Guernsey Financial Services Commission

Industry Seminar – 6 December 2013

Insurance Supervision and Policy Division Presentation:
Applying the Core Principles

Caroline Bradley, Deputy Director

Introduction – Jeremy Quick

Thank you Dale and good day everybody.

I am going to speak for a few minutes before handing over to Caroline.

Of all the financial sectors in Guernsey, the insurance sector in the last few years has been one of the least volatile, succeeding in maintaining business levels at a stable level despite significant turnover. That is in part at least due to the expertise and efforts of the industry members here today.

However the insurance sector in terms of employment remains the smallest in the Bailiwick. I would therefore like to make a few suggestions on how it might grow.

To begin with, we might focus less on the past and more on the future. Yes we more or less invented the PCC but that was a long time ago and the PCC concept has been copied widely. Yes we have ICCs, PORCS and so on but none of these products has given us the sort of boost that the PCC did awhile back. Indeed it may be that our success with PCC is holding us back. For instance our ILS transactions use the PCC but we do not have SPVs or SPIs here. Perhaps there has been a degree of over confidence in one product?

So, looking to the future, where are the specific opportunities? I would suggest we concentrate on three areas – although none of these will cause surprise.

The first of these is cat reinsurance. Although business cat volumes are up in Guernsey, it may be that we have already missed out on fully capitalising on the present upsurge in cat business and the best we can now do is consider how to position Guernsey best for the next upswing. I know the industry itself is thinking hard about this and it is already clear that the structural improvements that are likely to be necessary will involve joint work by industry, the government and the Commission.

Another area that we could develop further is specialist general insurance. We already have some success here. However, overall, this area continues to comprise a relatively small part of the Guernsey insurance sector. Here I would suggest we need to build up more expert underwriting ability and that of course means more human investment and an openness - not least by government – to import relevant expertise from outside the Bailiwick.

The third and last area that we could develop more is intra-group life and health re-insurance. Again we have had success here but at least from where I sit I see these large deals as being sporadic and often unrealised. It may be there here we need to think about more consistent marketing.

In all these areas, it seems to me that more competition would be a further spur to innovation. In particular I am thinking here of more local firms whose success is tied to that of the Bailiwick alone.

The Commission has a role here. And we are at this moment working hard with industry to ensure a faster processing of business – although industry itself has said that we already have a first-class record. However, ultimately the health of the sector depends on the industry itself.

So what are the risks over the next year? Of course in insurance there are the hardy perennials – premium mispricing, under reserving and so on. However the one risk that concerns me most is the need in Guernsey to have a solid and expert core of ideally local insurance NEDs. We have of course already many of these but the demands on them across a hybrid and often complex insurance sector are great; so we need more of them. I hesitate to offer any solution here other than to note that the sort of pay increase that has occurred in some of the banking sector for NEDs has generally not been repeated for insurance.

So, my overall assessment is that the insurance sector is doing very well but that it continues to need to think about new opportunities. Of course I recognise here that little of this will be new to most of you here. So I would do now like to ask Caroline to take over, not least to talk about major policy changes that we will face this year.

Thank you for your time.

Caroline Bradley

Good morning everyone.

Slide: Applying the Insurance Core Principles

This talk is called applying the Insurance Core Principles but don't worry, I am not going to take you through all the core principles in detail. Instead, since the Core Principles underpin everything that we do I will review what we have done during 2013 in relation to the new Core Principles and look ahead to 2014 and set out what we expect to be doing during the year. Just to clarify, the Core Principles are those Principles established by the International Association of Insurance Supervisors (the IAIS) which provide a globally accepted framework for insurance supervision. These are the standards by which we are judged by external agencies such as the IMF when they carry out their finance sector assessments. The Core Principles were substantially revised and updated in October 2011, hence the need for us to review how we comply with them.

