ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

Lught-Reill Shirveishyn Argidoil Ellan Vannin

Consultation Paper

Insurance (Fees and Solvency) (Amendment) Regulations 2024

CP24-04

Issue Date: 03 April 2024
Closing Date: 17 May 2024

Consultation Paper – CP24-04

This Consultation Paper ('Paper') is issued by the Isle of Man Financial Services Authority (the Authority), which is the regulatory body for financial services in the Isle of Man.

The purpose of the consultation is 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 (Fee) Regulations 2023.

The consultation is relevant to existing Isle of Man authorised insurers or their advisors, applicants for authorisation or their respective advisors and registered insurance managers.

The closing date for comments is **17 May 2024**.

Please send comments in writing and preferably by email to:

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Email: sian.eltman@iomfsa.im

Confidentiality and Data Protection

The information you send may be published in full or in a summary of responses. All information in responses, including personal data, 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 2018) with which the Authority is obliged to comply. The Authority is registered with the Information Commissioner as a data controller under Isle of Man data protection legislation. It collects and processes personal data to carry out its functions under relevant legislation and may share personal data with other parties where there is a legal basis for doing so. Further information on how the Authority collects and processes personal data can be found in the Privacy Policy on the Authority's website: https://www.iomfsa.im/terms-conditions/privacy-policy/.

If you have a query in relation to how this consultation has been carried out, please contact the Authority's Legal & Policy Division by email at Policy@iomfsa.im or by telephone on +44 1624 646000.

Contents

Glossary

Act	The Insurance Act 2008.
Authority	Isle of Man Financial Services Authority.
Fees Regulations	Insurance (Fee) 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. Introduction

1.1 What is the purpose of this Consultation Paper?

The purpose of the consultation is 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 (Fee) Regulations 2023.

1.2 Who may be affected by this Consultation Paper?

The consultation is relevant to existing Isle of Man authorised insurers or their advisors, applicants for authorisation or their respective advisors and registered insurance managers.

2. Consultation Process

2.1 The Authority's regulatory objectives

The Authority's regulatory objectives are set out in section 2(2) of the Financial Services Act 2008 as —

(a) securing an appropriate degree of protection for policyholders, members of retirement benefits schemes and the customers of persons carrying on a regulated activity;
(b) the reduction of financial crime; and
(c) the maintenance of confidence in the Island's financial services, insurance and pensions industries through effective regulation, thereby supporting the Island's economy and its development as an international financial centre.

The Authority must consider certain factors when discharging its functions in accordance with paragraph 3 of Schedule 1 to the Financial Services Act 2008. The most relevant factors for this consultation are considered as follows:

No	Factors
1.	The need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden.
2.	The desirability of implementing and applying recognised international standards.
3.	The need to safeguard the reputation of the island.

No	Factors
4.	The international character of the financial services, insurance and pensions industries and their markets and the desirability of maintaining the competitive position of the Island.
5.	The desirability of facilitating the development of the financial services, insurance and pensions industries.

2.2 Responding to the Consultation Paper

Open dialogue with stakeholders is an essential element for successful development of the Authority's proposals. Constructive feedback will help the Authority reach an informed decision on the content of the proposals and manner of implementation. Respondents should note the following when responding to this Paper:

- Submissions received by the closing date of the consultation will be considered but may not necessarily result in a change to the proposals following a review of all responses received.
- Professional bodies, trade associations and other representative groups should provide a summary of the people and organisations they represent when responding to a consultation as well as the methodology used to gain members' input.
- The Authority requests that submissions are not made anonymously as they will not be considered or included in the Feedback Statement.

All responses must include the name of the respondent, the name of the organisation the response is being made on behalf of, and whether we can publish the response in full, anonymously or not at all.

This Consultation Paper has been published on the Authority's website and the Isle of Man Government's Consultation Hub[1]. A list of specific representative groups to which this Consultation Paper has been sent is shown in Appendix A.

The Authority has included a number of questions in this document; however, readers are not limited to responding only to those questions.

3. Proposals

3.1 Insurance (Fees and Solvency) (Amendment) Regulations 2024

Attached in Appendix C is a copy of the draft Insurance (Fees and Solvency) (Amendment) Regulations 2024. The Authority has endeavoured to highlight changes made in the draft (compared to the current version) of the Valuation and Solvency Regulations and the Fees Regulations by using blue text (deletions are not shown). The changes, where considered necessary, are explained below.

