Guernsey Financial Services Commission

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Insurance Supervision and Policy Division Presentation:
Guernsey – International and Interconnected

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Good day. Before I hand over to John, I would like to talk for ten minutes about global regulatory developments in the insurance world and how these may affect Guernsey.

The global financial crisis was, first and foremost, a banking crisis. However regulators soon came to ask themselves whether insurance companies might also pose the same sort of threat to global financial stability as had banks. Indeed, one large insurance company had had to be rescued by the US fed at some cost to the US taxpayer. This one failure deepened regulatory concern.

The global regulatory architecture for insurance differed markedly at that time from that for banking – though the two have since come closer together. Whilst banking was thought of as absolutely central to any economy not least for the multiplier effect, this was less clear for insurance companies. Consequently, insurance companies were often regulated by government departments whose main function was consumer protection rather than financial stability. Whereas the Basel Committee at that time at least was dominated by the G-10, the International Association of Insource Supervisors (IAIS) was a far more broadly–based body, also more open to industry participation than its banking counterpart.

Regulatory concern about insurance companies was therefore not easily dismissed. Issues of regulatory knowledge and control were relevant but so too was the absence of any global capital standard, the presence of large global companies especially in the re-insurance sphere, the sheer size of the global insurance asset base and the often unclear use of derivatives and highly leveraged transactions. It was therefore unsurprising that the new overarching regulatory body, the Financial Stability Board, chose to include insurance risk in its core mandate.

After several years focus, some of the original concern about insurance companies has gone away. Insurance companies are seen to be fundamentally different from banks due for example to their long maturities at least for life, the depth of reinsurance available and the double protection offered by reinsurance and the limited use of derivatives. Regulators also came to recognise that in key areas such as life reserving, INBR and asset selection, insurance companies had a history of conservatism. It was also accepted that general insurance rarely threatened financial stability. Indeed for some insurance companies are seen as part of the solution than the problem, in so far as they take on more long-term non-traditional assets, although there are also dangers here.

Nevertheless, some regulatory concern about insurance companies remains and has largely materialised around capital for large international firms. The main issue is the continued lack of any agreed global capital standard. For this reason IAIS is now working towards such a standard by 2019. In the meantime, a crude approach is being applied to a smaller group of firms and is likely to be supplemented by an additional capital requirement.

It is unclear as yet as to how the international capital standard will be calibrated; whether it will have any impact on actual capital levels and whether national regulators will be able to police a level playing field.

Other regulatory themes remain live. One is the determination of regulators not to allow insurance companies to engage in any significant way in non-insurance activities. Another is the possibility of developing a resolution scheme along the lines of that for banks. This of course again raises the question of capital resources. We are still in the foothills of this but we can be confident that what regulators think is good for banks, has to be positively disproved in so far as insurance companies are concerned. Another emerging theme in IAIS is greater interest in conduct and consumer protection.

Cross-border issues may be even more difficult for insurance companies than banks. What in practice does it mean for example when life branches have to be backed by appropriate assets? Why is it that whilst in the European Community regulatory practice is converging, in the US it remains state-based?

So what does all this mean for Guernsey? In the immediate sense, it may not matter that much. We are just too small to matter and some of our key insurance sectors are specialized. But, in other areas, there may be implications; albeit long-term.

We are likely to have eventually an international capital standard. Here, we will have to watch Solvency II, simply because there is at present no other cross-border approach on these lines. Cross-border resolution issues may also come more to the fore – and we have several life companies that operate outside Guernsey. How would we stand if a local protection fund became mandatory? How might consumer concerns and greater autarchy affect the use of third party brokers? Will we be able to ensure a reasonable regulatory approach to PCCs, ICCs and captives in the wake for calls for greater standardisation?

Few of these questions are immediately relevant, given the slow speed at which global regulation moves. However, it would be wrong to believe that we are somehow forever insulated from all of this.

