

THE INSURANCE COMMISSION
OF THE BAHAMAS



NOTICE

To: All Registered Insurers and Intermediaries

Date: December 20, 2019

Re: Guidance Note: Implementation of the Commercial Entities (Substance Requirements) Act, 2018 and Guidelines

The Commercial Entities (Substance Requirements) Act, 2018 (CESRA) was enacted on December 21, 2018 to ensure that a commercial entity, deemed resident for tax purposes, has appropriate presence in The Bahamas commensurate with its economic activities.

The attached Guidance Note outlines the Commission's expectations on how the Commercial Economic Substance Requirements Act, 2018 (CESRA) and its Guidelines may impact its registrants and licensees. Under CESRA, insurance business is deemed a relevant activity. Therefore, all registrants and licensees must assess their operations and its compliance with the legislation.

The Commission strongly encourages all insurers and intermediaries to review the Guidance Note to remedy any deficiencies arising from their assessment to ensure conformity with this and all other Bahamian legal requirements.

The Guidance Note can be found on the Commission's website (www.icb.gov.bs) under the tab Policies and Practices – Other Regulatory Matters.

The Guidance Note is a part of the Commission's ongoing effort to enhance the insurance industry and benefit from comprehensive amendments to the legislation and supervisory practices. The Commission continues to develop general and specific policy guidelines, guidance notes, rules and procedures that effectively observe and promote international best practices. Accordingly, the Commission will update its Guidelines on the Roles and Responsibilities of the Principal/Resident Representative and will also issue a Guideline addressing the outsourcing of material functions within the first quarter of 2020.

The Commission welcomes all stakeholders to provide commentary on the Guidance Note. All comments and questions may be directed to:

Policies and Practices Unit
Insurance Commission of The Bahamas
Poinciana House, 31 East Bay Street
Nassau, Bahamas

Via email: policies@icb.gov.bs

Issued: December 20, 2019

Guidance Note:

Implementation of the Commercial Entities (Substance Requirements) Act, 2018 and Guidelines

INTRODUCTION

The Commercial Entities (Substance Requirements) Act, 2018 (CESRA) was enacted on December 21, 2018 to ensure that a commercial entity, deemed resident for tax purposes, has an economic presence in The Bahamas commensurate with its economic activities. Section 2 of CESRA applies to commercial entities that are incorporated registered or continued under the Companies Act, the International Business Companies Act, Partnership Act, Partnership Limited Liability Act or the Exempted Limited Partnership Act. CESRA, and its corresponding Guidelines, outline the requirements to which included entities must adequately demonstrate its compliance with the global standard for economic substance.

Under CESRA, an included entity is a commercial entity engaged in a relevant activity¹. Insurance business, as described by CESRA, is a relevant activity that includes predicting and calculating risk, insuring or re-insuring against risk and providing client services. These elements should account for the core income generating activity² (CIGA) for included entities.

The Insurance Commission of The Bahamas (the Commission) is mandated to ensure that all entities registered and licensed in accordance with the Insurance Act, 2005 and the External Insurance Act, 2009 assess their level of compliance with CESRA and its guidelines. Licensees are required to remedy any deficiencies arising from this review to ensure conformity with this and all other Bahamian legal requirements within the prescribed period for reporting.

PURPOSE

This Guidance Note addresses several material components concerning substance requirements that the Commission wishes for all its registrants and licensees to review. It also summarizes specific reporting requirements and proposed actions the Commission will pursue to ensure that licensees comply with CESRA.

This Guidance Note should be read in conjunction with the Commercial Entities (Substance Requirements) Act, 2018 and the Commercial Entities (Substance Requirements) Guidelines and is not intended to substitute or contravene any requirements mandated by CESRA. The Ministry of Finance is the Competent Authority responsible for the enforcement of all requirements mandated under CESRA and its supplementary guidelines.

¹ Relevant Activity - See section 4 of the Commercial Entities (Substance Requirements) Act, 2018

² Core Income Generating Activity - See Section 5 of the Commercial Entities (Substance Requirements) Act, 2018

SCOPE

This Guidance Note is applicable to all licensed and registered insurance entities conducting insurance business in or from within The Bahamas, except for entities that are resident owned in The Bahamas and conduct their core income generating activities within The Bahamas.

Key Areas

Section 5 of CESRA prescribes that an included entity's Core Income Generating Activity presupposes adequate a) amounts of annual operating expenditure; b) levels of qualified full-time employees; c) physical offices and d) levels of board management and control, within The Bahamas. CESRA considers adequacy as a qualitative measure rather than a quantitative measure. As such, CESRA considers the competence to do the job, to make decisions and to manage the operations according to the size, nature and complexity of the business.

The Commission has deemed the following components as key in assessing the potential impact to the insurance industry:

1. Core Income Generating Activity
2. Outsourcing
3. Corporate Governance and the Direction and Control of the included entity
 - a. Role of the Principal Representative and Resident Representative
 - b. Use of the Insurance Manager

Core Income Generating Activity (CIGA)

CESRA has identified the core income generating activity of insurance as predicting and calculating risk, insuring or reinsuring against risk and providing client services. The Commission recognizes that the core income generating activities for its registrants and licensees can also comprise, inter alia, the following activities:

1. Underwriting
2. Claims Management
3. Premium Collection and Renewal
4. Insurance Management Services
5. Insurance Brokerage
6. Loss Adjustment

Included entities that conduct the core income generating activities must ensure that the adequacy of their services remain commensurate with the size, nature and complexity of their business operations.

