ISLE OF MAN
FINANCIAL SERVICES AUTHORITY
Lught-Reill Shirveishyn Argidoil Ellan Vannin

Consultation Response

Insurance (Fees and Solvency)(Amendment) Regulations 2024

CR24-02

Issue Date: 21 June 2024

Contents

Glossary

Authority	Isle of Man Financial Services Authority
Act	The Insurance Act 2008.
Fees Regulations	Insurance (Fees) Regulations 2023
OECD	Organisation for Economic Co-operation and Development
Pillar 2	OECD's Model GloBE Rules for Pillar Two
Risk margin	A component of an insurer's technical provisions.
Solvency Capital Requirement ('SCR')	As defined in the Act.
Valuation and Solvency Regulations	Together, the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021 and the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021

1. Background

This Consultation Response is issued by the Isle of Man Financial Services Authority following Consultation Paper CP24-04[1].

The purpose of the consultation was to obtain views in relation to the Authority's proposals to amend the –

- Insurance (Long-Term Business Valuation and Solvency) Regulations 2021;
- Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021; and
- Insurance (Fees) Regulations 2023.

2. Summary of Responses

A full summary of responses can be found in appendix B.

(a) Support for changes to risk margin and loss adjusting capacity of deferred taxes adjustment

The responses were supportive of the proposed changes to the risk margin.

Two respondents queried whether the Authority would consider reinstating the additional deduction to the risk margin that is currently in place[2], once the outcome and impact of the global pillar 2 tax changes on insurers is fully understood. The Authority would be open to reconsidering the appropriateness of the risk margin to the Island's insurance industry once the consequences of the tax regime changes have materialised. However, at this time it does not have sufficient evidence to continue to apply the historic 1% reduction.

(b) Support for the introduction of the loss adjusting capacity of deferred taxes adjustment

The responses were supportive of the proposed introduction of the loss adjusting capacity of deferred taxes adjustment for non long-term business insurers. No material comments or questions were raised.

(c) Support for the other minor amendments

Only a small number of comments/questions were received on the other minor amendments. A summary of these and the responses provided by the Authority can be found in Appendix B.

[1] CP24-04 Update to the Insurance Solvency Framework and Insurance Fees Regulations - Cabinet Office of the Isle of Man Government - Citizen Space

[2] The current framework applies a 1% reduction to the Solvency II risk margin to reflect that the Isle of Man's lower tax environment reduces the cost of carrying on insurance business on Island. With the potential introduction of the global Pillar 2 tax rules, it is expected that some Island insurers may be subject to some level of tax in the future.

(d) Support for the Insurance (Fees) 2023 amendments

All respondents were supportive of the proposed changes. No comments or questions were received.

3. Changes to the Proposals

As a result of the responses received the Authority has made the following additional changes to the regulations. A marked-up version of the final regulations can be found in Appendix C. The blue text is the original proposed changes and the red text is the additional amendments.

(a) Changes made due to the deferment of the Insurance Regulations 2024

Originally, the draft Insurance (Fees and Solvency)(Amendment) Regulations 2024 and the draft Insurance Regulations 2024 were intended to come into operation on the same day, and as such the draft Insurance (Fees and Solvency)(Amendment) Regulations 2024 included references to changes being brought in by the Insurance Regulations 2024.

Due to the need for certain aspects of the draft Insurance Regulations 2024 requiring more consideration and engagement with industry before being finalised, the making of the Insurance Regulations 2024 has been deferred.

Hence, any reference to the Insurance Regulations 2024 in the draft Insurance (Fees and Solvency)(Amendment) Regulations 2024 has reverted back to the Insurance Regulations 2021, and any regulations relating to new provisions or changes proposed under the Insurance Regulations 2024 have been removed. This includes:

- References to standby insurer have been replaced with the original term ‘dormant insurer’;
- Part 2, amendments to the Insurance (Fees) Regulations 2023 has been removed; and
- The explanatory note has been amended to remove references to changes to the Insurance (Fees) Regulations 2023.

As a consequence of this, the Insurance (Fees and Solvency)(Amendment) Regulations 2024 has been renamed the Insurance (Valuation and Solvency) (Amendment) Regulations 2024.

The deferred changes will all be brought in at a later date, at the same time as the deferred Insurance Regulations 2024.

(b) Simplified calculation of the best estimate for class 12 insurers

There was some concern from insurance managers around the removal of a practicability test in regulation 18(2) of the non long-term business regulations, which enables insurers to use their accounting provisions as their best estimate provisions (insurers currently have to justify that it is practicable <u>and</u> proportionate to use the simplification). Managers were concerned that this would prevent some insurers from being able to use the simplification.

The intention of the change was actually to reduce the burden of compliance and make the simplification easier to apply.