[1] https://consult.gov.im/

3.2 Executive summary

In summary, the proposals are in 2 parts, Part 1 (Valuation and Solvency Regulations) and Part 2 (Fees Regulations):

Part 1 (Valuation and Solvency Regulations)

The proposed amendments to the valuation and solvency regulations -

- update the Risk Margin calculation methodology and various factor tables in line with international developments;
- enable non long-term business insurers to reflect the impact of the potential Pillar 2 tax reforms within their Solvency Capital Requirement through the loss adjusting capacity of deferred taxes adjustment (noting this is already available to long-term business insurers); and
- fix a number of minor 'snagging' issues identified since the Valuation and Solvency Regulations came into operation in 2022.

Part 2 (Fees Regulations)

The proposed amendments to the fees regulations –

- give the Authority the ability to resolve any difficulties in using –
    - "GTP" (gross technical provisions);
    - "GWP" (gross written premium);
    - "total accounting liabilities" or
    - "turnover",

  as a basis for regulatory fees;
- take account of changes made in the Insurance Regulations 2024, including the impact on regulatory fees from changes made to –
    - class 13; and
    - clarification of the Authority's approach to the authorisation and permission of composite insurers; and
- specify one fee level in respect of an application for an order sanctioning a scheme for the transfer of long-term business.

4. Part 1 (valuation and solvency regulations)

4.1 Update to the Risk Margin Calculation

The Risk Margin forms part of the value of an insurer's technical provisions. It seeks to ensure that the valuation of an insurer's insurance obligations is in line with what another party would require to accept those obligations in an arm's length transfer. In this way, the Risk Margin protects policyholders by giving them a high degree of confidence that they will continue to have a claim on a viable business. It also strengthens the safety and soundness of insurers.

Recent international developments in the UK and EU have highlighted that the current standard approach to the risk margin calculation shows a tendency to produce more volatile and higher values than expected to be observed in arm's length transactions, particularly in the case of long-term insurance business.

As a consequence of this, the UK amended its risk margin calculation with effect from 1 January 2024, and the EU has committed to make similar changes to its Risk Margin calculation in 2026. At the time of proposing the changes, the UK expected the changes would result in around a 65% cut in risk margin for long-term insurance business and a 30% cut in risk margin for non long-term business[2].

To date, the Authority has adopted the same Risk Margin calculation approach as the UK and EU, but with a 1% reduction in the cost of capital rate (i.e. 5% rather than 6%) due to the Isle of Man's low tax environment.

The Authority is intending to update its Risk Margin calculation in line with the changes being made in the UK, and as such is proposing:

- A reduction in the cost of capital factor from 5% to 4%.
- The introduction of a time dependent tapering factor to reduce the value and volatility of the risk margin for long-term business. [The tapering factor is not being introduced for non long-term business due to its predominantly short term nature.]
- The introduction of a tapering floor to provide a safeguard and to ensure that the Risk Margin does not fall below a certain level compared to the current calculation.

The Island is currently considering its approach to the Pillar 2 tax reforms (see section 4.2). This means that it is possible that some authorised insurers (both long-term business and non long-term business) may be subject to higher tax in future. As such, a reduced cost of capital rate due to low tax advantages is potentially no longer appropriate in all circumstances, therefore the Authority is proposing not to reduce the cost of capital rate applied in the UK/EU by 1% as has been done previously.

Subject to the responses to this consultation, the Risk Margin calculation in the Valuation and Solvency Regulations will be amended to reflect the new approach.

Question 1
Do readers agree to the proposed approach to amend the Risk Margin calculation? If not, why?

[2] Noting these estimates were made when interest rates were at historically low levels.

4.2 Introduction of the loss absorbing capacity of deferred taxes adjustment – applicable to non long-term business insurers only

On 20 December 2021 the OECD released the Model GloBE[3] Rules for Pillar 2. Pillar 2 seeks to ensure that multinational entities pay a minimum level of tax on their profits. The rules came into force on 1 January 2024 for jurisdictions that had signed-up in advance. The Isle of Man Government is currently considering its approach in respect of Pillar 2.

