structure and interrelations, (b) capital adequacy, (c) risk management and internal controls, (d) consolidated statements, and (e) intra group transactions. DGSFP may collect any additional information from, and inspect, all entities within the group in order to analyze the solvency of the group.
Assessment	Observed
Comments	DGSFP's framework for group-wide supervision is in line with current EU Directives. To improve observance with ICP 23, DGSFP is advised to consider the following improvements to its group-wide supervision framework: (a) Given the large number of insurance groups in Spain, DGSFP should review its capacity (under level 1) to carry out effective group-wide supervision. (b) In light of the recent financial crisis, DGSFP should consider improving the level 3 reporting requirements to include off-balance exposures, liquidity risks and possible contagion and reputation risks.
ICP 24	**Macroprudential Surveillance and Insurance Supervision** The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilise information from, and insights gained by, other national authorities.
Description of current practice	DGSFP collects and publishes insurance market statistics in an Insurance Sector Annual Report on its website. The 300+ page report provides comprehensive information on market performance during the year, including number of market participants, premium income by lines of business, technical and non-technical results for life and non-life business, claims experience, premium by distribution channels, and solvency positions. The report also provides a summary of DGSFP's work program during the year and regulatory development in Europe. The market statistics are comprehensive and widely used by industry and academia. The information on investment portfolio is down to the level of individual counters. This has enabled DGSFP to use Bloomberg data to verify asset values. It also enables DGSFP to perform a 3-year projection of individual insurer's solvency

ICP/Standard	Description
	position. DGSFP uses the statistics to generate ratios and ranking as a tool to prioritize supervisory attention. Due to the current volatility in the public debt market, DGSFP has carried out several research studies about the weight, amount and diversification of public debt within the Spanish insurance market from both an aggregated and individual perspective. Specific studies on the economic and financial impact of public debt crisis have been launched. DGSFP does not specifically identify systemically important insurers. However, it has assigned dedicated (but not exclusive) inspectors to the 13 largest insurance groups.
Assessment	Partly Observed
Comments	DGSFP collects and publishes a high volume of market statistics that are widely used by industry and academia for research purposes. To provide the context to the statistics, DGSFP is advised to include more macroeconomic factors, such as level of interest rates, financial market indices, inflation, inter-connectedness with other financial market participants, catastrophes and pandemics that may impact insurers and insurance markets. It appears that DGSFP does not use the wealth of statistics for qualitative analysis beyond the generation of ratios. DGSFP is advised to develop a macroprudential surveillance system, including mandatory industry-wide stress tests to identify trends, potential risks and plausible future unfavourable scenarios, so that it may take early action to reduce the likelihood of systemic risk. The current 3-year projection of individual insurer's solvency position is a good start. DGSFP should include sensitivity and scenario testing to identify vulnerabilities at the insurer level and at the industry level as well as to assess the potential systemic importance of insurers. The Spanish insurance market has high participation by foreign insurers. Some of its insurers also have operations in other countries. DGSFP should also consider regional and global market development in its macroprudential analysis. It is noted that DGSFP is developing a new analytical tool with a view to build an early warning system. Through coordination by EIOPA, DGSFP contributes to and receives information from other supervisors on market conditions.
ICP 25	**Supervisory Cooperation and Coordination** The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.
Arrangements	DGSFP has coordination arrangements at national and international levels. (See also ICP 3). Domestically, it has bilateral MoUs with BdE and CNMV to exchange information and collaborate on matters pertaining to financial sector supervision. Pursuant to these MoUs, DGSFP has exchanged information with the other sectoral supervisors on significant shareholders and market conduct matters. Joint cross-

ICP/Standard	Description
	sector training programs were also conducted to heighten the awareness of cross-sectoral issues. At the EU level, it has signed a MoU on cooperation for cross-border financial crisis management between financial supervisors, central banks and finance ministries. Formal arrangements are not required for supervisory cooperation within EU. Spain is an active participant in supervisory colleges as a result of substantial presence of foreign insurers in Spain. DGSFP participates in 23 supervisory colleges and is the designated group-wide supervisor for two of them. Outside of EU, DGSFP has signed three MoUs with Mexico, El Salvador and Uruguay to facilitate cross-border supervision of insurance groups.
Effective process	There is an established process through EIOPA for the involved supervisors to discuss and determine the need for group-wide supervision and to agree on the designated group-wide supervisor. As the designated group-wide supervisor, DGSFP acts as chairman and initiates discussions to facilitate information sharing on group-wide governance, risk exposure and financial soundness issues. The size of the colleges varies from 2 to over 20, depending on the complexity of the operations of the insurance groups. Relevant non-EU supervisors are also invited to participate in the supervisory college. At the initial meeting of the college, supervisors discuss and agree on the terms of reference, the role of individual supervisor and collective responsibility, and coordination arrangements. Some colleges have developed secure websites to facilitate information sharing and communication with the involved supervisors. DGSFP is the designated group-wide supervisor of Mapfre and Grupo Calatana Occidente. It has established the colleagues following the EIOPA and IAIS procedures.
Assessment	Observed
Comments	The engagement at EU and international level with relevant supervisors is high and collaborative. Colleges for two international groups have been established by DGSFP and are under continuous improvement. DGSFP is advice to allocate a budget to the supervision of international groups to accompany the growing requirements on the supervisory colleges.
ICP 26	**Cross-border Cooperation and Coordination on Crisis Management** The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.
Crisis management planning	DGSFP meets with relevant supervisors relating to cross-border insurers regularly. The frequency of the meetings is determined by the designated group-wide supervisor, taking into account the group risk profile, the risk profile of specific insurers in the group and external and local market conditions or circumstances. The group-wide supervisor usually organizes a meeting of the