Finally, and predating the 2007 crisis, we are already busy implementing the new Insurance Core Principles in Guernsey. The latter continue to evolve, not least as IAIS issues more detailed guidance known as Comframe. For example, we are currently concerned that group supervisory requirements are now being threaded through several of the ICPs rather than staying under one ICP. This means that a host regime likes ours risks being, marked down on several ICPs rather than just one. This is one immediate example where international developments do affect the Bailiwick.

At the Commission, we try to keep in touch with the above developments, given our limited resources. I sit on the IAIS Technical Committee and chair the Group of International Insurance Centre Supervisors or GIICS. Last month the Director General was elected by GIICS to the IAIS EXCO. Caroline Bradley holds the pen on the IAIS captive paper. All of this helps us see the way the wind is blowing and even I dare say very occasionally blow it in the right direction.

So to conclude, I see no immediate threat to Guernsey from post-2007 regulatory developments – though neither do I see business opportunities. However, I cannot say that this will always be the case and clearly we must continue to keep ourselves in the informational loop.

Thank you Jeremy. Good morning everyone. I am John Dunford, Deputy Director of the Banking and Insurance Supervision and Policy Division. As most of you will know I have returned to Insurance to hold the fort for Caroline Radley whilst she is seconded to the Channel Island Brussels Office. It is good to be back and what a lot is happening!

Slide: Agenda

There are four main areas I would like to cover today. A review of 2014 activity, a look forward to 2015, Insurance supervision under PRISM, and a number of other risk matters.

Slide: Review of 2014 activity

In relation to 2014 I will review the statistics, explain how we have delivered on the commitments made at last year's presentation regarding the streamlining of workflows, review the activity on the development of the solvency framework and other core principles, touch on recent stress testing and then try to keep your interest while I explain the impact of recent UK GAAP changes.

Slide: Statistics

First let look at some statistics

At the end of 2013 the figures for Gross written premium, Gross Assets and Net Worth were steady compared with the prior year. The majority of growth is still in cells, specifically insurance linked securities.

Slide: Growth in International Insurers Graph

Currently there are 809 international insurers. We broke through the 800 barrier in June. We continue to deal with a large number of applications each month (the quality of which I will come to later). This graph shows the steady growth over the last 10 years due mainly to cell growth. In 2012 this was mainly due to the UK Mortgage Indemnity scheme cells where as in 2013 and 2014 it is due primarily to Insurance Linked Securities cells

Slide: New Business

In the 12 months ended September 2014 there have been 95 new international insurers compared to 79 in the previous 12 months. This includes 57 PCC cells, 16 ICs and even 9 Captives which have been in steady decline for some years. In addition we have welcomed the licensing of one more Insurance Manager, the second in two years.

There have been 64 surrenders in the same period 39 of which were in December 2013 when 32 dormant PCC cells were closed.

Slide: New Business Pie Chart

This chart shows the type of new insurance cover written in the past 12 months.

The type of cover being written is dominated by catastrophe cover of various types in ILS cells. Also of interest and new to this chart is Longevity cover initially through the launch of the BT Pension scheme insurer which has sparked considerable interest for further insurers from pension schemes and actuaries. K&R, ATE and pilots loss of licence cover continue to feature in addition to an insurer owned by a Power Utility Group covering the damage caused by bush fires in the Australian outback and a European football club insuring the cost of it failing to get into the 2015/2016 Champions League.

Slide 8: Geographical source of business

This chart shows the Geographical Origin of new business over the past 12 months

The dominance of the UK as the main source of business has reduced due to the ILS business originating mainly from Cayman, Ireland and Switzerland.

Slide 9: Geographical source of all insurers

This chart shows the geographical of all 809 international insurers.

The geographical source of all 809 insurers shows the dominance of the UK as would be expected but also the growth in Cayman over the past few years.

Slide 10: Streamlining of workflows

Moving on to the streamlining of work flows.

Last year we promised to deliver on streamlining workflows in these areas. The first four items, Business Plan Changes, Loans, PQs for cell controllers and Directors and Alternates were addressed in guidance papers issued in January 2014. I am pleased to say that we are seeing the benefits of this in a reducing number of routine enquiries and correspondence.

