ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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INSURANCE (NON-LONG TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2020

CONSULTATION PAPER

CP19-05/T04

22 July 2019

This Consultation Paper is issued by the Isle of Man Financial Services Authority ("the Authority"), the regulatory authority responsible for the supervision of the financial services, insurance and pensions sectors in the Isle of Man.

What is it for?

This paper sets out the format of the Insurance (Non-Long Term Business Valuation and Solvency) Regulations for non-life insurers, provides background to how the Regulations have been produced, and finalises the Authority's view for consultation on all aspects of the Isle of Man's new risk based capital regime for non-life insurers.

Who is affected by it?

This document will be of direct interest to all existing and prospective insurance companies undertaking non-life insurance business in or from the Isle of Man.

Other parties with an interest in the Isle of Man non-life sector may also find this discussion paper and the issues raised of interest.

What consultation feedback is required?

We request all Isle of Man non-life insurers, reinsurers and any other interested parties to respond at their earliest convenience and by 13 September 2019 at the latest.

Feedback is also requested on the technical specifications.

Issue date	***22 July 2019***
Closing dates for responses	***13 September 2019***

Confidentiality

The information you send may be published in full or in a summary of responses.

All information in responses, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2015 and the Data Protection Act 2002). If you want your response to remain confidential, you should explain why confidentiality is necessary. Your request will be acceded to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.

1. Introduction

1.1. In line with the Authority's 2019 Roadmap, we are issuing the Insurance (Non-Long Term Business Valuation and Solvency) Regulations ("the Regulations") for non-life insurers for consultation.

1.2. Interested parties are invited to respond to the content and questions raised in this paper. The questions are set out in ***bold italics.***

1.3. Responses should be submitted to:

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2. Regulations

2.1. The Regulations cover the requirements for both Class 12 and non-Class 12 non-life insurers and are due to come into force on 1 July 2020.

2.2. The proposed criteria for determining Class 12 and non-Class 12 non-life insurers are covered in a parallel consultation paper CP19-04/T04.

2.3. The Regulations are based on the QIS5 technical specifications TS18-03(10) and TS18-03(200), and transpose requirements into Isle of Man secondary legislation.

2.4. The technical specifications previously issued by the Authority set out the detail of the calculations required to determine an insurer's solvency capital requirements and hence its solvency ratio under the Isle of Man's new risk-based capital regime. The Authority has refined the technical specifications and guidance they provide, over three QIS exercises, to reflect the characteristics of the Isle of Man's insurance industry.

2.5. As secondary legislation the Regulations do not include the guidance previously provided in the technical specifications. Where additional guidance is required by insurers, this will be published separately.

2.6. The Regulations have been drafted with the intention of communicating the calculations and formulae in a more accessible manner. To this end the technical detail for the calculations has been included as schedules to the main body of the Regulations.

2.7. The Regulations finalise the Authority's stance on the Minimum Capital Requirement applicable to non-life insurers. Further details are included later in this paper.

2.8. We request insurers provide comments on the proposed content of the draft Insurance (Non-Long Term Business Valuation and Solvency) Regulations 2020.

3. Amendments to the technical specifications

3.1. Premium and reserve risk SCR – contracts with term greater than one year

3.1.1. The SCR charge for premiums for future contracts has been amended to take account of the lower risk associated to future premiums from contracts with longer terms. Therefore, for future contracts with a term greater than one year, only 30% of the premium volume measure is to be taken into account when determining the charge.

3.1.2. The template has been updated and will calculate the reduction in premium volume measure on the insurer's behalf.

3.2. Counterparty default risk SCR – offsetting claims against parental loans

3.2.1. The Regulations have been amended to enable an insurer who loans money to its parent to reduce its counterparty SCR where it has a legally effective contractual arrangement in place with its parent, which allows an insurer to offset outstanding claims against outstanding loan balances.

3.2.2. Insurers should allow for this offsetting when calculating the loss-given-default for type 1 exposures.

3.3. Counterparty default risk SCR – 'pay-as-paid clauses'

3.3.1. The Regulations have been amended to enable an insurer, who has a legally effective clause in its insurance contracts to not pay claims in the event a counterparty (such as a reinsurer) defaults on its obligations, to reduce its counterparty default SCR accordingly.

3.3.2. Insurers should allow for this type of contractual arrangement when calculating the loss-given-default for their type 1 exposures.

3.4. Catastrophe risk SCR – marine risk SCR

3.4.1. The Regulations have been amended to replace 'tanker' in the Marine Risk SCR calculation with 'any marine vessel' in order to broaden the scope of the charge.