Outsourcing

CESRA does not prohibit included entities from outsourcing aspects of their business to service providers within The Bahamas. The Commission anticipates that insurance entities will continue to outsource professional specialist activities such as actuarial services and reinsurance activity to service providers not resident in The Bahamas. Included entities conducting insurance business must be able to demonstrate that there is adequate supervision of the outsourced

activities and that their core income generating activity occurs in The Bahamas. Persons or entities identified as an outsourcing service provider to an included entity have an obligation to report their compliance using the appropriate forms prescribed by the Competent Authority.

Entities conducting insurance must not use outsourcing of these individual activities to circumvent the substance requirements of CESRA. Entities outsourcing specific activities must ensure that they will continue to demonstrate their ability to supervise the activity based on their size, nature and complexity. Further, there must not be any “double-counting” of services by an outsourced service provider that provides services to more than one included entity. Included entities must regularly review the terms of the outsourcing agreement to ensure that the provider has adequate capacity to facilitate the outsourced services. Included entities conducting insurance business remain responsible for ensuring that accurate information is reported on the prescribed form submitted to the Competent Authority.

Corporate Governance and Control

The Commission’s Corporate Governance criteria seeks to determine the extent to which the appropriate controls are in place and are being adhered to in accordance within the Board and Senior Management’s corporate governance policy. The Commission’s legislative framework requires its registered and licensed entities to have the necessary board oversight, corporate structure and technical competencies to conduct insurance business. Accordingly, as indicated within CESRA, an included entity demonstrates substance requirements for management and control when the following criteria are satisfied:

1. An adequate number of board meetings are conducted in The Bahamas;
2. A quorum of the Board of Directors is physically present within The Bahamas during those meetings;
3. Strategic decisions of the included entity are made at these meetings and corresponding minutes recorded; and
4. Board of Directors has the necessary knowledge and expertise to discharge its duties

These criteria are applicable to all registered and licensed entities of the Commission and will continue to form part of our overarching risk-based supervisory methodology. Where appropriate, the Commission will amend the Principal Representative Guidelines to clearly demonstrate this mandate.

Branches

The Head Office of a branch entity provides support for many of its commercial activities. Insurers that conduct business as a branch entity will be expected to satisfy the adequacy of people, premises and expenditure based on their size, nature and complexity. Branches with head offices that are tax resident in a jurisdiction other than The Bahamas must demonstrate to the Competent Authority that it is tax compliant within their home jurisdiction.

External Insurer

Presently, all companies licensed under the External Insurance Act, 2009 are required to appoint a resident representative; however, an insurer is not required to have a physical presence to

conduct insurance business. They may choose to operate through their appointed Resident Representative or may choose to operate through a licensed insurance manager.

Principal/Resident Representative

The Insurance Act, 2005 requires a Principal Representative and the External Insurance Act, 2009 requires a Resident Representative who should both be resident in The Bahamas. These representatives are responsible for oversight of the insurance entities.

The Commission will continue to assess the roles and responsibilities, together with the fitness and propriety, of the Representative commensurate with the size, nature and complexity of the business operations of the included entity. CESRA's core principle is that there exists adequate mind and management in The Bahamas to direct the relevant activity of the included entity. The insurance entity should evaluate the role of the Principal/Resident Representative to determine whether these persons have sufficient authority to meet the requirements of CESRA.

Insurance Manager

Entities who choose to operate through a licensed insurance manager must also identify an individual who may be appointed as a Principal Representative or Resident Representative charged with the responsibility of directing an insurer's activities. The insurance manager may conduct outsourced activities such as underwriting, marketing, claims handling, actuarial services or insurance management services. These outsourced activities must formally be captured through a service level agreement.

The Commission expects the insurance manager to do the following:

1. Provide market knowledge and expertise to the licensed insurer through its experienced professional staff and other related services.
2. Perform most of the day-to-day transactions.
3. Prepare and maintain accounting records and work along with an insurer's auditor to produce audited financial statements.
4. Monitor the investments of the corporate funds.
5. Prepare for and coordinate regular Board meetings.
6. Coordinate with other service providers.

An insurance manager licensed to conduct insurance business in The Bahamas may provide outsourced services to another included entity. An insurance manager that is licensed in The Bahamas, but is also tax resident in a jurisdiction other than The Bahamas, must demonstrate to the Competent Authority that it is tax compliant within their home jurisdiction.

REPORTING REQUIREMENTS

CESRA mandates that all regulated included entities report on its compliance with the Act to the Competent Authority within nine months of its fiscal year end. Reporting on substance requirements will be for the 2019 fiscal period to be reported in 2020. The Competent Authority requires that all reporting be completed by September 2020, per a fiscal year end date of December 31.



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Regulated Included Entities should submit the prescribed form in the manner outlined by the Competent Authority. For more information on submission requirements regulated included entities may contact the Competent Authority.

CONCLUSION

As indicated earlier, this note addresses material components associated with the Commercial Entities Substance Requirement Act 2018, and its corresponding Guidelines. An included entity's compliance with CESRA must be observed in its ability to conduct core income generating activities in The Bahamas. The demonstration of economic substance should reflect the principle of adequacy. An included entity will have to ensure that it maintains appropriate records to demonstrate the adequacy of the resources used and expenditures incurred.



Glossary

For this guide the following terms and initials may be used. Please refer to the Insurance Act, 2005, External Insurance Act, 2009 and the Commercial Entities Substance Requirements Act, 2018 for their complete definition and description.

Core Income Generating Activity (CIGA)

Economic Substance

Included Entity

Principal Representative

Relevant Activity

Resident Representative