

CLIENT ALERT

INSURANCE | TURKEY

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WELCOMING NEW YEAR WITH RECENT CHANGES IN INSURANCE LEGISLATION

The Insurance and Private Pension Regulation and Supervision Agency ("**SEDDK**") has published a series of legislation by the end of the year 2021 to establish adequate and effective internal systems to monitor and control the risks to which institutions in the insurance and private pension sectors are exposed, as well as to protect the assets of insurance companies.

REGULATION ON INTERNAL SYSTEMS IN INSURANCE AND PRIVATE PENSION SECTORS ENTERED INTO FORCE

The Regulation on Internal Systems in Insurance and Private Pension Sectors (the "**Regulation**") published in the Official Gazette No. 31670 dated 25 November 2021, repealing the Regulation on Internal Systems of Insurance and Reinsurance and Pension Companies (the "**Abolished Regulation**") published in the Official Gazette No. 26913 dated 21/6/2008, entered into force on the date of its publication by the SEDDK.

CHANGES WITHIN THE SCOPE OF THE REGULATION

- **Definitions within the scope of internal control and internal audit systems and the procedures and principles regarding their operation**

The Regulation aims to bring certain concepts to life that had not been covered under the Abolished Regulation, by determining the procedures and principles regarding the internal control, risk management, actuary and internal audit systems to be established by insurance, reinsurance and pension companies, special establishments operating in the insurance and private pension sectors, and insurance and reinsurance brokers with legal personality, and their operation.

In this context, the Regulation covers insurance, reinsurance and pension companies established in Turkey, the organisations of foreign insurance and reinsurance companies in Turkey, the Assurance Account, Insurance Information and Monitoring Centre, Pension Monitoring Centre, Insurance Arbitration Commission, Turkish Motor Vehicle Bureau, Natural Disaster Insurance Institution, Private Risk Management Centre and insurance and reinsurance brokers with legal personality.

- **Standards and procedures regarding primary and secondary systems, business continuity and Management Statement**

While the standards and procedures regarding primary and secondary systems, business continuity and Management Statement are explained in the Regulation, the internal control, risk management, actuary and internal audit functions and the qualifications of the department and personnel responsible for carrying out these functions are also being defined in detail.

- **Obligation of Board of Directors to establish, operate and develop an internal system through an audit committee**

The Regulation states that the Board of Directors will perform its obligation to establish, operate and develop an internal system through an audit committee consisting of two members of the board of directors who do not have executive duties and meet the criteria set out in article 6 of the Regulation. The Board of Directors is also obliged to present to the independent auditor the management statement, giving assurance about the company's internal systems regarding the related audit period. In addition, the Regulation determines the duties of the members of the Audit Committee regarding the functions related to the internal systems, which used to be classified as Internal Audit in the Abolished Regulation. It should also be noted that, within the scope of the exception set out in Article 13 of the Regulation, special establishments, insurance and reinsurance brokers with legal personality are not obliged to establish an audit committee.

- **Obligation to carry out general information system control**

Another change within the scope of the legislation is the obligation to carry out general information system control regarding the activities related to information system and management, and control the processes of these activities in accordance with the information and communication security guide published by the Presidency's Digital Transformation Office or the Control Targets for Information Technologies (COBIT).

- **Obligation to establish an actuary department affiliated to the audit committee**

The Regulation imposes the obligation to establish an actuary department administratively and functionally affiliated to the audit committee in order to fulfil the "actuary functions" newly introduced by the Regulation, to follow up the company practices related to these duties and to make regular reports to the senior management and related departments in order to take remedial measures where necessary. The purpose of the actuary department is to fulfil the actuary function and thus provide assurance to the SEDDK regarding the investment risk for investments made under the general pricing policy of the institution, the actuary adequacy of reinsurance agreements, the financial situation of the institution, the reliability and adequacy of technical provisions, asset and liability risk management, and insurance policies. According to Article 4(4) of the Regulation, the Natural Disaster Insurance Institution, Special Risks Management Centre and Turkish Motor Vehicles Bureau are obliged to establish an actuary department and function in addition to the departments and functions defined in the Regulation. Special establishments that are not obliged to establish an actuary department and insurance and reinsurance brokers with legal personality are required to carry out these activities in accordance with the provisions of the Regulation if they operate the actuary function or establish an actuary department.

