



Guidelines to the Insurance Industry on Management of Investment

November 2015

To

Insurance Companies

Reinsurance Companies

GUIDELINE ON MANAGEMENT OF INVESTMENTS

DRAFT

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1.0 Authorization

IN EXERCISE of the powers conferred by sections 3A (a), (b) and (g) of the Insurance Act, the Insurance Regulatory Authority (herein referred to as Authority) issues the guideline set out here below, for observance by all insurers registered under the Insurance Act Cap 487, in respect of management of investments.

2.0 Introduction

- 2.1 Investments are an important part of an insurer's assets and a considerable source of its income.
- 2.2 Where investments are not managed properly, this can lead to losses thus threatening an insurer's financial soundness and can cause major liquidity problems.
- 2.3 In order to protect policyholders, it is therefore essential that insurers apply sound and prudent investment management practices.

3.0 Objectives

- 3.1 The purpose of this guideline is to ensure that the assets of insurers are managed in a manner that is consistent with its risk profile, liquidity needs and liability profile.
- 3.2 It sets out the expectations of the Authority regarding investment management which are consistent with international best practices and Insurance Core Principles issued by the International Association of Insurance Supervisors.
- 3.3 This guideline seeks to highlight guiding principles which the Authority views as critical to the insurer in establishing sound and prudent investment management practices.
- 3.4 The investments shall be made in a sound and prudent manner and is required to maintain the following basic parameters of investment:
 - a. **Security** – Insurers shall invest in low-risk assets to ensure preservation of capital.
 - b. **Liquidity** – Insurers shall invest in assets that can easily be disposed of without affecting the price.

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- c. **Diversification**—Insurers shall invest assets in a wide range of instruments so as to spread the risk.
- d. **Return**—Insurers shall invest assets in instruments that generate high income whilst considering the associated risks.

Principle 1: Governance Structures

4.0 Insurers shall develop an investment management framework which is supported by effective and efficient governance.

4.1 Board of directors¹

4.1.1 The roles and responsibilities of the board of directors with regard to an insurer's investment management shall be as follows:

- Participate in examining and approving the investment strategy and ensure it is implemented.
- Examine and approve the investment policy, while ensuring that senior management reviews the policy periodically and when required.
- Ensure that the investment management is handled by competent and experienced persons of integrity.
- Examine the reports on the quality and performance of the investment portfolio. The board members should have a clear understanding of the investments in which the insurer seeks to invest, including their characteristics and related risks.
- Follow-up on any activity, transaction or situation that is irregular or problematic.
- Ensure that internal control mechanisms are in place.
- Specify the content and frequency of investment management reports to be submitted to the board.
- Where the investment function is outsourced, the board shall bear the ultimate responsibility.

4.1.2 The examination could consider the following aspects, among others:

- changes in the investments and their performance in light of market trends and the insurer's risk profile;

¹A reference to the board of directors can also include a board committee, such as a board committee established to examine specific issues.

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- major investment positions taken as well as the depreciation and write-off of investments; and
- investments issued or guaranteed in connection with transactions between affiliated legal persons or associates as they could constitute a source of conflict of interests.

4.2 Senior Management

4.2.1 The roles and responsibilities of senior management with regard to an insurer's investment management are:

- develop and implement the investment strategy;
- develop the insurer's investment policy, recommend its approval by the board of directors and ensure that it is implemented;
- develop and implement procedures with respect to investment activities;
- periodically analyze and assess the quality and performance of individual investments as well as the overall portfolio, and report to the board on a regular basis and upon request; and
- establish internal control mechanisms so as to ensure that investments comply with the insurer's policy and procedures and with legal and regulatory requirements.

4.3 Investment Managers

4.3.1 Where an insurer uses services of investment managers, the managers shall be qualified and competent to carry out the assigned task.

4.3.2 The insurer shall monitor the work of investment managers to ensure that the insurer's strategy is being adhered to.

4.4 Risk Management Function

4.4.1 The roles and responsibilities of the risk management function with regard to an insurer's investment management are:

- monitor adherence to the approved investment policy and regulatory obligations;
- formally note and promptly report breaches;
- review risk management activities with regard to investment; and

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- ensure that the investment strategy is aligned with the overall risk management policy of the insurer.

