



**ISLE OF MAN
FINANCIAL SERVICES AUTHORITY**

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**Responses to Consultation
CP17-15/T12 Insurance
(Long-Term Business
Valuation and Solvency)
Regulations 2018**

RESPONSE SUMMARY

This 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.

It summarises the responses received to consultation CP17-15/T12, Insurance (Long-Term Business Valuation and Solvency) Regulations 2018

The Authority welcomes any comments from participant insurers on the content of this paper.

Issue date

29 June 2018

1. Introduction

1.1 Consultation on Valuation and Solvency Regulations

- 1.1.1 During the period 12 December 2017 to 16 February 2018, the Authority conducted a consultation relating to the draft Insurance (Long-Term Business Valuation and Solvency) Regulations for life insurers, which transposed the QIS4 technical specification TS17-03/T04 into Isle of Man secondary legislation.
- 1.1.2 This paper summarises the responses received to that consultation and the Authority's response.

2. Responses received

- 2.1.1 11 out of 13 life insurers provided responses to the consultation paper.

2.2 Actuary's report

- 2.2.1 Feedback relating to regulation 7 paragraph 2 was received. This regulation states that the actuary's report should document all tasks that have been undertaken by the actuarial function.
- 2.2.2 One insurer commented that they had defined 'all tasks' to mean activities relating to the present and future valuation of the insurer's assets, liabilities, own-funds, technical provisions and SCR that have been undertaken by the actuarial function. They commented that it may be appropriate for brevity to summarise this by confirming in the report that the requirements of the draft CGC Part 7 44(2) c has been complied with.
- 2.2.3 Part 7 44(2) c of the CGC lists the appropriate activities that the insurer's actuarial function must carry out. Not all insurers will carry out all of the activities listed in the CGC, so we do not intend to require actuaries to state that they have complied with Part 7 44(2) c of the CGC.
- 2.2.4 However, we believe it could be useful to refer to the CGC to illustrate the activities that must be included in the actuary's report, where they are carried out. Therefore we have amended the wording in Regulation 7 (2) to read as follows:

"The report must document all tasks that have been undertaken by the actuarial function, in particular those activities that are required by the Corporate Governance Code of Practice for Regulated Insurers. The report must also include the results of these activities, and must clearly identify any deficiencies and give recommendations to the Board as to how those deficiencies should be remedied."

2.3 Capital Add-on

- 2.3.1 One insurer commented that the restriction to the add-on exceeding zero should be removed as making this change could allow the IOM market to attract low risk business with good capital efficiency for shareholders. However, they also commented that if this approach would be felt to jeopardise SII equivalence, they could see why only positive add-ons might be preferred.

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- 2.3.2 The Authority's intention is to only use capital add-ons on an exceptional basis, and as a measure of last resort when other supervisory measures have been ineffective.
 - 2.3.3 For existing insurers, the purpose of applying a capital add-on would be to provide policyholders with an extra layer of protection, should either their insurer's risk profile move significantly out of line with the market, and hence the SCR does not provide the level of protection it was designed to, or when their insurer has a significant failure of its governance system, which may increase the risk of policyholders obligations not being met.
 - 2.3.4 Furthermore the SCR is the prescribed statutory capital requirement, which has been designed to meet the average risk profile of life insurers in the Isle of Man, and therefore we don't anticipate insurers own assessments of their risk profile to deviate significantly from the SCR.
 - 2.3.5 Another insurer confirmed they were happy with the proposed basis for applying capital add-ons. The remaining 9 insurers did not provide comment.

2.4 Peer Review

- 2.4.1 Several insurers requested clarification on the Authority's intended approach to peer review of actuarial work carried out within the actuarial function of the insurer.
- 2.4.2 It is important to stress that at this point in time the Authority is not proposing to impose an Actuarial peer review framework on insurers. Currently all actuaries performing actuarial work in the Isle of Man are required to comply with their professional requirements for review of actuarial work, whether this be through compliance with APS X2 if they are a Member of the UK's Institute and Faculty of Actuaries, or other standards published by the actuarial professions to which the actuary belongs.
- 2.4.3 The Authority will seek to understand what peer review frameworks have been adopted by Appointed Actuaries (and perhaps other actuaries who are providing material actuarial advice) and may request supporting documentation relating to this peer review. For the avoidance of doubt, this will not be undertaken to assess compliance with professional standards, but is aimed more at providing the Authority, as a user of the information, with assurance that the work has been properly prepared and that reliable conclusions can be drawn from it in accordance with the general principles of peer review. We will of course provide any relevant feedback as the reporting regime becomes embedded, through our ongoing engagement with individual firms and the Manx Insurance Association.

2.5 MCR Proposals

- 2.5.1 Feedback relating to the £3 million absolute floor for Minimum Capital Requirement was received. One insurer stated that they do not feel that a fixed amount floor should be applied as the number seems arbitrary and could be a barrier to entry to start-up insurers which might otherwise be viable.

