Guernsey Financial
Services Commission

Industry Seminar – 23 November 2012

Insurance Division Presentation

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Good afternoon everybody.

Today I will begin by talking through the 2011 and 2012 insurance business trends. I will then go on to overview 2012 supervisory activities; after which I will highlight 2012 supervisory themes. I will finish by outlining the projected supervisory work for 2013 and the impact of the new centralised units. The talk will last about half an hour and will be posted on the Commission's website with hyperlinks on 26 November 2012. If you have any questions, please keep them until the panel session that follows when there will be plenty of opportunity to discuss issues. At that panel session I will be joined by the two Insurance deputies.

I will begin by talking about insurance business trends.

The most recent annual returns cover the period up to year ending 2011. These show that, taking into account inflation, aggregate gross assets and net worth for all Guernsey insurers was roughly stable in 2011 (slide p2 and p3). In contrast, aggregate premiums rose by about £0.5bn including taking into account inflation (slide p4). This was due to an increase in premium in one local large captive. Overall therefore the story in terms of annual returns for 2011 is one of stability.

The annual returns also reveal trends in aggregate solvency ratios (slide p5). 2011 saw the continuation of the trend of a decline in solvency ratios both for non-life and life business, reflecting many factors including dividend payments and a growth of balance sheet. Nevertheless the solvency ratios in aggregate terms themselves remain strong at around 2,000% for non-life and around 500% for life business.

The 2011 end year figures also show the P&L outturn for authorised managers and insurance intermediaries (slide p6). These are stable. Authorised managers in total generated fee income of £29mn in 2011, exactly the same as in 2010 and profits of some £6mn as opposed to £5.6mn in 2010. Insurance intermediaries generated commission and fee income of £20.4mn compared to £20.8mn in 2010.

Moving away from the annual returns, it is possible to look at a more up-to-date annual period; that is from October 2011 to October 2012. The key feature of this period was the licensing of PCC and PCC cells in relation to the New Buy Scheme sponsored by the UK Government and the Homebuilders Federation. Out of the total of 89 additional PCC cells approved, 45 were due to the New Buy Scheme; with more such cells in the pipeline.

With this in mind we can now look at trends during October-October (slide p7). Company numbers continued their long term trend downwards although the drop was not too dramatic - from 260 to 249 or 4%. PCCs remained stable at 67, although this was as a result of 7 additions and 7 surrenders. Aggregate PCC cells however rose from 341 to 406 - an increase of 19%; but, without the 45 New Buy Scheme cells, the increase would have been 6% (slide p8). Activity for incorporated cell companies remained subdued as a total number of 5 and for their incorporated cells at a total number of 17.

The net impact of these changes is that, if the New Buy scheme is set aside, general numbers remain broadly stable. On the other hand the New Buy Scheme has significantly increased the number of PCC cells – as the slide shows.

Turnover remains high. As a proportion of the number of entities in existence the Commission processed 150 additions and surrenders October-October 2012. That is 20% of the overall total of 746, albeit this includes the New Buy scheme. This is a similar turnover number to last year. This high rate of turnover absorbs significant Commission resources.

Some tentative conclusions about trends can be drawn from the above figures. As far as business trends go, the story is one of stability, with unusual activity this year due to the New Buy scheme. This suggests an industry at maturity, albeit coping well with difficult economic conditions and one capable of attracting enough new business to replace the old. Even allowing for the fall in solvency ratios in aggregate terms, the relative levels remain high enough to suggest little (at least in aggregate terms) of regulatory concern, although of course this says nothing around the current adequacy of technical reserving or the appropriateness of premiums. The PCC cell concept continues to be robust and insofar as there is a story here it is of the increasing industry preference to use cells rather than companies. On the other hand the aggregate company number is down only marginally and there continue to be new companies licenced.

It is worthwhile placing Guernsey here within the global context (slide 9). The Bailiwick continues to provide insurance or reinsurance for the global catastrophic market, despite the fact that 2011 was a bad year in the global market. The Bailiwick also continues to provide global expatriate facilities and UK pension de-risking. The local insurance intermediary market remains stable. The focus of the insurance industry in Guernsey continues to be the UK captive market and that is where growth in both 2011 and 2012 is coming from. Whatever might be said about emerging markets, this core market continues to be the mainspring of the industry in Guernsey.

I would now like to update you on 2012 divisional supervisory activities.

In terms of licensing or approvals, the average turnaround time remained stable and well within the informal target of 30 calendar days, despite increased volumes this year. This is good for local business. However, as implied above, in order to continue to achieve this target the division adequate resource.