The Insurance (Long-Term Business Valuation and Solvency) Regulations 2021 currently enables insurers to use a 'loss-absorbing capacity of deferred taxes' adjustment. The loss-absorbing capacity of deferred taxes adjustment reflects the fact that new deferred tax assets would be booked in the event that the insurer incurred unexpected losses, hence resulting in an increase in own funds.

This same adjustment was not included in the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021 to achieve simplicity (as it was not relevant to the majority of non long-term business insurers at that time).

The potential change in tax requirements means that it is now possible the loss-adjusting capacity of deferred taxes adjustment could benefit non long-term business insurers that are part of large international groups. Hence, the Authority is proposing to proactively amend the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021 to include the same loss absorbing capacity of deferred taxes adjustment as the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021.

For further information on the loss-adjusting capacity of deferred taxes adjustment, please see this note published by the European Insurance and Occupational Pensions Authority.

Question 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?

4.3 Other minor amendments

The Authority has taken this opportunity to include several minor amendments for snagging issues that have been identified since the valuation and solvency regulations came into operation in 2022, and to update the SCR factors and tables in line with international experience. Full details of each change can be found in Appendix B – Details of Additional Changes.

[3] GloBE stands for Global Anti-Base Erosion.

Question 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?

5. Part 2 (fees regulations)

5.1 Regulation 36 – regulation 3 amended

Regulation 36:

- **sub-paragraph (a)** defines "approved supervisor" as it is used in the amended fee tables;
- **sub-paragraph (b)** updates the definition of "category" or "class" consequential to changes made in the Insurance Regulations 2024;
- **sub-paragraph (c)** refines the definition of "group";
- **sub-paragraph (d)** defines "controlling interest" as it is used in connection with material change of control;
- **sub-paragraph (e)** updates cross references, where applicable, which now refer to the Insurance Regulations 2024;
- **sub-paragraph (f)** omits the term ISPV as it is no longer used in the Fees Regulations;
- **sub-paragraph (g)** provides a definition of "permitted" as it is used in the fee regulations;
- **sub-paragraph (h)** provides a definition of "registered" as it is used in the fee regulations;
- **sub-paragraph (i)** corrects terminology used in respect of permits; and
- **sub-paragraph (j)** makes a clarifying amendment in connection with the calculation of "total accounting liabilities".

5.2 Regulation 37 – regulation 5 amended

Regulation 37: removes sub-paragraphs (10) and (11) of regulation 5, as the equivalent of ISPV fees (class 13 fees) under the Insurance Regulations 2024 will not be fixed forward on a case-specific basis.

5.3 Regulation 38 – new regulation 5A

Regulation 38: gives the Authority the ability to resolve any difficulties in using –

- "GTP" (gross technical provisions);
- "GWP" (gross written premium);
- "total accounting liabilities" or
- "turnover",

as a basis for regulatory fees. This may help, for example, if the adoption of accounting standards adversely impacts the ease with which such figures may be derived from an insurer's financial statements (which might be the case, for example, with International Financial Reporting Standard (IFRS) 17 – Insurance Contracts).

5.4 Schedules 1 to 5 amended

The amendments to schedules 1 to 5 –

- take account of changes made to the Insurance Regulations 2024, including the impact on regulatory fees from changes made to –
    - class 13 (where class 13 fees are generally set at 80% of existing fees applicable to class 12); and
    - clarification of the Authority's approach to the authorisation and permission of composite insurers (where fees are the sum of any long-term business and non-long-term business fees applicable to the classes held by the insurer); and
- specify one fee level in respect of an application for an order sanctioning a scheme for the transfer of long-term business.

Question 4
Do readers agree to the amendments to the fees regulations? If not, why?

6. Questions (summary of the questions as appearing in 4 and 5)

Questions
1. Do readers agree to the proposed approach to amend the risk margin calculation? If not, why?
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?
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?
4. Do readers agree to the amendments to the fees regulations? If not, why?

7. Next Steps

Following closure of the consultation period on **17 May 2024**, the Authority will review the responses received and publish a Feedback Statement on the Authority's website and the Isle of Man Government's Consultation Hub.

Following the making of the amendment regulations, the Authority will publish new versions of the LTB_Return, NLT_Return_Class_12 and NLT_Return_Classes_3-9&11 which incorporate the changes to valuation and solvency regulations.