- 2.5.2 When setting the absolute floor of the MCR, the Authority determined an appropriate minimum amount of capital it would require a new long-term business commercial insurers wishing to set up in the Isle of Man to hold. In reality the new insurer would be required to hold at least its expected SCR, which for a commercial life insurer is likely to be significantly higher than the £3 million absolute floor. The Authority does not view this floor as a barrier to entry for new commercial life insurers.
- 2.5.3 Another insurer confirmed they were happy with the proposed basis for the calculation of the MCR. The remaining 9 insurers did not provide comment.

2.6 Technical Data

- 2.6.1 One insurer queried the frequency and timing of when the Authority will be publishing its technical data (such as risk-free interest rate term structures).
- 2.6.2 The Authority will be publishing its technical data around the 13th of the first month in each quarter, i.e. data will be published on the 13 January for December quarter ends, 13 April for March year ends, 13 July for June year ends and 13 October for September year ends.
- 2.6.3 The data will be published on the Authority's website.
- 2.6.4 Should an insurer require technical data at a different date, they can request this from the Authority.
- 2.6.5 No other insurers queried this.

2.7 Inclusion of new business in the SCR

- 2.7.1 6 insurers queried the wording of Regulation 45, paragraph (3). The current wording is:
- "Pursuant to paragraph (2), the SCR covers existing business of the insurer as well as, if applicable, new business to be written in the 12 months following the valuation date. With respect to existing business it must cover only unexpected losses".*
- 2.7.2 The reference to new business is applicable to non-life insurers only and so we have removed it from the final Insurance (Long-term Business Valuation and Solvency) Regulations.
- 2.7.3 Therefore we have amended the wording in Regulation 45, paragraph (3) to read as follows:
- "Pursuant to paragraph (2), the SCR covers unexpected losses relating to existing business of the insurer".*

2.8 Question and answer log

- 2.8.1 One insurer requested whether a question and answer log could be established for issues relating to the regulations and reporting templates.
- 2.8.2 The Authority will give consideration to publishing details of responses to any queries received in relation to the new capital and solvency framework.

3. Material changes to Regulations

- 3.1.1 Following the results of the consultation, and a review from the Attorney General's office, several amendments were made to the Regulations. The majority of these were minor, formatting and language changes.
- 3.1.2 There were two material change to the SCR methodology which are explained below:

3.2 Counterparty default – deposits with local banks

- 3.2.1 The Island has both incorporated banks, which are subsidiaries of UK/Jersey and South African banks, and branches of UK, Jersey and South African incorporated banks.
- 3.2.2 Currently none of the Island's banks, whether incorporated or not, have a credit rating.
- 3.2.3 Where the insurer has an exposure to an Isle of Man branch of a bank incorporated elsewhere the insurer should 'look through' to the credit rating of the UK/Jersey/South African incorporated bank as the bank and branch are the same legal entity as the bank.
- 3.2.4 Under the QIS4 counterparty default charge, where the insurer has an exposure to an unrated incorporated bank the insurer should treat it as unrated and hence could incur a significant charge.
- 3.2.5 Given that we are also the Regulator for incorporated banks, our Board has determined it appropriate to amend the way the counterparty default charge is determined for unrated incorporated banks.
- 3.2.6 Therefore Regulation 86 has been amended to include an additional paragraph, (5) as follows:
"Exposures of an insurer to a bank, incorporated in the Isle of Man and licensed under the Financial Services Act 2008 to conduct deposit taking activity, for which a credit assessment by a nominated ECAI is not available, must be assigned a probability of default of 0.5%."
- 3.2.7 The counterparty default risk helper tab will be updated accordingly.

3.3 Proportionality and simplifications within the SCR

- 3.3.1 The Regulations have been amended to include the following regulations which reflect the proportionality and simplifications allowable within the SCR calculation that were available in the QIS4 technical specification.
- 3.3.2 The new regulations are:
- Regulation 54: Proportionality relating to simplified calculations within the SCR;
 - Regulation 71: Simplified calculation for spread risk on bonds and loans
 - Regulation 86: Simplified calculation of the risk mitigating effect on underwriting risk and market risk
 - Regulation 87: Simplified calculation of the risk mitigating effect for reinsurance arrangements and securitisations
 - Regulation 88: Simplified calculation of the risk mitigating effect for proportional reinsurance arrangements
 - Regulation 90: Simplified calculation of the risk-adjusted value of collateral to take into account the economic effect of the collateral

4. Material changes to templates

- 4.1.1 Following the results of the consultation and the Attorney General's office review, the amendments to the Regulations have flowed through to the descriptions in the RER_LT1_SCR Forms. Apart from these minor amendments the forms remain unchanged.
- 4.1.2 The helper tabs have also been updated for changes to the references to the regulations. Furthermore, the counterparty default helper tab has been amended as follows:
- The counterparty default SCR calculation for type 1 exposures has been updated to reflect the new treatment of Isle of Man incorporated banks as discussed in 3.2.
 - The counterparty default SCR calculation for type 2 exposures has been updated to be consistent with the calculation approach in the Regulations. Insurers should be aware that receivables should now be split in the helper tab between receivables from intermediaries that have been due for more than 3 months, and all other type 2 exposures.

5. Next steps

- 5.1.1 The Regulations were made on 28 June 2018 and will come into force on 30 June 2018.
- 5.1.2 Any queries should be directed to Sian Eltman, sian.eltman@iomfsa.im.