For the calendar year, in 2012 the division is on track to complete 15 onsite visits compared to 23 last year (slide p10). The lower number is explained by the fact that the division devoted some resources in 2012 to the internal transformation project.

In 2012 the division is due to complete 10 prudential meetings for insurance intermediaries compared to 17 last year (slide p11). This year the division has been piloting the concept of the prudential meeting – that is where the division meets a licensee for about an hour - outside the insurance intermediary area and we have completed 6 of these prudential visits – making a total of 16 prudential meetings in 2012. So in aggregate we have completed 16 as opposed to 17 prudential meetings in 2012, but this year we have covered more than just insurance intermediaries. Looking to the future we have concluded that the prudential meeting is a cost efficient way of keeping in contact with all types of licensees at a high level and we intend to continue with it in 2013.

2012 saw the roll out of the Commission's new enforcement process (slide p12). Between January and September 2012 the division completed 33 enforcement cases. Of these 23 resulted in no further action with 10 leading to specific sanctions. However, all these sanctions were agreed. No public action was taken in any case although general observations are fed back to the industry – for instance I will talk later about sales practices.

This outturn was as expected. Generally licensees fix problem before sanctions are applied or agree sanctions with the Commission. It is rare for the Commission to use its powers to impose actions. However, this year we have in place an enforcement process that is transparent, structured and can be challenged by the firm. This is an improvement on the position that existed up to this year. Last year the Commission said that it would improve the enforcement process and it has delivered this year. Of course further improvements are continuous – for instance recently we introduced a fast track approach for less material cases.

2012 also saw the further enhancement of the divisional statistics website page in order to bring it more in line with our peers and enhance financial stability in Guernsey. The next two slides show some illustrative views of insurance in case you have not looked at the site recently (slide p13 & p14). The divisional website page also now includes for the first time data on insurance intermediaries.

In order to cover routine international obligations both of a firm-specific and policy nature, four short international trips were made within Europe (slide p15). Divisional activity here remains constrained in that the main focus at present for international regulators is the issue of globally systemic insurers; and this is an area where the Commission's contribution is always going to be limited.

In order to further work on the IAIS Captive Working Paper (where the relevant global group is chaired by Guernsey), four additional international trips were made, of which two were outside Europe. I should explain for clarity that IAIS stands for the International Associations of Insurance Supervisors - which is the global body that sets insurance standards. The Commission remains committed to work on the captive working paper as it gives Guernsey the chance to shape international thinking about captives in line with its own and it is this that remains the focus of our international work.

The division made an appropriate contribution to all the transformation projects currently being run in 2012 by the Commission (slide p16). A particular effort was made with regard to the Authorisations Unit where the division supplied the sponsor, the chair of the Working Party and eventually the assistant director of the Unit itself. This project was completed on time and budget. With the exception of on-site work – where we still undertook 15 visits – the Division has still been able to deliver its insurance supervisory work as well as working on the

transformation projects. For example, the division has still been able to process over 150 applications to date even though, as the graph shows, this is a significantly increased number (slide 17).

Partly as a result of the creation of the centralised units, full-time divisional staff have been reduced from 18 this time last year to 15 people today (slide p18). This has involved a reduction in support functions and the removal of one senior post. Divisional staff turnover remains low although this year we have hired two new entrants to fill vacancies; and we are still not up to a full complement. Skilled insurance people remain difficult to find, as I am sure is your experience as well. I should add that we are now training our insurance staff much more and we are in the process of arranging industry secondments.

We continue to outsource our actuarial requirements and this works well for us as we pay for resources when they are needed. On the other hand, actuarial advice is never cheap and there is nothing we can do about this. We continue to support the teaching of the Guernsey Insurance Certificate, though the residual funding of this has now been taken over by BIIA.

Moving now on to fees (slide p19), the Commission has proposed an increase in cell – as set out in the slide. The Commission has since received industry comment; mostly from insurance managers. Commissioners will take these comments into when they make their final decision and I cannot say what they will decide. They will however wish to consider the issue with the FEPG.

On the one hand, although cell numbers are going up, company numbers are going down (slide p20; slide p21 is blank). The annual cell fee is £1,650 whereas that for a company is £5,040; so for every company lost we need three cells – whereas our rate over the last few years has been one company lost and only two cells formed. So, on the one hand this is a simple question of how to make ends meet.
It is also a question of fairness – should we instead ask life and general companies as well as intermediaries to make up the difference?