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

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

Appendix B – Details of Additional Changes

Proposed changes to the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021:

- References to 'dormant insurer' are being updated to 'standby insurer' in line with proposed changes to the Insurance Regulations 2021, and references to the Insurance Regulations 2021 are being updated to the Insurance Regulations 2024.

- Regulation 18 (Calculation of the best estimate), paragraph 18(2) requires a class 12 insurer to demonstrate that if it is not practicable or proportionate for it to use the full discounted cash flow approach to determine its best estimate provisions (i.e. in accordance with paragraph 18(1)), then it can use its accounting provisions as its best estimate provisions.

  The Authority has reconsidered this stance and believes it should always be practicable for a class 12 insurer to carry out the full discounted cash flow approach (i.e. as an authorised insurer, a class 12 insurer should have sufficient technical capability and resource to carry out such an assessment). Hence, paragraph 18(2) is being amended so that only the proportionality test applies.

- Regulation 21 (Calculation of the risk margin), paragraph 21(3) allows a class 12 insurer, where it is not practicable or proportionate for it to use the full Risk Margin calculation approach (i.e. in accordance with regulation 21(2)), then it can use a simplified approach.

  The Authority has reconsidered this stance and has determined it is practicable and proportionate for all class 12 insurers to use a simplified approach to determining the Risk Margin. Hence paragraph 21(3) is being amended to remove the practicable and proportionate test.

- Regulation 33 (Equity risk capital requirement), sub-paragraph (1)(b) is being amended to add additional clarity to the definition of 'type 2' equities.

- Regulation 36 (Spread risk capital requirement), paragraph 36(8) is being amended to clarify that the minimum modified duration of 1 year applies to sub-paragraphs 36(2)(a) and 36(2)(b) and paragraph (7).

- Regulation 38 (Counterparty default risk capital requirement), sub-paragraphs 38(3)(g) and 38(4)(a) are being amended to provide additional clarity in respect to exposures to entities within the same corporate group.

- Regulation 40 (Premium and reserve risk capital requirement), paragraph 40(6), and Regulation 59 (NSLT health premium and reserve risk capital requirement), paragraph 59(7), are being amended to make it clear that the reinsurance premiums netted off should be gross of reinsurance commission.

- A minor correction is being made to Regulation 41 (Lapse risk capital requirement), paragraph 41(1) to clarify that the capital requirement for lapse risk is the reduction in value of an insurers basic own funds following an instantaneous permanent decrease in any profit that has been anticipated within an insurer's insurance contracts.

- Clarification is being added to Regulation 54 (Fire risk capital requirement) to make it clear how the largest fire concentration risk should be determined, and how the capital requirement for fire risk should be determined.

- Regulation 64 (Pandemic risk capital requirement) is being updated to include an element to reflect medical expense pandemic risk and a new paragraph in Schedule 2 (Factors, tables and lists), paragraph 9(10) (NSLT health risk factors), is being added to include the applicable factors for use in the medical expense pandemic risk calculation.

- Schedule 2 (Factors, tables and lists) is being amended as follows:
    - paragraph 4(1) (Currency risk capital factors) is being extended to include a category for all other currencies not already included in the table. This is to be used for immaterial currency exposures to currencies not already listed in the table. Where an insurer has a material exposure to a currency not listed in the table it should continue to request approval from the Authority under paragraph 4(2) as to how the exposure should be treated;
    - paragraph 5(2) (Spread risk factors) is being extended to include factors for unrated bonds and loans;
    - paragraph 6(3) (Market concentration risk factors) is being amended for clarification of the factor used for unrated incorporated banks;
    - paragraph 7(4) (Counterparty default risk factors) is being amended to provide clarity on the treatment of exposures in the approved entities list in Schedule 4. These exposures are deemed to have no risk of default and can therefore be excluded from the counterparty default risk SCR;
    - paragraph 7(8) (Counterparty default risk factors) is being amended to aid clarity in the application of the paragraph to other types of group exposure; and
    - paragraph 8(8) (Underwriting risk factors), paragraph 9(7) and paragraph 9(9) (NSLT health risk factors) are being updated to reflect new factors published.