ICP/Standard	Description
	supervisory college at least once a year. An MoU On Cooperation Between The Financial Supervisory Authorities, Central Banks And Finance Ministries Of The EU On Cross-Border Financial Stability was signed by DGSFP in June 1, 2008. The MoU aims to ensure cooperation in financial crises through appropriate procedures for sharing of information and assessments, in order to facilitate the pursuance of their respective policy functions and to preserve stability of the financial system of individual Member States and of the EU as a whole. EIOPA has developed a tool to gather information on crisis situations which will be distributed to the insurance groups in the Helsinki Protocol List and EU supervisors. Moreover, EIOPA has conducted an exercise on crisis simulation in September 2011 for all European supervisory colleges. The simulation exercise was successful in all 23 supervisory colleges in which Spain participates. There is a proposal for EIOPA to coordinate a harmonized emergency plan for European colleges of supervisors. BdE and DGSFP held an exercise in 2007 to test communication links in crisis situations. Insurance regulation requires insurers to establish contingency plans to anticipate adverse situations that may threaten their viability. During on-site inspections, DGSFP ensures that the insurer has in place an appropriate contingency plan. However, DGSFP does not require the insurer to regularly test the plan.
Information sharing	Subject to confidentiality, the Spanish insurance legislation allows DGSFP to share with other relevant supervisors within EU information necessary to manage a crisis, including but not limited to: group structure, inter-linkages between the insurer and the financial system in each jurisdiction where it operates, and potential impediments to a coordinated solution. Becoming aware of an evolving crisis, DGSFP would be able to provide the following information to the designated group-wide supervisor, to be shared within the college: i. a description of the emergency situation, with an indication of any impact on policyholders and on the financial markets; ii. an identification of the insurers in the group which are affected, with relevant information on their financial situation; iii. an overview of any measures taken by the group; and iv. an overview of any measures taken by any of the supervisory authorities concerned and a description of any existing national arrangements relevant to the management and resolution of the crisis. Upon receipt of the information, the group-wide supervisor distributes the information via a secure communication channel on the established college website and secure email infrastructure. This infrastructure is tested regularly by college members. All college members are able to produce on short notice the information included

ICP/Standard	Description
	in a document named "Information to be exchanged in crisis situations." This information forms the basis for an effective handling of the emergency situation and for information exchange within the college.
When coordinated solution not possible	Supervisory college strive to find a coordinated supervisory solution to a crisis. EIOPA Regulation[14] stipulates that the relevant Competent Authorities should strive to agree on a viable solution; in cases where no such solution can be reached, recourse may be made to the EIOPA Mediation Mechanism, according to General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the EU.
Public communication	DGSFP strives to have a coordinated approach to public communication with other supervisors at all stages of the crisis, to maintain public confidence and avoid unnecessary public anxiety.
Assessment	Partly Observed
Comments	DGSFP follows EIOPA and IAIS protocols on cooperation and coordination in cross-border crisis management. However, the colleges have not tested crisis simulations beyond EU. There are no resolution plans among cross-border supervisors. Work on determining SIFIS is in early stages. Until its resources are increased, DGSFP intends to rely on the list of SIFIs published by FSB annually as well as on the joint work of EIOPA and ESRB regarding the identification of systemic risk and undertakings that may pose a systemic risk. DGFSP does not require insurers to regularly test their contingency plans. It is advised that DGSFP should require it.

[14] Articles 19 and 20 of Regulation (EU) 1094/2010 of the European Parliament and the Council of November 24, 2010 establishing a European Supervisory Authority.