Slide: Review of 2013 activity

In reviewing 2013 I will start by looking at some of the statistics and trends we have seen during the year and then move on to review the policy work that we have undertaken in relation to the ICPs which leads on to other areas such as legislative changes and workflows.

Slide: Statistics

Firstly I thought I would just review some of the statistics for the year. In terms of the overall size of the industry we are seeing a levelling off in the growth in written premiums, gross assets and net worth. This is perhaps reflective of a continuingly competitive insurance market which sometimes makes the captive option marginal from an economic perspective.

We can also take a look at the new business that we have seen during the course of this year. As you can see, the growth is dominated by PCC cells and that growth this year has been driven by Insurance Linked Security (ILS) deals whereby a cell writes a fully collateralised catastrophe reinsurance deal.

It is very noticeable now in our statistics that there are many more cells than standalone companies. This trend has been accelerated in the past couple of years by the Homebuyers cells and by ILS cells.

Having said that, we have had some interesting new companies established; although the number of new companies tends to be offset by the number of surrenders so there is no overall growth in that area. We continue to see the establishment of entities to write specialist covers such as kidnap & ransom and fine art and Guernsey appears to be an increasingly popular domicile for those types of risks. A number of new reinsurance entities with substantial capital have also been established and we have also seen the establishment of an ICC which forms part of a Sharia compliant structure. One new insurance manager has also been licensed.

Slide: Solvency – ICPS 14-17

Now I will move on to look at some of the policy work we have been doing. Since I was appointed to the role of Deputy Director in October 2011 the solvency project has been on-going but we have made substantial progress this year and this is largely thanks to the contribution from the GIIA Regulatory & Technical committee. In the first quarter this year we undertook a capital impact assessment based on a sample of around 30% of the market.

The results of this enabled us to move forwards and we were able to develop some of the more detailed and practical aspects of the framework based on industry's feedback.

We then issued a consultation paper in September, I don't propose to go through the detail of that paper today but I would just urge people to read the paper and to respond to the consultation – the closing date is only 10 days away. We do have a good dialogue with GIIA but there are some areas on which an industry consensus may not be possible and we do wish to hear from individual firms as well. In particular, those who are not members of GIIA should take the opportunity to let us have their views.

During the consultation period we have continued to meet and discuss with industry and some tweaks to the framework will be requested as a result of those discussions. We will issue a feedback paper during the early part of 2014 following which we will finalise draft solvency rules which we will issue for discussion.

Slide: Corporate Governance

Another area where the Core Principles have changed substantially is in the area of Corporate Governance. There is much greater focus on all aspects of Corporate Governance following the financial crisis and the realisation that many of the problems could be traced back to a lack of oversight and understanding at board level. I know that the Commission's proposal to replace a Code with Rules is not widely supported by industry and we will listen to feedback in this respect.

Slide: Public Disclosure – ICP 20

The final area on which we are currently consulting is 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. We would of course wish to hear in particular from any firm that will be caught by these requirements.

Slide: IAIS Captive Application Paper

Finally I should just mention the continuing work on the IAIS Captive Application Paper that has continued during 2013. This is a paper which explains how to apply the Core Principles in the context of captive supervision. We think it is important that the IAIS is seen to acknowledge captives as a legitimate form of insurance in order to help dispel some of the suspicion that exists in some jurisdictions and organisations. The drafting of this paper is now substantially complete following a meeting last month.

Slide: Look ahead to 2014

So, turning now to next year. Our first job, as I have already mentioned, will be to analyse the consultation responses and issue a feedback document in which we will outline any changes to the proposed framework that we have made as a result of the consultation process. We then need to complete the internal processes and legislative changes to enable the rules to come into effect during 2015.

We will need to see the Captive Application Paper through the process of adoption by the IAIS. The IAIS is currently reviewing its procedures for adoption of papers but once the new process has been agreed the paper will be put through that process during 2014. At the latest we would expect it to be adopted by October 2014.

