GUERNSEY FINANCIAL SERVICES COMMISSION

EXPLANATORY NOTE RELATING TO THE GENERAL BUSINESS SOLVENCY SUMMARY SPREADSHEET

This explanatory note is designed for use in conjunction with the General Business Solvency Summary Spreadsheet ("Solvency Spreadsheet"), available on the Commission's website.

General

The Solvency Spreadsheet should be used by every licensed insurer writing general business, including each individual cell of Protected Cell Companies, to calculate the minimum solvency requirement and the solvency margin achieved.

The Solvency Spreadsheet is designed to provide a practical basis for the application of the minimum solvency requirements under Schedule 2 of The Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended, ("the Law"), The Insurance Business (Approved Assets) Regulations, 2008 and The Insurance Business (Asset and Liability Valuation) Regulations, 2008, all of which are available on the Commission's website. It includes three measures of solvency, based on:

- Retrospective premiums
- Prospective premiums
- Current level of claims reserves

The minimum solvency requirement is dynamic, and the Solvency Spreadsheet should be used to ensure that the requirement is met at all times, as required under Section 30 of the Law.

Most cells within the spreadsheet are locked to ensure the integrity of the embedded formulae. All data should therefore only be input into the cells with a grey background.

It is appreciated that this form may not be able to accommodate all of the requirements of the wide variety of insurers licensed by the Commission. Therefore, in order to provide flexibility, a comments area has been included on Sheets 2, 3 and 4 to allow those completing these sheets to note any areas of deviation from normal practice.

If in doubt about any aspect of the Solvency Spreadsheet, please contact the Commission for further guidance.

Sheet 1 – Solvency Computation Summary

This sheet provides a summary of the premium based and claims based solvency requirements, which are taken from the calculations performed by Sheets 2 and 3, and selects the higher of the two requirements to be the minimum solvency requirement.

It also provides a summary of the solvency margin achieved, which equates to the net assets from the regulatory balance sheet calculated by Sheet 4, and calculates whether the minimum solvency requirement has been met.

The premium based solvency requirement included in Sheet 1 is either based on the retrospective premium calculation or the prospective premium calculation, depending on the level of net premium income ("NPI"). If the NPI on a prospective basis is 110% or more than the NPI on a retrospective basis, then the premium based solvency requirement on a prospective basis should be used. If the NPI on a prospective basis is less than 110% of the NPI on a retrospective basis, then the premium based solvency requirement on a retrospective basis should be used.

Sheet 2 – Premium Based Solvency Calculation

This sheet calculates the premium based solvency requirements using two different calculations, one based on retrospective premiums and one based on prospective premiums.

As the retrospective premium based solvency calculation is based on the net premiums earned during the preceding financial year, the resulting solvency requirement will remain unchanged during the whole of the current financial year. The premiums used in this calculation should equate to those shown in the audited accounts.

As the prospective premium based solvency calculation is based on best estimates of the expected net premiums to be earned for the current year, the resulting solvency requirement may change during the current financial year as estimates are revised and renewal terms are agreed. The premiums used in this calculation should generally equate to those shown on the business plan for the current year, unless the financial year and the policy year are not coterminous.

The premium based solvency calculation also includes space for novations or portfolio transfers, reflecting the requirements of Section 1(5) of Schedule 2 of the Law, which states: "…funds received for the assumption, by a licensed insurer, of insurance obligations under a novation, portfolio transfer or other scheme or arrangement shall be included in the gross premium income computation unless the novation, transfer or other scheme or arrangement is supported by an actuarial certificate acceptable to the Commission".

Sheet 3 – Claims Based Solvency Calculation

This sheet calculates the claims based solvency requirement and reflects the requirements for determining the value of the loss reserves for each class of business as detailed in Section 1(1)(b) of Schedule 2 of the Law and the Notice to All Licensed Insurers Writing General Insurance Business in Respect of Loss Reserves for Solvency Purposes. This calculation is intended to provide a solvency requirement based on the potential deterioration of claims reserves.

The "loss reserves per statutory accounts" column should include outstanding claims, IBNR, IBNER and any provision for unexpired risks. Where insurers use Unearned

Premium Reserves (UPR) as a proxy for loss reserves (e.g. IBNR) and so effectively reserve for losses through their premium earnings patterns, then the UPR figure should be entered in the loss reserve column. Where this is the case, any related Unearned Reinsurance Premium Reserves (URPR) should be entered in the reinsurance recoverables column.