On the other hand, there is the issue of competition with other financial centres, many of whom are subsidised though the Commission is not. Also, some cells are simple and others complex, so is it fair to charge all the same fee – although you can imagine the difficulty of drawing a line between the two. Perhaps in time, cell volumes will greatly increase. However, to argue this you would have to believe that demand is price elastic.

All I can say is that there are of course always good arguments on both sides of questions like these. And we must simply leave Commissioners now to make their decision taking note of these arguments as well as the wider issues around fee increases.

As ever, 2012 saw a series of idiosyncratic supervisory issues that the division dealt with on a case-by-case basis with particular firms. In most cases the root cause of regulatory problems in particular firms is poor corporate governance. In terms of feedback to you, I cannot emphasis enough that the key challenge for you in terms of avoiding regulatory action is to ensure that your board has the right people on it and that your senior management is competent. Mistakes of course do happen but if they are mistakes that would not have happened if the board and senior management had been more awake, then the Commission is less likely to be forgiving.

I would now like to move to some of the supervisory themes of 2012. These themes are to do with Solvency II, IAIS policy preparation, the annual returns, the UK Retail Distribution Review (RDR), and intermediary sales practices.

At the beginning of the year the Commission discussed the question with industry and the government as to whether Solvency II transitional co-equivalence was in the best interests of the Bailiwick (slide p22). Co-equivalence means running two regimes simultaneously one of which is compliant with Solvency II and the other which is not. This is not the time to rehearse the arguments one way or the other but the Commission remains committed to the view that co-equivalence is in the long-term economic advantage of the Bailiwick. On the other hand the government, on the advice of the industry, did not agree with this conclusion and this is where the case currently rests. The Commission maintains a watching brief here though recent developments have been slow. For example there is talk that Solvency II will now not take place in Europe until 2016.

Whilst still on policy, the Commission has spent a lot of time this year working on discussion papers to ensure compliance with the new IAIS International Core Principles. These discussion papers have facilitated robust but cooperative meetings with the industry. The Commission is now in a better position to produce later in the year a consultative paper in relation to the International Core Principles (slide p23).

For those not directly involved, the discussions may be divided into two themes. On the one hand there have been those around qualitative issues, these being disclosure, the regulatory ladder of intervention and corporate governance of group supervision. On the other hand there have been more quantitative discussions around solvency issues. With regard to the latter, some in the industry support a step up in complexity. Others have pointed to the simple nature of many insurance entities in the Bailiwick and the need to produce a simple regulatory approach for them. The Commission is endeavouring to cater for both types of requirement. In particular it has worked in detail on a quantitative spread sheet that will enable both it and firms to understand the capital implications of various proposals. It is of course vital for both the Commission and the industry to understand the latter in detail and that is why we will be requiring firms or at least possibly a sample of firms, to formally submit our spread sheet as a quantitative impact study. The work done so far sets us on a fair course for the future.

Given the work required on the quantitative impact study, what this will tell us about stressed positions, and the consequent demand on industry resources, this year we will not be undertaking our annual stress test exercise. This will ease work demand on several of the larger companies.

Another theme for the division in 2012 has been the documentation and analysis of the annual returns (slide p24). In 2012 every single annual return was checked for correctness, and for breaches or near breaches of solvency as well as for key risk indicators such as combined ratios repeatedly in excess of 100%. Although, no systemic issue was revealed, this process resulted in a number of bilateral discussions with particular firms around solvency and around profitability. I would urge you to get in contact with us first on issues like this rather than let us ring you once we have digested the annual returns. The Commission has also written to GIIA with feedback and suggestions as to how the process might run more easily for all concerned in 2013. For example it would help if returns that had been ready for some time were not all sent into us at the very last moment.

The next issue is the Commission's response to the UK Retail Distribution Review (RDR) (slide p25). In May of this year the Commission sent its advice to the new government, it later discussed the paper with the government and in October it placed the advice on its website. The Commission's view – which emerged after a lot of internal discussion and occasional disagreement - is that the case for RDR is not proven and that the Commission wants to see how things develop before it takes a further view in particular on higher educational requirements and the banning of commissions for long term life products. There is no single right answer to RDR and different views are legitimate, given that this is a complex area to get right. The Commission's paper rehearses the argument against commission, especially when undisclosed, as tainting advice but also sets out the alternative of disclosure and the problem of social exclusion were RDR to be implemented. There is also the point that nobody yet can be certain as to how RDR will work out in the UK. The Commission is supportive of the government consultation on RDR and expects further work around RDR to take place in 2013.