The Guidance Notes and Information Concerning Insurance (Valuation and Solvency) Regulations were published on 24 May 2023. Guidance Note 6(4) clarified that the Authority considered it always proportionate for a class 12 insurer to use Regulation 18(2) unless one of the factors included in 6(4)(b)[3] are met, in which case an insurer must use Regulation 18(1).

Given that the Authority had already deemed it proportionate for a class 12 insurer to use Regulation 18(2), it felt that the practicability test was no longer required, and could be an unnecessary hurdle for insurers to have to overcome to use regulation 18(2).

Hence, an insurer wishing to use 18(2) is now able to do so automatically (without having to carry out a practicability or proportionality test), unless it exhibits one of the factors in guidance note 6(4)(b). For example, if an insurer is aware that the discount rates it uses to determine its accounting provisions are higher than the rates published by the Authority then the simplification cannot be automatically applied, and the insurer will be required to seek approval from the Authority in order to use the simplification.

For information, a further change has been made following the consultation which extends the use of regulation 18(2) to all non long-term business insurers unless they have been deemed a commercial non long-term business insurer under the ‘Guidance Notes and Information Concerning Various Insurance Regulations and the CGC’.

An updated ‘Guidance and Information Note concerning Insurance (Valuation and Solvency) Regulations’ has been published on the website.

(c) Simplified calculation of the best estimate for non-commercial class 3-9 and 11 insurers.

The Authority is currently amending its requirements for class 3-9 and 11 insurers who are not deemed to be commercial non long-term business insurers (as defined in the Guidance Notes and Information Concerning Various Insurance Regulations and the CGC’) and one of these amendments will be the removal of the requirement to have an actuarial function.

It is therefore possible that non-commercial class 3-9 and 11 insurers will no longer have access to the expertise required to determine best estimate provisions under Regulation 18(1) and that this may increase the risk of inaccurate and inappropriate best estimate provisions being determined.

At the same time, the Authority will be removing the SCR audit requirement for these class 3-9 and 11 insurers. Hence the level of independent oversight of the calculation of the best estimate provisions is also being reduced.

[3] These include where a higher discount rate is used in the financial statements than would be under the valuation and solvency regulations, or where an insurer has contracts extending across multiple years.

Given the above, the Authority has decided to allow all non-commercial insurers to have the option to use regulation 18(2), and set their best estimate provisions to be equal to their accounting provisions, should they choose to do so. This will have the following benefits:

- The technical provisions on an accounting basis are likely to be more prudent than the best estimate provisions determined under regulation 18(1), hence the risk of an understated SCR through inappropriate determination of best estimate provisions under Regulation 18(1) is reduced;
- The accounting provisions remain subject to independent oversight through the external audit; and
- Insurers can still choose to use regulation 18(1) where they have sufficient expertise available, and can benefit from lower best estimate provisions and hence SCR.

Please note that Guidance note 6 of the Guidance Notes and Information Concerning Insurance (Valuation and Solvency) Regulations has been amended to apply to all non-commercial non long-term business insurers, and hence insurers are not allowed to use Regulation 18(2) where one of the factors in guidance note 6(4)(b) applies.

(d) Simplified calculation of the risk margin for non-commercial class 3-9 and 11 insurers

For the same reasons as for applying the best estimate assumption above, the Authority has decided to allow non-commercial class 3-9 and 11 insurers to use the same simplified risk margin calculation as can currently be used by a class 12 insurer.

The returns have been updated to include a risk margin calculation tab.

Insurers are still able to use the full risk margin calculation approach should they wish to do so (as this might result in a lower risk margin).

(e) Treatment of called up but unpaid by more than 3 months share capital

One respondent queried the Authority’s proposal to require called-up but unpaid by more than 3 months share capital to receive a more penal Tier 3 own-fund SCR treatment.

The Authority views this treatment as appropriate because an insurer’s own-funds should be immediately and permanently available should an insurer be subject to a stress situation. The Authority’s concern with called-up but unpaid share capital is that it is possible that the provider of the share capital could default on its commitment to pay in this share capital in times of distress.

However, the Authority does acknowledge that there may be legitimate situations where called-up share capital may remain unpaid for durations longer than three months. Hence, it has subsequently amended Regulation 111 and 116 of the Insurance (Long-Term Business Valuation and Solvency) Regulations and Regulation 75 and paragraph 3 of Schedule 9 of the Insurance (Non Long-Term Business Valuation and Solvency) Regulations to include called-up but unpaid by more than 3 months share capital as an allowable ancillary own-fund.

Therefore, under the changes, an insurer can apply to the Authority for approval to treat the called-up but unpaid by more than 3 months share capital as Tier 2 ancillary own-funds.