Pursuant to Article 48 of the Regulation, internal control, risk management, actuary and internal audit functions can be outsourced in the event the internal systems departments are not able to provide such services, provided that said internal systems departments are structured within the organisation, necessary personnel are employed and work plans are prepared by the relevant departments.

- **Reporting duty of the Board of Directors to the SEDDK as regards internal control and internal audit**

Article 54 of the Regulation details the reports that must be prepared by the board of directors and submitted to the SEDDK within the scope of the internal control function, risk management function, actuary function and internal audit function. With the exception of information in the nature of trade secrets and taking into account the issues regarding the protection of personal data, companies and special establishments must officially publish the reports indicated in paragraph 2 of Article 55 of the Regulation, in a way that can be easily accessed by the public. The temporary article of the Regulation explains that the first reporting will be made for the activities carried out in January-March 2023 and that reporting is not required for activities carried out before this date.

- **Aim of the Regulation**

The SEDDK's statement on the new Regulation indicates that the management understanding of the sector will be strengthened, the institutional competencies and the quality of the service offered to the insured will be increased, and accordingly, the sector practices will be harmonised with the Insurance Core Principles (ICP), and standards relative to the institutionalism and transparency of the European Union Solvency 2 standards will be complied with.

Notwithstanding, the control mechanisms in the primary and secondary systems, which are the building blocks of the internal system, combined with the new definitions and concepts established by the Regulation, in which the segregation of duties is prioritised, will help the establishments within the scope of the Regulation to resolve their internal systems and audit functions more quickly and effectively without conflicts of interest.

OTHER DEVELOPMENTS IN THE INSURANCE LEGISLATION

In addition to the amendments made by the Regulation, SEDDK aims to describe the regulatory framework of insurance legislation with circulars focusing on more technical issues, such as reimbursement mechanisms in life insurance, minimum capital amounts expected for insurance branches, and the capital adequacy level determined for 2022 in insurance companies:

- **Reimbursement of a portion of life insurance expenses and brokerage commission , with a term of more than 1 year**

The Turkish Commercial Code No. 6102 states that insurance contracts that have been in force for at least one year and whose premiums have been paid for one year can be terminated by the policyholder at any time. In line with this regulation and clause (a) of the 8th paragraph of the Regulation on Technical Reserves of Insurance, Reinsurance and Pension Companies and Assets to be Invested in These Reserves that stipulates the expenses to be taken into account in the actuarial mathematical reserve calculation, new Circular No. 2021/23 and dated 26 November 2021 will be effective as of 1 April 2022. It states that, in the event of early termination of life insurance with a contract term of more than one year, the portion of expenses and brokerage commission (production expense) amounts included in the tariff premium must be returned to the policyholder. In this context, in life insurance with a term of more than one year in connection with individual loans, the return calculation should be made on the basis that the portion of expenses and brokerage commission (production expense) amounts included in the tariff premium belong to the entire insurance period.

- **Changes in minimum capital amounts for insurance branches**

In addition, in Circular No. 2021/24 that abolished Circular No. 2020/9 and dated 9 October 2020 determining the new minimum establishment capital amounts, SEDDK updated the minimum capital amounts stipulated for insurance companies that have completed the establishment procedures and requested a license (including insurance companies and reinsurance companies and each insurance branch requested in addition to the base share capital) and published it in the annex of the Circular. Accordingly, the base share capital was set as 36,576,000 TL (approx. 2.35M EUR), similarly for life and non-life companies.

- **Capital adequacy level determined for 2022 in insurance, reinsurance and pension companies**

Furthermore, Circular No. 2021/25 and dated 26 November 2021 on Profit Distribution of Insurance, Reinsurance and Pension Companies describes a 20% security installation in the self-valuation stage. In this respect, it states without prejudice to the provisions of other legislation that regulate the companies whose shares are traded in the stock exchange, that the profit distributions to be made over the results of the 2021 financial statements of insurance, reinsurance and pension companies (including retained earnings and distributable reserves) should be limited to a level that does not reduce the capital adequacy level below 135% for the 2022 fiscal year.



In compliance with Turkish bar regulations, opinions relating to Turkish law matters that are included in this client alert have been issued by Özdirekcan Dündar Şenocak Ak Avukatlık Ortaklığı, a Turkish law firm acting as correspondent firm of Gide Loyrette Nouel in Turkey.

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