For those policies reserved up to the maximum aggregate limits under the policy terms (i.e. where there can be no further adverse deterioration), the value of the loss reserves to be used in the calculation should be nil as per paragraph (1) of the Notice to All Licensed Insurers Writing General Insurance Business in Respect of Loss Reserves for Solvency Purposes. Therefore, the whole of the loss reserve should be removed from the claims based solvency calculation by including that figure in the "Less: Reserved to Maximum" column.

For those policies that are partially reserved up to the maximum aggregate limits under the policy terms, the claims based minimum margin of solvency calculated will be limited to the maximum residual loss under the policy, defined as the maximum aggregate limit under the policy terms less the total loss reserves and claims paid to date in respect of the policy, as per paragraph (2) of the Notice to All Licensed Insurers Writing General Insurance Business in Respect of Loss Reserves for Solvency Purposes. To achieve this, the "Less: Almost Reserved to Maximum" column should be completed as per the following example:

Maximum aggregate exposure =	£100,000
Loss Reserves =	£49,000
Claims Paid =	£50,000

If the 5% solvency ratio were applied to the £49,000 of loss reserves, the solvency requirement for this policy would be £2,450. However, as the maximum residual loss for this policy is only £1,000 (i.e. £100,000 – (£49,000 + £50,000)), the claims based solvency requirement for this policy should be capped at this amount. In order to achieve this, a figure of £1,450 should be entered into this column.

Sheet 4 – Regulatory Balance Sheet

This sheet converts the statutory assets and liabilities as per the audited accounts into regulatory assets and liabilities.

Regulatory Assets

Regulatory assets are those assets that qualify to count towards the maintenance of the solvency margin requirement. These assets should be divided into the four asset classes (Class 1, 2, 3 or 4) as defined in The Insurance Business (Approved Assets) Regulations, 2008 and entered in the 'Approved assets' section of the "Value per Statutory Accounts" column. Where these assets fall into a range of asset classes, a detailed breakdown by asset class should accompany the solvency spreadsheet (as required by The Insurance Business (Annual Return) Regulations, 2008).

There are no valuation restrictions on assets that fall to be classified as Class 1 assets. However, as detailed in The Insurance Business (Asset and Liability Valuation)

Regulations, 2008, the following restrictions apply to assets that fall into Classes 2, 3 and 4:

- Class 2 assets- where an asset is approved by the Commission in writing as a Class 2 asset, it should be valued at 100% unless the Commission directs otherwise; and

- Class 3 and 4 assets- where the value of a single asset, or the aggregate value of all assets that have exposure to the same counterparty, exceeds 10% of the total market value of gross assets, the approved asset proportion is limited to 10% of the insurers' total market value of gross assets. Where such a restriction applies, the total value of the restriction should be entered as a negative figure in the "Classes 3 and 4 10% Adjustment" column within the 'Approved Assets' section.

Any assets that do not meet the definition of either Classes 1, 2, 3 or 4 should be classified as unapproved assets and entered in the 'Unapproved assets' section of the "Value per Statutory Accounts" column with an appropriate description (i.e. accounts receivable greater than 90 days old). As unapproved assets are not allowed to count towards the maintenance of the solvency requirement, any such assets are automatically deducted from the calculation via the "Unapproved Asset Deduction" column.

Where an irrevocable letter of credit ("LOC") approved by the Commission has been issued for the benefit of the licensee to help support solvency, the amount of this LOC should be included as a Class 2 asset in the "Approved Letters of Credit" column.

Regulatory Liabilities

Regulatory liabilities are those liabilities that must be deducted from the regulatory assets to derive the regulatory net assets which are taken forward to Sheet 1 as the "Solvency Margin Achieved".

Where a licensee has preference shares that are classified as debt instruments or a subordinated loan from the parent to help support solvency, these amounts should be included in the 'Non-insurance Liabilities' section in the "Value per Statutory Accounts" column and then deducted in full in the "Preference Shares / Subordinated Loans / Other Adjustments" column to reduce the regulatory liability to zero.

Please note that this explanatory note does not take the place of the Law and regulations, rules and codes, and if there is any conflict between the two, the Law, regulations, rules and codes will always take precedence.