Table 17. Recommendations from the 2006 FSAP and Their Implementation

Reference Principle[15]	Recommended Action	Steps Taken
Principle 3. Supervisory authority	To implement an institutional arrangement for insurance supervision that enables: (i) strengthening of regulatory governance in terms of independence of the supervisory body (i.e., the establishment of procedures regarding the appointment and dismissal of the head of the supervisory authority and members of the governing body); (ii) the supervisory authority to issue secondary regulation by administrative means that is binding to the insurance industry; and (iii) a budgetary scheme that could allocate more financial resources to insurance supervision and a more flexible scheme for the allocation of resources; increase supervisory authority's staff and to attract and retained high skilled personnel; and provide the necessary resources to enhance supervisory infrastructure and tools.	Not implemented. Spanish Government considered adopting a "twin-peak" structure for financial supervision prior to the financial crisis. The proposal has been put on hold due to the crisis, and the creation of the European Supervisory Authorities from January 2011, which are similar to Spain's existing supervisory framework.
Principle 6. Licensing	To include, as part of the licensing process for insurance companies, specific suitability requirements for the actuaries that will participate in the technical management of the company.	Pending implementation of Solvency II by October 31, 2012.
Principle 7. Suitability of persons	To consider, as an additional element for the fit and proper scheme applicable to key functionaries, specific fit and proper requirements for actuaries. To introduce the obligation for insurers to inform the supervisory authority, in a timely manner, of circumstances that may affect the fitness and propriety of its key functionaries.	Pending implementation of Solvency II by October 31, 2012. Current requirement to "maintain" the licensing conditions (including the fitness and propriety of effective managers) can be strengthened.
Principle 9. Corporate governance	To establish general requirements on corporate governance applicable to insurers in which clear responsibilities for the board of directors and senior management are included.	Pending implementation of Solvency II by October 31, 2012.
Principle 10. Internal control	To explicitly consider in regulation the requirement for insurers to maintain a framework for internal control that includes internal auditing procedures, risk management systems, assessment of outsourced functions, and clear responsibilities for the board of directors.	Insurance regulation was amended in 2007 that partially implemented this recommend-ation. Full implementation will be achieved when Solvency II is

[15] The 2006 assessment was benchmarked against the ICPs issued by the IAIS in 2003.

Reference Principle[15]	Recommended Action	Steps Taken
		adopted.
Principle 11. Market analysis	• To implement regular analysis of the conditions of the market, not only in terms of the past developments and present situation, but also to identify trends, scenarios and issues that could have an impact on future development, financial position, and/or financial stability of the market. • To include as part of the systematic financial and statistical information required of insurers for supervision purposes, the information required to conduct regular analysis of market conditions.	A new reporting template was introduced in 2008/2009, requiring insurers to submit relevant information to DGSFP on quarterly and yearly basis. Using the information, DGSFP analyses the market and publishes an annual report available on its website.
Principle 17. Group-wide supervision	• To strengthen the coordination and collaboration framework between the insurance supervisory authority, and the BdE and the CNMV, in order to create and implement effective mechanisms for group-wide analysis and effective group-wide supervision of financial conglomerates. • To provide the necessary resources to the insurance supervisory authority so it can participate effectively on group-wide supervision (see recommendation on ICP 3).	• A high level committee, CESFI, was created to exchange information on potential systematic financial stability issues. During the recent financial crisis, the committee met every 1–2 months and has been proven useful. • The number of staff involved with group-wide supervision has doubled since 2006. However, this may have taken away resources from other supervisory functions as the overall head count has remained unchanged.
Principle 18. Risk assessment and management	• To include explicitly in the regulatory framework specific requirements on risk assessment and management for insurers, in order to recognize the wide range of risks that they face and to assess and manage them in a comprehensive and effective manner. • To include, as part of the supervisory process, a regular assessment of the aggregation and correlation of risks, risk diversification, and the overall effect that specific financial and technical risks might have on the global position of supervised insurers.	Insurance regulation was amended in 2007 that partially implemented this recommend-ation. Full implementation will be achieved when Solvency II is adopted.
Principle 21. Investments	• To incorporate in the insurance regulatory framework explicit requirements for insurers to have in place an overall strategic investment policy approved and reviewed regularly by the Board of Directors, that addresses the different aspects linked to investment risks (see	Amended ROSSP in 2007. The adoption of Solvency II will further strengthen the observance of this ICP.

Reference Principle[15]	Recommended Action	Steps Taken
	recommendation on ICP 9). • To include in the regulation specific fit and proper requirements for staff involved with investment activities, in terms of appropriate levels of skills, experience, and integrity. • To consider within the regulatory framework requirements for insurers to implement audit procedures to ensure the timely identification of internal control weaknesses and operating system deficiencies on investment operations that include contingency plans (see recommendation on ICP 10).	
Principle 22. Derivatives and similar commitments	To consider in the regulatory framework explicit requirements on the board of directors to satisfy itself that it has the necessary expertise to understand the important issues related to the use of derivatives; to approve and review periodically a policy on their use; and to have in place risk management systems and audit procedures covering the risks from derivatives (see recommendations on ICP 9, 10, and 18).	Amended ROSSP in 2007.
Principle 28. Anti-money laundering, combating the financing of terrorism (AML/CFT)	• To provide the necessary resources to the insurance supervisory authority so it can maintain an effective supervision on AML/CFT requirements to insurers (see recommendation on ICP 3). • To draft legislation on AML/CFT requirements for insurance agents and brokers.	Not implemented. However, there is a coordination protocol between DGSFP and the FIU to facilitate the supervision of AML/CFT.