



**ISLE OF MAN
FINANCIAL SERVICES AUTHORITY**

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**INSURANCE (LONG-TERM
BUSINESS VALUATION AND
SOLVENCY) REGULATIONS 2018
CP17-15/T12**

**Issue date: 12 December 2017
Closing date: 16 February 2018**

This consultation paper is issued by the Isle of Man Financial Services Authority (“the Authority”, or “we”), 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 (Long-Term Business Valuation and Solvency) Regulations for life insurers, including how the Regulations have been produced and finalises the Authority’s view on all aspects of the Isle of Man’s new risk based capital regime.

Who is affected by it?

This document will be of direct interest to all existing and prospective insurance companies undertaking long-term insurance business in or from the Isle of Man. In particular, it will be of interest to those with functional responsibility and oversight of the finance, actuarial and risk management functions within those companies.

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

What action is required?

We request all Isle of Man life insurers respond to the comments raised in the paper at their earliest convenience. The closing date for any comments on this consultation is 16 February 2018.

Please send the above preferably by email to:

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1. Introduction

- 1.1.1. In line with the Authority's 2017 Roadmap, we are issuing the Insurance (Long-Term Business Valuation and Solvency) Regulations ("the Regulations") for life insurers for consultation.
- 1.1.2. Interested parties are invited to respond to the content and questions raised in this paper. The questions are set out in ***bold italics***.

2. Regulations

2.1. Content and format

- 2.1.1. The Regulations are based on the QIS4 technical specification, TS17-03/T04, and transpose requirements into Isle of Man secondary legislation.
- 2.1.2. The technical specification previously issued by the Authority set out the technical detail of the calculations required to determine an insurers capital resources, solvency capital requirement and hence solvency position under the Isle of Man's new risk based capital regime. The Authority has refined the technical specification and guidance it provides, over four QIS exercises, to reflect the characteristics of the Isle of Man's insurance industry.
- 2.1.3. As secondary legislation the Regulations do not include the guidance previously provided in the technical specification, but transcribe the calculations and requirements from the technical specification into regulation. Guidance will be provided separately.
- 2.1.4. As well as the content previously communicated in the technical specification, the Regulations also set out the Authority's stance on the Minimum Capital Requirement ("MCR") for life insurers, and the application of capital add-ons. Further details on both these items can be found later in this document.
- 2.1.5. In preparing the Regulations, the Authority has also referenced EIPOA's Commission Delegated Regulations (EU) 2015_35 and 2016_467 and the Solvency II Directive (2009_138_EC), with the aim of achieving consistency where possible and appropriate.
- 2.1.6. The Regulations are due to come into force on 30 June 2018.
- 2.1.7. ***We request insurers provide comments on the proposed content of the draft Insurance (Long-Term Business Valuation and Solvency) Regulations.***

2.2. Amendments to the technical specification

2.2.1. The changes described in this section have been made to ensure consistency with the latest Solvency II calibrations and approach, and therefore ensure that the SCR is appropriately calibrated at a 99.5% confidence level over a one-year period.

Interest rate risk – decrease in term structure of interest rates

2.2.2. When determining the decrease in the term structure of interest rates, there is now a floor of the original basic risk-free rate applied when the original basic risk-free rate is negative.

2.2.3. This means that when the original basic risk-free rate is negative, the decrease in the term structure of interest rates is nil.

2.2.4. See Regulation 63, paragraph 4.

2.2.5. The helper tab has been updated accordingly.

Counterparty default risk capital requirement – Type 1 exposures

2.2.6. The calculation for the Solvency Capital Requirement (“SCR”) for counterparty default risk for type 1 exposures is dictated by which of three bands the percentage of the standard deviation of the loss distribution of type 1 exposures falls into.

2.2.7. In the Regulations, the lower band has been increased to 7% of the total loss-given-default on all type 1 exposures, up from 5%.

2.2.8. See Regulation 81, paragraph 2.

Counterparty default risk capital requirement – Loss-given-default on a mortgage loan

2.2.9. The calculation for the loss-given-default of a mortgage loan i (LGD_i) has been amended to the following:

$$LGD_i = \max(0; Loan_i - 80\% \cdot Mortgage_i)$$

where:

- a. $Loan_i$ denotes the value of the mortgage loan i ;
- b. $Mortgage_i$ denotes the risk-adjusted value of the mortgage i .

2.2.10. See Regulation 82, paragraph 5.

2.3. New content in the Regulations

Minimum Capital Requirement (MCR)

2.3.1. In our consultation paper CP16-05, which launched the QIS3 exercise for life insurers, the Authority introduced the MCR. This was further tested in the QIS4 exercise.

2.3.2. The information gathered has been reviewed and used to determine the final proposed calibration of the MCR.

2.3.3. The final calibrated MCR is:

$$MCR = \max(MCR_{SCR}; FMCR)$$

Where:

$$MCR_{SCR} = \max(35\% \cdot SCR; 25\% \cdot SCR_{noMA})$$

- *SCR* is the Solvency Capital Requirement ('SCR') of an insurer determined in accordance with Part 3 of the Regulations;
 - *SCR_{noMA}* is an insurer's SCR determined in accordance with Part 3 of the Regulations with the exception that the insurer must not allow for the impact of future management actions as defined in Regulation 24.
 - *FMCR* is the absolute floor of an insurer's MCR, set to £3 million.
- 2.3.4. The Authority signalled through the QIS exercises that its preferred approach was to express the MCR as a percentage of the SCR. This approach was broadly supported by participants. Solvency II adopts an approach where the MCR is based on Technical Provisions overlaid with an upper bound of 45% of the SCR and a lower bound of 25% of the SCR. Our calibrated percentage of 35% sits in the middle of this band.
- 2.3.5. The Authority considered the results of the Solvency II approach. For the majority of Isle of Man life insurers the results of the MCR were either capped at 45% of the SCR or floored at 25% of the SCR. This suggests a poor model fit resulting in an MCR that is insensitive to the risk profile of insurers. Therefore this approach was rejected.
- 2.3.6. The impact of potential future management actions can be taken into account in determining the SCR. These can have a material impact on the SCR. There is an element of uncertainty as to the effectiveness of future management actions, in particular where management actions are significant. We therefore believe it is appropriate to set an MCR floor that is based on an SCR that does not include any potential future management actions. The 25% applied to the SCR excluding management actions, *SCR_{noMA}*, reflects the 25% lower bound in the Solvency II approach.

2.3.7. For full details see regulation 126.

2.3.8. ***We request insurers provide comments on the proposed calibration of the Minimum Capital Requirement, in particular the inclusion of a floor and the absolute amount of the floor.***

Capital Add-on

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

2.3.10. 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.

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

- a. the risk profile of an insurer deviates significantly from the assumptions underlying the SCR standard formula approach;
- b. the insurer's systems of governance deviate significantly from the requirements of the Corporate Governance Code of Practice for Regulated Insurance Entities, 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.

2.3.12. The capital add-on will have a numerically positive value.

2.3.13. The capital add-on for risk profile deviations will be determined in the same way as the SCR, i.e. the capital add-on will correspond to the Value-at-Risk of the basic own funds of an insurer, subject to a confidence level of 99.5% over a one-year period.

2.3.14. The capital add-on for systems of governance deviations will reflect an assessment of the significance of the deviation, and will be determined on a case by case basis.

2.3.15. 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.

2.3.16. The SCR using the standard formula approach, together with the amount of the capital add-on imposed by the Authority, will constitute an insurer's SCR.

2.3.17. For full details see Regulation 52.

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

Data Quality

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

2.3.20. 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.

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

2.3.22. For full details see Regulations 43 and 44.

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