We will also, during next year, need to finalise a gap analysis in relation to the Core Principles. The bulk of the gaps identified have been addressed by the current consultation paper but there may be other minor gaps that can be filled by amendments to the Commissions internal processes and procedures or to the way we approach on-site visits.

Slide: Legislative changes

Legislative changes anticipated next year have to some extent been flagged up in various consultation papers issued by the Commission during 2013. In order to implement the new solvency framework we propose some amendments to the Insurance Business Law to remove the solvency requirements from the Law and to make Solvency Rules instead. We will also need to repeal the approved asset regulations and the asset and liability valuation regulations as those matters will be addressed in the Solvency Rules. I cannot give a definite timetable for the legislative changes at this stage but you will at least have the drafts early next year, well in advance of the changes coming into effect.

We propose to review the Licensing Regulations and the Annual Return Regulations in order to simplify and streamline the information collected – this will also tie in with other Commission projects that are working towards the electronic submission of information.

We will also work on guidance material to accompany each new regulation or rule so that this can be in place prior to new rules coming into effect. We will aim to have this guidance drafted in the first quarter of next year for discussion with GIIA.

Slide: Streamlining of workflows

Also, next year, we propose to do some work on streamlining of workflows in order to make the most efficient use of our time and resources.

We are looking at options for certain applications to be fast-tracked or, in some cases, pre-authorised. This already happens to a limited extent for certain PCC cells involved in ILS transactions but it is proposed to roll this out more widely so that any cell that meets certain criteria can be assured of a fast turnaround by the Commission. Where circumstances permit, such as where there are likely to be a number of cells all following a specific model, we can pre-authorise the cells so that the manager can get them up and running and simply notify the Commission afterwards. We are working with the GIIA ILS subcommittee to issue some guidance around our approach to these types of deals. Since we don't have Special Purpose Insurer legislation it is hoped that issuing some guidance or a protocol will, in the short term, be helpful to those seeking to bring the business to Guernsey.

I mentioned earlier that we are looking at the annual return requirements to see if those can be streamlined. Certain documents will no longer be required as the information is collected under the new solvency framework and others are of limited value and may be dispensed with.

In relation to business plans we will issue some guidance to reduce the number of referrals to the Commission. A change of business plan has only ever been required to be notified to the Commission but it has become the norm for changes of business plan to be referred to the Commission for approval and we have encouraged this by routinely giving approval or no objection. We will issue guidance on what constitutes a material change of business plan, for example, for a captive a material change of business plan might be starting to write unrelated party business. However, for a commercial insurer, especially one writing retail business, we would probably want to know about any new line of business. A captive should then only need to submit its business plan once a year with the annual return. We will also issue some further guidance regarding what should be contained in the business plan. It became apparent when trying to assess which insurers were commercial rather than captive that most business plans are inadequate for that purpose.

We hope that the number of requests for approval for parental loans will reduce following the introduction of the new solvency regime but, before we get there, we will try to apply those principles to the approvals we currently give. This will provide greater consistency and will mean that you will be confident about the amount the Commission will approve before you ask. It will also mean that we will spend less time trying to analyse parent company accounts.

We also wish to review the PQ requirements for cell controllers. The Law technically only requires a PQ for any individual shareholder controller who owns 50% or more of a cell. However, over the years we have collected PQs for anyone else we think is appropriate simply because they might be the manager's main contact at the parent company and we have therefore deemed them to be a controller. In future we will only require PQs from actual shareholder controllers. However, this does put more onus on the Manager and the Board of the PCC to ensure they have carried out sufficient due diligence on the individuals involved with a cell.

I would also like to review the requirements for staff of the insurance manager acting as alternate directors in one-off situations because, for example, a director is ill or is fogged in somewhere. Currently we require you to seek prior approval in those situations but it seems to me that it would be simpler to ask you to submit a PD with notification after the event providing that the staff member has already lodged a PQ with the Commission. This does not mean that the regular use of alternates is encouraged but we do need to have a practical approach to these situations.