This leads to the last key theme that it is one that comes from our 2012 onsite visits (slide p26). 8 of the 15 on sites we undertook in 2012 were themed around the issue of sales practices in relation to local long-term insurance intermediaries. The results are still being discussed with the relevant parties, so our views have not yet been finalised. The main discussion points are around weak implementation of client fact finding, limited shaping of the risk profile in line with that of the client, and suitability letters that did not explain why a particular product was right for a particular client.

If there are proven issues around sales advice, then the Commission will take forward this issue actively over the next few months. This will include our writing to all insurance intermediaries highlighting the issues. In particular, the Commission is likely to focus the on-sites on this issue again in 2013. I would therefore urge insurance intermediaries now to check and if necessary improve their sales practices.

In the 2011 Annual report, the Insurance Division committed to several 2012 objectives (slide p27). All of these have been met. In particular:

1. The Division has become more proactive through its assessment of the annual returns, through focusing on themed on sites and also in increasing due diligence around the examination of the annual actuarial validation for key life companies
2. The Division continues to define a response to new international regulations through its IAIS work
3. The Division continues to play its part in the transformation project
4. The Division has improved its statistical base, not least through website enhancement

This raises the question of 2013 supervisory activity (slide p28). 2013 will not see the division do anything particularly new but it will see the division further embed progress away from being compliance orientated to being more risk focused. This policy work will eventually lead to a more nuanced approach around both solvency and regulatory action vis-à-vis particular types of firms. Prudential meetings will enable the division to cover a wider range of firms, particularly the more risky ones. On-time analysis of the annual returns means that the division will be able to focus faster on solvency in particular firms. In 2013 the division intends to continue the deeper analysis of annual actuarial reports. Overall all these continued initiatives mean that the Commission will become a more risk-based regulator, in line with international requirements.

The transformation project in 2013 will continue to bolster this strategy. In 2012 the processing of personal information moved to the Authorisation Unit (slide p29). This was a processing task better done by centrally based experts than by the insurance division. Financial crime onsite visits are also now undertaken by a central team rather than by the insurance division. This has meant that on a Commission-wide basis fewer internal resources will be directed towards insurance and more towards banking where the risks are greater.

In 2013, the Data Management Unit will become accountable for processing for example the annual returns - a task for which it will be better suited than the division; and of course the more that this process can be made part of the extranet in the future, then the better it will be for everybody. The Data Management Unit will also produce insurance division statistics – freeing up the division to interpret and take action on the results. In due course the Sentinel project will make the collation of data easier through intranet direct entry of data (slide p30).

Finally in 2013, the Authorisation Unit will take accountability for processing aspects of the divisional authorisation process. This subject is still being scoped but the more that the division can be relieved of processing tasks the better, not least given high annual turnover in the insurance division. The transformation project is therefore an integral part of the movement towards risk based supervision in insurance.

It could be argued that these centralised units will have the effect of distancing the insurance division form licensees. As far as authorisation and data are concerned, the opposite is true. If we spend less time simply validating data, then we have more time to analyse it. In addition, all regulatory decisions remain with the insurance division. It is true that the division will in due course become less expert in financial crime mitigation. However in my view, important as this subject continues to be, I think the division has spent too much time on this subject to the detriment of prudential work. In that context I also welcome the removal of general insurance from the Handbook. This will bring Guernsey back into line with the UK and will enable Guernsey insurers to compete more easily for niche business in the UK. In addition, the AML/CFT division will provide a high quality of resource not least around insurance sector financial crime (slides p31 and 32).

To conclude, it is my impression that usually there is a general sense that insurance issues relating to the Bailiwick are best resolved amicably between the Commission and the industry. I would point to the work done together this year to keep the Guernsey Insurance Certificate alive, and the work on IAIS policy. This does not mean that the Commission and the industry have to agree on everything – clearly we don't and Solvency II is an example of this.

In individual cases, insurance firms here can take a hint about the need to improve their controls without the need for heavy-handed action by the Commission. The Commission now has a more robust enforcement process and this increases its ability to get to get tough with some firms. However if the Commission does this, it does it because it has to in line with its mandate and not with any sense of it being a singular objective. Increasingly the Guernsey government is playing its role in the insurance policy debate and, indeed, is leading it where appropriate as, for example with RDR – and this is to be welcomed.

So thank you for coming today and we will now have a panel session in which both I and two Deputy Directors of Insurance, Caroline Bradley and John Dunford, will take any questions (slide p33). Two of our staff – Chris and John – are circulating amongst you so please wait for a mike before you ask your question as otherwise not everybody will be able to hear what you say.