4.5 Audit

4.5.1 Insurers shall conduct an audit of their investment activities which ensures timely identification of internal control weaknesses and deficiencies in the management information systems.

4.5.2 Where the audit is performed internally, it must be independent.

4.5.3 The roles and responsibilities of the internal audit function with regard to an insurer's investment management are:

- 4.5.3.1 evaluate the independence and effectiveness of the insurer's investment management functions;
- 4.5.3.2 periodically review the insurer's asset portfolio to ensure that it is consistent with the insurer's investment policies and procedures as well as regulatory obligations;
- 4.5.3.3 monitor adherence to the approved investment policy and regulatory obligations;
- 4.5.3.4 give assurance that the insurer's investments are secure and are made and kept in the name of the insurer.
- 4.5.3.5 Assess the effectiveness of the internal controls.

4.6 Internal controls

4.6.1 Insurers shall design and implement effective internal controls.

4.6.2 Insurers shall establish adequate systems of internal control to ensure that assets are managed in accordance with the overall investment policy, and the legal and regulatory requirements. Key controls include but are not limited to segregation of duties, approvals, verifications and reconciliations.

4.6.3 Internal controls with respect to investment include:

- 4.6.3.1 concentration limits;
- 4.6.3.2 valuation and recording of investments in accordance with generally accepted accounting principles. Special attention should be paid to investments used for arbitrage trading and hedging purposes;
- 4.6.3.3 responsibilities of depositories and the terms and conditions of custodial arrangements;

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- 4.6.3.4 cash flows generated through investments such as income, repurchases and redemptions at maturity;
- 4.6.3.5 reporting on investments;

Principle 2: Strategy, Policy and Procedures

5.0 Insurers shall have in place an investment strategy and implement a policy and procedures to execute the strategy at the operational level.

5.1 The Investment Management

5.1.1 An insurer shall, in managing its investments, have the following in place:

- 5.1.1.1 An investment strategy and policy;
- 5.1.1.2 Systems that allow the identification, measurement and assessment of investment risks and the aggregation of these risks at different levels.
- 5.1.1.3 Adequate procedures for the measurement and assessment of investment performance;
- 5.1.1.4 Adequate and timely internal communication of information on investment activities;
- 5.1.1.5 Procedures to identify and control the dependence on and vulnerability of the insurer to key personnel and systems;
- 5.1.1.6 Procedures for any changes of the investment strategy should be specified.
- 5.1.1.7 Internal controls, such as segregation of duties, approvals, verifications and reconciliations.
- 5.1.1.8 Internal procedures to review the appropriateness of the investment policies and procedures
- 5.1.1.9 Rigorous and effective audit procedures and monitoring activities to identify and report weaknesses in investment controls and compliance.

5.2 Investment Strategy

5.2.1 Insurers shall develop an investment strategy that is in line with the operational objectives, plans, organizational structure and appropriate control measures.

5.2.2 The investment strategy should allow the insurer to:

- develop a policy and implement the procedures necessary for the insurer to achieve sound investment management; and
- aim for a risk/return balance based, in particular, on its business lines and its risk appetite. To this end, the insurer shall regularly determine and revise the investment risk tolerance levels based on its objectives.

5.2.3 An insurer shall take the following into consideration when developing an investment strategy:

- 5.2.3.1 insurer's risk appetite and tolerance levels.
- 5.2.3.2 the scope of investment risks, including market risk, insurance risk, credit risk, liquidity risk and operational risk;
- 5.2.3.3 capital and solvency requirements;
- 5.2.3.4 details of the insurer's investment selection criteria, standards and other parameters including the asset allocation mix across investment categories;
- 5.2.3.5 conditions governing the mortgaging or lending of the insurer's assets and guidance for such arrangements;
- 5.2.3.6 any restrictions or prohibitions on the acquisition of certain investments deemed to involve greater risks or are subject to high volatility;
- 5.2.3.7 the extent to which the insurer's investments can be diversified including alternate risk mitigating strategies;
- 5.2.3.8 the company's policy on the use of financial derivatives and other structured products;
- 5.2.3.9 accountability for all investment transactions; and
- 5.2.3.10 investment authorization criteria and limits.

5.2.4 The investment strategy shall be reviewed regularly and as needed, particularly in light of changes in the capital markets, the development of new financial products and the insurer's commitments to the policyholders.