- Schedule 8 (Requirements for the use of external credit assessments) is being amended to provide additional clarity on how to determine the correct assessment for certain types of exposures.

- Schedule 9 (Assessing the quality of basic own fund items into Tier 1, Tier 2 and Tier 3) is being amended as follows:
    - paragraph (1) (Tier 1 basic own fund items) sub-paragraphs (4) and (5) have been amended to correct an invalid reference and to clarify when a dividend is deemed to be foreseeable;
    - paragraph (2) (Tier 2 basic own fund items), sub-paragraph (1) has been updated to make it clear that (1)(a) relates to called-up but unpaid ordinary share capital and the related share premium account.
    - paragraph (2) (Tier 2 basic own fund items), sub-paragraph (2) has been updated to restrict the duration that eligible Tier 2 own fund items can be called-up but remain unpaid for. If they remain unpaid beyond the restriction, then they will be classed as Tier 3 own funds.

      Such a duration restriction was always a requirement of the technical specification in the QIS exercises, but was accidently omitted from the Regulations. The Authority does not believe it is appropriate to allow share capital to be called-up but unpaid indefinitely, as there is no certainty that these own fund items would be available to absorb losses in a stress scenario. Insurers who currently allocate called-up but unpaid share capital to Tier 2 own funds should assess the impact on their solvency position of this change;

    - An extra sub-paragraph (3) has been included under paragraph (3) (tier 3 basic own fund items) to capture basic own fund items that do not meet the features of Tier 1 or Tier 2 and are not included in the existing list of Tier 3 own fund items. For clarity, where an insurer has called-up but unpaid own funds that have been unpaid for more than three months, these own funds would be captured here and hence would be Tier 3 own funds.

- Schedule 10 (Risk margin calculation), paragraph 1 (Assumptions underlying the risk margin calculation) is being amended to include an extra sub-paragraph (5) to provide for the circumstance where an insurer wishes to use a simplified approach for determining its SCR in a particular future year, rather than carry out a full projected SCR calculation. This was allowable under the QIS exercises' technical specifications and a number of insurers are currently utilising one of the simplified approaches.

Proposed changes to the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021:

- References to ‘dormant insurer’ are being updated to ‘standby insurer’ in line with proposed changes to the Insurance Regulations 2021, and references to the Insurance Regulations 2021 are being updated to the Insurance Regulations 2024.

- Regulation 45 (Equity risk capital requirement, paragraph 45(1) is being amended to provide more clarity as to what should be included within type 2 equities.

- Regulation 115 (Tier 2 basic own funds), paragraph 115(1) has been updated to make it clear that sub-paragraph (1)(a) relates to called-up but unpaid ordinary share capital and the related share premium account.

- Regulation 94 (Standard deviation for NSLT health premium and reserve risk), paragraphs 94(5) and 94(6) are being amended to reflect new factors being published.

- Regulation 97 (Health catastrophe mass accident risk capital requirement), paragraph 97(5) is being updated to reflect new factors being published.

- Regulation 99 (Health catastrophe pandemic risk capital requirement), paragraph 99(2) is being amended to include an element to reflect medical expense pandemic risk.

- Regulation 115 (Tier 2 basic own funds), paragraph 115(2) is being updated to restrict the duration that eligible Tier 2 own fund items can be called-up but remain unpaid for. If they remain unpaid beyond the restriction, then they will be classed as Tier 3 own funds.

  Such a duration restriction was always a requirement of the technical specification in the QIS exercises, but was accidently omitted from the Regulations. The Authority does not believe it is appropriate to allow share capital to be called-up but unpaid indefinitely, as there is no certainty that these own fund items would be available to absorb losses in a stress scenario. Insurers who currently allocate called-up but unpaid share capital to Tier 2 own funds should assess the impact on their solvency position of this change.

- An extra new paragraph (3) has been included under Regulation 116 (Tier 3 basic own funds), to capture basic own fund items that do not meet the features of Tier 1 or Tier 2 and are not included in the existing list of Tier 3 own fund items. For clarity, where an insurer has called-up but unpaid own funds that have been unpaid for more than three months, these own funds would be captured here and hence would be Tier 3 own funds.

- Schedule 1 (Requirements for the use of external credit assessments) is being amended to provide additional clarity on how to determine the correct assessment for certain types of exposures.