(f) Clarification for the composition of own-funds to meet the SCR

Internal feedback was received that the drafting of Regulation 109 of the Insurance (Long-Term Business Valuation and Solvency) Regulations and Regulation 73 of the Insurance (Non Long-Term Business Valuation and Solvency) Regulations was ambiguous and could be interpreted differently. To avoid this the wording has been amended to remove the ambiguity.

4. Next Steps

The Authority made the Regulations on the 20 June 2024 to come into operation on 30 June 2024. The amendments will be reflected in keeling versions of the:

- Insurance (Long-Term Business Valuation and Solvency) Regulations 2021; and
- Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021,

which will be available on the Authority's website shortly.

The Authority has published updated returns on its website. These should be used by all insurers for return submissions on or after 30 June 2024.

The Authority has published an updated 'Guidance Note and Information on the Valuation and Solvency Regulations' and 'Guidance Note on Various Insurance Regulations and the CGC' which can also be found on the website.

In case of any query, please contact the undersigned —

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Appendix A – List of Groups to which this Consultation Response has been sent

- Isle of Man Captive Association
- Isle of Man Insurance Association

Appendix B – Summary of Responses

1. Do readers agree to the proposed approach to amend the risk margin calculation? If not, why?		
No.	**Responses (Anonymised)**	**FSA Response**
1	The reduction in the risk margin from 5% to 4% can only be positive however it would be preferable if the risk margin was part of the SCR calculation rather than a deduction to capital.	Noted.
2	Update to the risk margin calculation – Update is to reduce the cost of capital to 4% and introduce a tapering floor to the Risk Margin calculation, in line with Solvency II UK. Allowing for these updates improves the overall solvency coverage of [the insurer]. Given the developments in the UK on this matter I would be supportive of the proposed amendment in full.	Noted.
3	[The insurer] does not object to the proposed amendment to the risk margin calculation. [The insurer] recognises that the proposed approach will bring IOM in line with UK and will in effect remove a potential competitive advantage for long term insurance companies domiciled in the Isle of Man. This is not thought to be a material driver of [the insurer's] business model.	Noted.
4	We agree with the proposed approach regarding the amendment to the Risk Margin calculation and note the reduction in the cost of capital factor from 5% to 4% which would be congruent with the UK.	Noted.
5	We are supportive of the proposed approach to amend the risk margin calculation. We note the Authority's comments relating to the Island currently considering its approach to the OECD Pillar 2 tax reforms and the associated removal of the 1% reduction to the cost of capital rate used to determine the risk margin relative to the UK/EU. Once the Island's position in relation to the OECD Pillar 2 tax reforms is clearer, would the Authority seek to reinstate the 1% deduction to the costs of capital rate used to determine the risk margin, if appropriate?	See response in 2(a).
6	[The insurer] agrees with the proposed approach to amend the RMC, as this is in line with the UK changes with the impact already quantified.	Noted.
7	We agree with the proposal to decrease the risk margin from 5% to 4%, which aligns the IOM with recent international developments. However, in order to maintain its competitive advantage, we would advocate for a further reduction of 1%, as previously implemented. In our experience with non-long term insurers, it is evident that not all captives will be impacted by the Pillar 2 tax reforms, prompting consideration as to why the wider industry should bear the consequences.	See response in 2(a) and noted.
8	The company agrees to the proposed approach to amend the risk margin calculation.	Noted.

9	We are in agreement with the proposed changes to the risk margin. Overall, we believe that the lower cost of capital is more appropriate to insurance businesses such as [the insurer], with a very long run-off period and significant non-market SCR components. The proposed new approach would produce a risk margin and an SCR that is more meaningful.	Noted.
8	We welcome the change in methodology which for [the insurer] has the effect of reducing volatility in the calculation of our risk margin. However, we note that the change in margin, decreases the capital advantages of Isle of Man insurers over the UK. Please could the Authority explain how this change will not lead to capital issues for small/ capital restricted insurers?	The 1% reduction in the cost of capital has a positive impact on all insurers, resulting in lower risk margins and a freeing up of capital. Please also see the response in 2(a).

2. Do readers agree to the adjustment for the loss adjusting capacity of deferred taxes being included within the non long-term business valuation and solvency regulations? If not, why?		
No.	**Responses (Anonymised)**	**FSA Response**
1	Deferred taxes – It seems logical that this amendment is accepted.	Noted.
2	We agree to the adjustment for the loss adjusting capacity of deferred taxes being included within the non long-term business valuation and solvency regulations owing to the expected impact of the Pillar II tax regime requirements.	Noted.
3	As the emphasis is on "could benefit" then this can be seen as a positive development. The Authority will need to confirm which asset line in the NLT return this value should be included in.	Noted. The Loss adjusting capacity of deferred tax adjustment is a deduction applied to the SCR, after the other SCR risk submodules have been applied. The return has been updated accordingly and is available on our website.
4	The company has no comments or objections to these proposals.	Noted.