3.4.2. Marine vessel is defined as any sea worthy vessel (such as tankers, bulkers, container ships, roll on roll offs, cruise ships and fishing vessels) where the maximum hull value is greater than £250,000.

3.5. Spread risk SCR and market concentration risk SCR

3.5.1. The Regulations have been amended to allow for simplified calculations of the spread risk and market concentration risk SCRs.

3.5.2. Whilst the approach to both SCR calculations is simpler, there may be a small number of insurers for whom the more simplified approach results in a more prudent capital requirement. From analysing the QIS5 returns the Authority does not anticipate the impact on insurers to be material.

3.5.3. The return and the helper tabs have been updated accordingly and now require fewer inputs.

3.6. Use of stop loss insurance

3.6.1. The Regulations have been amended to make it clearer how aggregate stop loss insurance arrangements should be allowed for when determining the SCR.

3.6.2. Aggregate stop loss insurance arrangements that meet the requirements for risk mitigation techniques can be used to reduce the non-life and NSLT health underwriting risk capital requirements. The non-life and NSLT health SCR is limited to the insurer's retention under the stop loss arrangement.

3.6.3. The stop loss arrangement must provide for complete compensation for aggregated losses of the insurer that relate to claims during a specified time period and that are larger than a specified retention level.

3.6.4. The arrangement must be included as a type 1 exposure in the counterparty default risk SCR. For the counterparty default SCR calculation, the impact of the risk mitigation arrangement is the underwriting risk SCR less the retention limit under the stop loss arrangement.

3.7. Allowance for aggregate caps

3.7.1. The Regulations have been amended to make it clearer how contractual liability caps (or 'aggregate caps') should be allowed for when determining the SCR.

3.7.2. Contractual liability caps can be used to reduce the non-life and NSLT health premium and reserve risk SCR and catastrophe risk SCR.

3.7.3. The templates determine an insurer's premium and reserve volume measures taking into account the maximum residual exposure under the contract (i.e. the liability cap less any claims already settled during the exposure period).

3.7.4. Where an insurer has already reached its maximum exposure under the contract, there can be no further SCR charge.

3.7.5. For clarity, contractual liability caps do not need to be allowed for in the counterparty default risk SCR.

3.8. Risk Margin

3.8.1. The Regulations require insurers to determine an appropriate risk margin for each line of business, either using:

- the full method, where the risk margin is determined based on the run-off of the insurer's SCR over the lifetime of its obligations;
- a partial method, where the risk margin is determined based on the run-off profile of the insurer's obligations; or
- a simple method, where the risk margin is determined as a percentage of the insurer's best estimate.

3.8.2. Non-Class 12 insurers are required to use the full method, whereas Class 12 insurers can use one of the simplified approaches where it is deemed proportionate.

3.8.3. In QIS5, very few insurers made an attempt to determine a risk margin, even using the simplified approach, therefore for the launch of the new regime, the Authority has included an additional tab in the RER_NLT1_SCR_Form_Class_12_Insurers template which will require Class 12 insurers to determine a risk margin using at least one of the approaches in the regulations.

3.8.4. Overtime, as the new IFRS regime is implemented, the Authority will consider the use of accounting provisions to determine the risk margin as well as the best estimate.

3.8.5. ***We request Class 12 insurers consider the risk margin requirements and feedback where they have any concerns.***

3.9. Approved External Credit Assessment Institutions (EACIs)

3.9.1. The Authority has expanded its list of approved EACI's to include two more EACI's, Global Credit Ratings Co. and NACI.

3.9.2. The mapping table will be published on the Authority's website when the new regime goes live. For information, the table has been included as an appendix.

4. New Content in the Regulations

4.1. Minimum Capital Requirement ('MCR')

4.1.1. The Regulations set out the Minimum Capital Requirements for class 12 and non-class 12 insurers' non-life insurers.

4.1.2. When an insurer's own funds fall below the MCR the authorisation of that insurer will be withdrawn in cases where the insurer is unable to rectify the issue subject to a remedial plan and timeframe agreed with the Authority.

4.1.3. The MCR has been set to be a percentage of an insurer's SCR, subject to a minimum floor. This is similar to the MCR for life insurers. The percentage is calibrated to the 85% level for both class 12 and non-class 12 insurers:

- For non-class 12 insurers the MCR is set to 35% of the SCR, subject to an absolute floor of £500,000.
- For class 12 insurers the MCR is set to 75% of the SCR subject to an absolute floor of £100,000.

4.1.4. The higher percentage for class 12 insurers is required to calibrate the lower 1 in 10 year capital requirement to an 85% level.

4.1.5. Where an insurer does not hold sufficient own funds to meet its MCR, it will be required to raise additional capital to avoid a regulatory breach before the regime goes live. Grandfathering arrangements will be considered for the affected firms should they require additional time to comply.