All of these items will be done as early next year as possible and we will certainly aim to do them during the first quarter.

Slide: Impact & Risk – practical considerations

Following the Commission's reorganisation and centralisation of processes we have considered our supervisory approach within the division in order to achieve further efficiencies.

You will all be used to our rolling programme of on-site visits which means that you expect to have a visit every three to four years. Over the past couple of years we have tried to make those visits more focussed on specific themes whilst still maintaining the rolling programme. Going forwards we propose that on-site visits will be predominantly thematic. So, for example, instead of visiting a Manager and looking at all aspects of that operation, we will pick a theme and visit a series of Managers to look at that theme. It means that each visit will be much shorter but that you might see us a bit more frequently. This means that we will then be able to compare standards across all firms and issue market feedback when appropriate.

Some areas of risk that we might want to look at initially include corporate governance, in particular in relation to commercial insurers.

There also appears to be an increasing number of small commercial insurers that tread a very fine line regarding carrying on business in the UK. We would expect insurers to be aware of, and to have adequate controls in place to ensure that they do not fall foul of, UK regulations. We need to be especially vigilant in respect of any insurer dealing with UK retail customers because that is where the reputational risk for the Bailiwick lies.

I would also ask you to consider the necessity for routine meetings on captive related matters. If meetings are necessary it would be helpful to have a written briefing in advance of the meeting so that we can hopefully give a definite answer when we meet. We remain happy to meet prospective clients, if you feel that it helps, or to meet if there is a material issue to be resolved. We will be meeting with the larger commercial insurers more regularly than we have in the past as part of the impact focussed supervisory process that William described yesterday.

Slide: Other risk matters

There are a number of other matters that I wanted to mention as areas where we see risk going forwards.

The first of those is in relation to due diligence. As the number of captive opportunities for large corporate entities dries up there has been a shift towards business from smaller companies or even individuals. In some cases we are finding that the due diligence carried out by the Manager prior to submitting the application has been lacking. Whilst the Commission may sometimes have access to information that you may not have been able to find, it is worrying when simple Google searches turn up something that the Manager is clearly not aware of. Please could I ask you to bear in mind, as the sources of business become more varied, that you must ensure that you have carried out adequate due diligence on your potential client.

The Commission will be alert to abusive tax structures or proposals to provide insurance for such structures and will want to look carefully at the corporate governance around such structures and those that introduce them. This is an important reputational issue for Guernsey.

Also, for the avoidance of doubt, any proposal that is aimed at retail customers, even if via a fronting insurer, will be treated as a commercial insurer not a captive. When dealing with retail customers, or indeed any other unrelated party, you can expect that the application, including in particular the business plan, will be scrutinised in much more detail than for a pure captive. We see this as an area of risk that should not be underestimated.

We also think that non-executive Directors need to consider their role in the governance of commercial insurers, especially those dealing with retail customers. The Commission expects that the time and commitment required for a commercial insurer, however small that insurer might be, is significantly more that it would be for a captive and the Commission will expect the NEDs to be aware of the retail customer issues.

We also need to stay abreast of risks that are emerging for which insurers could be held liable even though the risk was not envisaged as part of the policy. We are hearing of policyholders in the US taking legal action against property insurers for breach of contract and receiving far more in damages than their original claim would ever have been worth. Also, there have been lawsuits against utility service providers for not responding quickly enough to restore services following a hurricane. In the US, there also is a long list of cases against companies who are thought to be emitting high levels of greenhouse gases and thus contributing to climate change. This raises issues for liability insurers as their pollution exclusions may not stand up to this scrutiny.

Finally, there are emerging risks associated with Nanotechnology which are not yet addressed by most liability policies.

All insurers need to be aware of how these emerging risks may impact in the future on policies that they are writing now.

So that concludes what I wanted to say today. Thank you all for attending and we are happy to take questions now.