5.3 Investment Policy

5.3.1 An insurer's investment policy shall establish the principal parameters within which the insurer should manage its investment activities. The policy should be sufficiently supported to ensure effective management, particularly in respect of situations where the risk is considered to be high.

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5.3.2 In light of the investment strategy developed by the insurer, the investment policy shall address the following elements, at a minimum:

- 5.3.2.1 Insurer's risk appetite and tolerance levels;
- 5.3.2.2 types and characteristics of the investments;
- 5.3.2.3 expected returns and the purpose of the investments, such as liquidity, matching, pledging of collateral, hedging and trading;
- 5.3.2.4 investment concentration limits;
- 5.3.2.5 investments decision criteria, standards and other parameters;
- 5.3.2.6 processes relating to intra-group management of investment activities;
- 5.3.2.7 procedures for analyzing and evaluating investments when deciding to make an investment and when carrying out a transaction; and
- 5.3.2.8 monitoring and control of investments.
- 5.3.2.9 accountability for all investment transactions; and
- 5.3.2.10 investment authorization criteria and limits.
- 5.3.2.11 asset liability matching.

5.4 Asset Liability Management (ALM)

- 5.4.1 Insurers shall hold sufficient assets to support their liabilities including technical provisions and capital requirements.
- 5.4.2 Insurers shall develop an Asset Liability Matching (ALM) policy. The policy shall be appropriate to the nature, scale and complexity of the insurer's operation.
- 5.4.3 Insurers shall invest in portfolios well diversified across different asset classes and within a particular asset class. Investment decisions should be guided by portfolio perspective rather than individual asset-return/ risk characteristics.
- 5.4.4 Insurers shall have in place effective procedures for monitoring and managing their asset/liability positions to ensure that their investment activities and asset positions are appropriate to settle their liabilities when they become due.

5.5 Procedures

- 5.5.1 An insurer shall develop and maintain documented investment procedures that are subject to effective oversight.

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- 5.5.2 The investment management procedures shall allow an insurer to manage its investment activities properly, particularly with respect to acquisitions or disposals.
- 5.5.3 Investment decisions shall be based on analyses and valuations that take into account in particular the insurer's investment risk tolerance levels and expected returns. This should be supported by full documentation.
- 5.5.4 An insurer shall evaluate and understand the source, scope and types of risks associated with an investment activity. Adequate procedures shall be implemented so as to manage investment risks, while giving consideration to the interrelationships and interdependencies between the risks to which the insurer is exposed. Adequate methods should be used to measure the insurer's risk exposure and establish techniques for mitigating the risks.
- 5.5.5 An insurer shall consider various internal and external factors that are likely to affect the risks it is exposed to, its risk tolerance levels, its objectives, the general economic climate, interest rates, legal and regulatory requirements.
- 5.5.6 An insurer shall establish reporting mechanisms so that the risks encountered are communicated to all parties involved in its investment activities.
- 5.5.7 An insurer shall determine the value of its investments in an objective manner and ensure that the information used to do so is reliable.
- 5.5.8 An insurer shall establish investment analysis tools particularly on the following elements:
- nature, characteristics and liquidity of the investments; and
 - degree of exposure to various risks for each type of investment and for the investment portfolio as a whole, particularly in light of concentration limits.

5.6 Concentration Limits

- 5.6.1 An insurer shall set concentration limits in light of its capital requirements and shall cover all its exposures, in particular with respect to issuers and counterparties.
- 5.6.2 The concentration limits could be expressed in relation to the following parameters, among others:

- 5.6.2.1 types of investments and their attributes, including risk, returns, maturities, security, subordination, conversion features, complexity.
- 5.6.2.2 liquidity and transferability of the securities;
- 5.6.2.3 geographic zones and industry sectors;
- 5.6.2.4 counterparties.