We have already introduced fast-tracking authorisation for ILS and other fully funded entities in certain circumstances. We are also engaged in discussions on whether specific legislation in relation to ILS business is required

The streamlining of annual returns is linked to our revised solvency framework and to the commission wide project on online submissions. However, we are confident that the annual return process can be streamlined, particularly for captives. We have already streamlined the processing of annual returns resulting in us being able to identify Key Risk Indicators as soon as the annual return is received.

Slide 11: Risk Based Solvency Regime

The new Risk Based Solvency Regime will be operational from early 2015. Close coordination between the Policy Council, the States, GIIA and the Commission is required and is in motion. The Rules and Feedback paper will soon be issued. Legislative changes are in motion. As long as there are no future challenges we will instigate a soft launch at the end of January 2015.

Slide 12: Corporate Governance Code

After consultation with industry the plans to replace the Corporate Governance code with rules has been withdrawn and, instead a revised code has been drafted. This will be issued soon.

Slide 13: Public Disclosure ICP 20

We have consulted in the area of Public Disclosure. The changes will only be of concern to the larger commercial firms and by that we mean a firm writing more than £5m of premium or with more than £25m of technical provisions. Captives are exempt as are Reinsurers.

Slide 14: Stress Testing

Stress testing is already used to some extent in the OSCA. However, in future, specific stress testing will be applied to life companies to calculate solvency requirements. In addition we continue to apply across the board stress testing to key insurance firms – the last time in 2010 and again this year.

The deadline for responses was 31 October and results are in the process of being reviewed.

Slide 15: Impact of UK GAAP changes

UK GAAP is changing for accounting periods commencing 1 January 2015. For insurance companies, additional disclosures are required under FRS 103 which will result in significant resource requirements and additional costs. For captive insurance companies the additional disclosures will not provide meaningful information that is not already available to key stakeholders (that additional information can be requested by both the parent and Commission if required).

If licensees are not intending to follow IFRS and wish to consider an alternative form of accounts, by excluding the additional disclosures under FRS 103, amendments have just been made to both Companies Law and the IBL by way of Regulations in order to address this.

It is possible for captives (and others such as PCCs) to request a derogation from the Commission from these additional disclosure under the IBL, and to prepare an alternative form of audited financial statements. Guidance is on the Commission's website which will assist in identifying which insurance licensees can approach the Commission for such a derogation, if this has not been done already. The Guidance also includes details of the steps to be taken by licensees.

It is not intended that the derogation will weaken the audited financial statements.

Following the issue of the derogation, the Board of a licensee will need to agree to the waiver of an audit under Companies Law: the waiver will need to be registered with the Registrar before the end of the current accounting period.

In order to exclude the additional disclosures, licensees will need to be exempt from audit under Companies Law, which requires the financial statements to be prepared on a true and fair basis. The alternative form will be prepared on a properly prepared basis. In order to ensure that the directors' responsibilities are not weakened (which will be excluded from Companies Law via the audit exemption), the Commission requires these responsibilities to be brought back in via a standard condition on the licensee's insurance licence. As part of the derogation, the Commission will therefore require licensees to agree to a standard condition on the licence. This is again explained further in the Guidance.

If a licensee is considering requesting a derogation from the additional disclosures under FRS 103, and has reviewed the Guidance on the Commission's website, they can discuss this with the Commission, normally via the insurance manager.

Also, if a derogation under the IBL is agreed and an audit is to be waived under the Companies Law, please ensure you speak to your auditor.

Slide 16: Look ahead to 2015

Looking ahead to 2015 as well as continuing business as usual of supervision under PRISM the key continuing initiatives will be:

- the revision of laws project within which we will ensure that our IAIS Core Principles gap analysis is linked,
- Implementation of the risk based solvency regime
- training for ourselves and industry ion using and interpreting the results of the risk based solvency regime,
- Some insurers preparing financial statements on a properly prepared basis not true and fair.