4.1.6. For full details see Part 4 of the Regulations.

4.1.7. ***We request insurers provide comments on the Authority's proposed Minimum Capital Requirements.***

4.2. Capital Add-on

4.2.1. The Authority can adjust an insurer's SCR determined using the standard formula approach by way of a capital add-on.

4.2.2. A capital add-on adjustment will be made on an exceptional basis, and the use of a capital add-on by the Authority will be only as a measure of last resort, when other supervisory measures are ineffective or inappropriate.

4.2.3. A capital add-on will only be considered by the Authority in the following circumstances:

- The risk profile of an insurer deviates significantly from the assumptions underlying the SCR standard formula approach;
- The insurer's systems of governance deviate significantly from the requirements of the relevant CGC and those deviations prevent it from being able to properly identify, measure, monitor, manage and report the risks that it is or could be exposed to and that the application of other measures is in itself unlikely to improve the deficiencies sufficiently within an appropriate time-frame.

4.2.4. Any capital add-on applied will have a numerically positive value.

4.2.5. At a minimum, the capital add-on will remain in place for as long as the circumstances under which it was imposed are not remedied to the satisfaction of the Authority.

4.2.6. For full details see Regulation 24.

4.2.7. ***We request insurers provide comments on the Authority's proposal for applying capital add-ons.***

4.3. Data Quality

4.3.1. The Regulations introduce various data quality requirements that the insurer must comply with.

4.3.2. Under the new regime the insurer is required to have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of its technical provisions.

4.3.3. In addition, where data does not comply with the data quality requirements, the insurer is required to document appropriately the limitations of the data and how such limitations will be remedied.

4.3.4. For full details see regulation 22.

4.3.5. ***We request insurers provide comments on the Authority's proposed data quality requirements.***

4.4. Board Report

4.4.1. The Regulations require an insurer to prepare a report for its board on an annual basis which provides the board with sufficient information to enable it to adequately understand and assess the appropriateness of the key assumptions, expert judgements and results relating to the valuation of the insurers technical provisions and capital requirements.

4.4.2. This regulation applies whether the insurer is required to have an actuarial function or not.

4.4.3. For full details see regulation 8.

4.4.4. ***We request insurers provide comments on the Authority's proposed data quality requirements.***

5. Additional Information

5.1. Reporting Requirements

5.1.1. The Regulations do not cover the reporting requirements for non-life insurers as these will be consulted on as part of the Insurance Regulations 2020.

5.1.2. However, the Authority can confirm that the regulatory electronic returns will be consistent with the templates issued as part of the QIS exercises. The Authority intends to circulate the templates along with the Insurance Regulations consultation.

5.2. Requirements for insurers in run-off at 30 June 2020

5.2.1. The Authority is currently considering to what extent the draft Regulations will apply to insurers that are currently in run-off and for whom full compliance with the new regime may not be proportionate. The requirements for existing insurers in run-off will be consulted on along with the Insurance Regulations 2020, later this year.

Appendix: Association of credit assessments with credit quality steps

In accordance with the Insurance (Non-Long-Term Business Valuation and Solvency) Regulations 2020, the credit assessments of an External Credit Assessment Institution (ECAI) are to be associated with the following credit quality steps:

Credit quality step	**Standard & Poor**		**Moody**		**Fitch**	
Rating Type	*Long-term rating*	*Short-term rating*	*Long-term rating*	*Short-term rating*	*Long-term rating*	*Short-term rating*
0	AAA		Aaa		AAA	
1	AA	A-1+	Aa	P-1	AA	F1+
2	A	A-1	A	P-2	A	F1
3	BBB	A-2, A-3	Baa	P-3	BBB	F2, F3
4	BB	Lower than B	Ba	NP	BB	Lower than B
5-6	Lower than BB		Lower than BB		Lower than BB	
Credit quality step	**AM Best**		**NACI**		**Global Credit Ratings Co.**[1]	
Rating Type	*Long-term rating*	*Short-term rating*	*Long-term rating*	*Short-term rating*	*Long-term rating*	*Short-term rating*
0	aaa		1		AAA	
1	aa	AMB-1+	1	1	AA	A1+
2	a	AMB-1-	1	2	A	A1
3	bbb	AMB-2, AMB-3	2	3	BBB	A2, A3
4	bb	AMB-4	3	Lower than 4	BB	Lower than B
5-6	Lower than bb		Lower than 3		Lower than BB	

[1] These are the GCR International Scale Ratings. Please refer to the GCR website for how to map from a National Scale Rating to an International Scale Rating.