5.6.3 The following table shows the maximum percentages allowed for each investment category.

No.	Investment Category	Maximum Limit%
1.	Government securities issued – National and Counties	100
2.	Fixed deposits in institutions licensed under the Banking Act, CAP 488 of the Laws of Kenya.	95
3.	Cash and demand deposits in institutions licensed under the Banking Act, CAP 488 of the Laws of Kenya.	30
4.	Equity securities	
	Ordinary shares –Quoted	30
	Ordinary shares –Unquoted	10
	Preference Share – Quoted	10
	Preference Share – Unquoted	
4.	Debt Securities	
	Corporate Bonds – Secured	10
	Commercial paper- Secured	10
	Commercial paper – Unquoted	5
	Debentures - Listed Entities	10
	Debentures - Unlisted Entities	5
5.	Land & Buildings	50
6.	Investment Property	70
7.	Investment in related companies	10
8.	Policy Loans up to maximum of the Cash Surrender Value	100
9.	Secured loans	10
11.	Mortgages	20
12.	Real Estate Investment Trusts (REITs) approved by the Authority	10
13.	Foreign investments	5

5.6.4 An insurer transacting general insurance business shall not invest more than 10% of the total assets of the insurer in any corporation, commodity or group of related corporations.

5.6.5 An insurer transacting long term business shall not invest more than 5% of the total assets of the insurer in any company, commodity or group of related

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companies. Where the company or group of related companies is a bank or financial institution, the maximum limit for the investment shall be 10%.

5.6.6 An insurer shall seek prior approval from the Authority for any investments not listed in the table.

Principle 3: Intra-group management

6 Insurers shall manage investments in accordance with the framework established for the group.

- 6.1 Where an insurer is part of a group, investment procedures shall be established for the insurer and the entities within the group.
- 6.2 The procedures shall cover certain situations that could entail greater risks for one or more entities within the group, or for the group as a whole.
- 6.3 Where an insurer outsources management of investment to a specialized entity within the group or to an outside service provider, the insurer shall maintain responsibility for ensuring that the risks related to its investments are managed in a sound and prudent manner.
- 6.4 An insurer shall ensure that its investments are secure and are made and kept in the name of the insurer.

Principle 4: Monitoring and control of investments

7.0 Insurers shall monitor and control their investment portfolio effectively and efficiently.

- 7.1 An insurer shall establish management practices to properly monitor and control its investments both individually and on a portfolio basis.
- 7.2 An insurer shall put in place adequate systems of internal control to ensure investment activities are supervised.
- 7.3 An insurer shall analyze and assess its portfolio on a regular basis to ensure the quality and performance of its investments.

- 7.4 An insurer shall adjust and monitor the selection of investments, particularly when material discrepancies arise with respect to actual versus expected returns or a significant change takes place regarding the risk associated with one or more investments.
- 7.5 An insurer shall ensure that the investment portfolio is diversified to mitigate investment risks.
- 7.6 Insurers shall prepare regular and timely reports which describe the company's exposure. Reports should include:
- 7.6.1 details of, and comments on, investment activity during the period and comparison with corresponding previous period;
 - 7.6.2 details and values of invested asset by type;
 - 7.6.3 an analysis of credit exposures by counterparty;
 - 7.6.4 details of any regulatory or internal limits breached in the period and the actions taken thereto;
 - 7.6.5 status of asset-liability matching;
 - 7.6.6 planned future activity; and
 - 7.6.7 details of the position of assets and liabilities.

Principle 5: Scenario analysis and stress testing

8.0 Insurers shall routinely carry out scenario analysis and stress testing so as to identify vulnerabilities and assess their impact

- 8.1 An insurer shall consider various assumptions, design scenarios and carry out stress testing in order to assess the impact of adverse market conditions on its investments, while taking into consideration the risks associated with the investments such as interest rate risk, liquidity risk, foreign exchange risk, credit risk and counterparty risk.
- 8.2 Scenario analysis and stress testing shall be discussed amongst the board of directors, senior management and staff assigned to manage the insurer's investments. This shall be supported by appropriate documentation.
- 8.3 Where an insurer identifies any vulnerabilities that could impact on its investment, the insurer shall consider taking appropriate actions.

10.0 Enforcement

- 10.1 The Authority may impose requirements on an individual insurer to invest in a specified manner, or restrict or prohibit an insurer from investing in certain asset classes or individual asset to safeguard insurance funds.
- 10.2 Such requirements, restrictions or prohibitions will form part of supervisory actions as a result of the Authority's assessment of an insurer's risk profile and investment risk management function.

11.0 Effective Date

The effective date for this guideline is **October 2015**

12.0 Enquiry

Enquiries on any aspect of this guideline shall be referred to:

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