5	We confirm our agreement to this proposal.	Noted.

3. Do readers have any comments on any of the proposed minor amendments to the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021 or the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021?

No.	**Responses (Anonymised)**	**FSA Response**
1	In Appendix B, Regulation 18 the removal of “practicable” makes us slightly nervous that the IOMFSA might expect full discounted cash flows to be carried out. Some self-managed small insurers (if any still exist) may find this difficult.	See response in 3(b).
2	Regulation 18: We would prefer that a class 12 insurer was allowed to use its accounting provisions as its best estimate provisions without requirement to demonstrate that it is proportionate (similar to the approach proposed for Regulation 21 in the consultation). The requirement to demonstrate proportionality could be requested on an exception basis should the Authority deem this to be necessary.	
3	By removing the word "practicable", if proportionality cannot be applied, it will lead to additional work in calculating full discounted best estimates. We assume, therefore, that the Authority considers accounting provisions may be driving materially undervalued best estimates. We would like to request guidance on what is considered proportional. We would like the Authority to consider leaving practicable in, or can the captive decide whether it uses accounting provisions or best estimate?	
4	Regulation 18: We would request that the Authority consider whether, if proven that there is no material difference and it is proportionate, that the accounting basis could be used to determine the calculation of best estimate technical provisions for insurers that hold a 3-9 insurance licence. The Insureds’ data is available for any period which would be required for the determination of historic materiality.	See response in 3(c).
5	Regulation 21: We would request that the Authority consider the simplification of the risk margin calculation in respect of class 3-9 insurance licence holders which could be calculated in accordance with the class 12 return, if proven that there is no material difference and it is proportionate. This should be in line with the proposed amendments to Schedule 10.	See response in 3(d).
6	Schedule 9: We would question the requirement to treat called up but unpaid share capital and related share premium, that is not due to be received within the corresponding	See response in 3(e).

	three months, as Tier 3 rather than Tier 2 capital for own funds purposes in respect of existing insurers. The called up but unpaid share capital and related share premium is limited to 50% of the SCR amount and further subject to counterparty default risk, which we would suggest is commensurate to the risk. Following our conversation, we understand that the called up but unpaid share capital and related share premium may be eligible as an ancillary own-fund item subject to approval of the Authority under Regulation 75 which will ensure that the own funds total is not adversely affected.	
7	We are supportive of the proposed minor amendments to the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021.	Noted.
8	It will be difficult to justify to a client that does not hold cash deposits for >3months why a 1 year term should be applied. A simple spread risk example shows that 100m / Rating 2 / held 1 yr generates a 700k SCR, whereas a 92/365 term generates 176k, therefore SCR requires a further 524k of SCR. Can we also have a 3/6 month term?	This query relates to the clarification that the duration used in the spread risk SCR sub-module must be greater than or equal to 1. This is not a new change, and the formula in the return has always reflected the floor of 1. The Authority notes that there is frustration around the duration having a floor of 1 when many insurers have applicable exposures to spread risk that are of a lower duration. The calibration of the Authority's spread risk module is taken from the European Insurance and Occupational Pension Authority's Solvency II framework. As such the Authority is not in a position to amend the underlying calibration as it's not clear what the implications on the results of the calculation would be, for example it may no longer reflect a 99.5% confidence level.

9	Would prefer Class 12 simplification to permit 1 reputable rating agency as opposed to ensuring all rating agencies were considered, to reduce Class 12 workloads.	Where multiple credit quality assessments are available from different agencies, the Authority believes these should be considered to ensure that ‘cherry picking’ the best rating is avoided.
10	Clear definition of "called up" required.	The Authority believes this to be a standard, widely understood term (for example, where the insurer is a company, the meaning is given in the relevant companies act under which the insurer is established) and therefore is not intending to provide a definition.
11	Given the imminent introduction of UK captive legislation and comparison to our competitors, are these changes necessary at this time?	The Authority felt it was appropriate for insurers to be able to benefit from the changes to the risk margin and loss adjusting capacity of deferred tax adjustment as soon as possible.
12	The company has reviewed the proposed minor amendments and has no comments or objections in respect of these.	Noted.
13	We do not have any comments or concerns in relation to these two proposals.	Noted.
14	No Comments.	Noted.

4. Do readers agree to the amendments to the fees regulations? If not, why?		
No.	**Responses (Anonymised)**	**FSA Response**
1	No comments	Noted.
2	[The insurer] do not object to the fee amendments.	Noted.
3	We agree to the proposed amendments of the fee regulations.	Noted.
4	The clarifications to the definitions is appreciated and we are supportive of the proposed amendments.	Noted.

Appendix C – Updated draft Regulations

See separate document attached.