Slide 17: Probability Risk and Impact SysteM – PRISM

We mentioned at the last industry presentation that the Commission would be switching to a new impact and risk-based supervisory framework in 2014. This framework is called PRISM, the Probability Risk and Impact System, and Insurance were the first regulatory division to adopt PRISM in late 2013.

Risk based supervision starts with the premise that not all firms are equally important to the economy and that a regulator can deliver most value through focusing its energies and finite resources on the firms that are most significant and on the risks that pose the greatest threat to financial stability and consumers.

Our first step therefore has been to classify all of our firms into four categories of impact. High, medium High, Medium Low and Low. Impact indicates the degree of damage a firm could cause to the financial system, economy and population were it to fail or to engage in persistently poor conduct.

Our subsequent engagement with a firm is driven by its impact level, so those classified as high impact can expect to see the Commission more regularly than before and with a greater focus on detail. Conversely, those firms classified as low impact will not usually see the Commission unless there has been an adverse event.

A large percentage of international insurers are, as one would expect, classified as low impact but there a number of high, medium high and medium low impact insurers.. The cycle of engagement for these insurers is lengthier than you are currently used to covering areas such as business model analysis, Governance reviews, financial risk reviews and in-depth discussions with senior management and directors.

Slide 18: Risk Categories

When we do engage with you we will come on site and look at ten different risk categories. The quick thinking of you will realise there are eleven risk categories on the screen (the eleventh, Financial Crime Risk, will be the subject of a separate cycle of visits from our Financial Crime team).

From these periodic engagement tasks, we will be able to form a view as to the level of risk in a particular area and we may require a firm to reduce that specific risk via a Risk Mitigation Plan.
Finally, the conclusions reached by supervisors are now subject to internal challenge at cross-Commission Risk Governance Panels, in order to ensure that the conclusions reached and any outcomes are consistent and proportionate. In 2014 the Insurance team will present at 7 Risk Governance Panels of which 5 have already been held and we will be holding a further 6 Risk Governance Panels in 2015.

Slide 19: Other Risk Matters

Having returned to Insurance I have witnessed , with concern, some areas of risk that although mentioned by Caroline last year are worth repeating plus some new observations of my own. On average the Insurance team is dealing with ten applications per month.

The level of due diligence, that accompanies applications, undertaken by Insurance Managers is sometimes inadequate and unacceptable. Yes the Commission has access to information not available to Managers but simple internet searches often identify issues which the Manager should have been fully aware of. In addition PQs are not checked to ensure they contain all pertinent information or that they have been signed!

Sense checks of business plans and projections should often identify issues which the Commission is picking up and which therefore delay processing of the application. Examples are the business plan stating that the programme will be fully reinsured but the projections do not show any reinsurance. Claims are estimated, in the business plan, to take eighteen months to settle and yet projections and cash flows show settlement of claims immediately and no claims reserves in the balance sheet.

We have recently had a PQ which failed to disclose information about former convictions easily sourced on google. We even had an applicant who had been economical with the truth as to why his previous insurance company in another jurisdiction had been placed into liquidation. On checking with that jurisdictions regulatory authority it transpired that the regulator had placed the company into compulsory liquidation due to breaches of the insurance law.

Undertaking such due diligence takes valuable resource away from supervising insurers.

It is not uncommon to receive an application and a request that it be dealt with as soon as possible as the Manager has promised a turnaround within two weeks. Our Service level Standard is to give in principle approval 28 calendar days after receipt of an application and we regularly beat that standard.

Service Level Standards are disclosed on the GFSC website. The Commission reports on the performance achieved for 43 standards of which 15 directly relate to Insurance.

Slide 20: Conclusion

In conclusion we have reviewed activity in 2014 including a significant number of applications and the first time that the number of insurers has reached over 800.

We have briefly looked forward to 2015 and the practical application of the risk based solvency regime.

Slide 21: Any Questions?

Jeremy and I would be happy to answer any questions you may have.