Guernsey Financial Services Commission

GUERNSEY AND THE DEVELOPMENT OF GLOBAL AND EUROPEAN INSURANCE CAPITAL STANDARDS

FEEDBACK ON THE DISCUSSION PAPER ISSUED BY THE GUERNSEY FINANCIAL SERVICES COMMISSION

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This feedback paper reports on input received by the Guernsey Financial Services Commission on the Discussion Paper issued in September 2017.

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1: Executive Summary

1.1 Background

This paper details and responds to the feedback received on the Discussion Paper ("DP"), "Guernsey and the Development of Global and European Insurance Capital Standards" issued in September 2017.

This paper describes the evolution of global and European insurance capital standards and discusses the future for Guernsey's regulatory framework in that context. The DP sought public feedback to help inform the important decision which has to be made as to the future of the Guernsey insurance solvency framework which will potentially affect the Bailiwick's insurance sector and its economic prosperity.

1.2 Feedback received

The DP was issued publicly. Twelve responses were received in total: six from Guernsey licensed insurance managers, four from licensed insurers, one from an interested individual and a response was also received from the Guernsey International Insurance Association (GIIA). While a small number of responses have been received it should be noted that the respondent insurance managers act for over 86% of licensed insurers. Moreover, a number of international insurers and managers who have not directly responded to this DP are members of GIIA and would have had an opportunity to contribute to the GIIA response. The response received should, therefore, provide a fair representation of the position of the Guernsey international insurance sector.

It should, however, also be noted that no written responses were received directly from domestic insurers or kidnap & ransom insurers and these licensees are not members of GIIA.

The Commission is grateful to all respondents for taking the time to consider and comment on the DP. Fuller consideration of these comments is in section 2.

1.3 Summary

- There is no consensus view on whether the jurisdiction should pursue Solvency II (SII) equivalence for its insurance regime.
- Whatever the arguments in favour of SII equivalence might be, the Commission believes that equivalent status is in practice unavailable to Guernsey given that it is unlikely that the European authorities would countenance an equivalence application from Guernsey in the foreseeable future.
- It remains important that the Bailiwick is seen to adhere to the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs) and the progress of the developing IAIS Insurance Capital Standard will continue to be monitored.

2: Summary of Feedback

2.1 Overall position

There is no consensus view on whether the jurisdiction should pursue SII equivalence for its insurance regime. There are, however, certain areas of consensus which can be highlighted:

- There is no support for seeking SII equivalence for any sector other than commercial general re-insurance (although even here there is no consensus view on SII equivalence for commercial re-insurance.)
- There is no support for an application for group solvency equivalence under Article 227.
- While the principle that firms within scope/likely to benefit from SII equivalence should pay for it was generally accepted, there were no specific offers to finance the equivalence process.

The small number of points of broad agreement noted above is indicative of the diverse views and perspectives within the Guernsey insurance industry.

2.2 Responses

Below is a detailed summary of responses.

a) *Do you consider ICS a medium-term option for Guernsey and if so why?*

Generally respondents recognised that ICS may be a medium-term option for Guernsey but qualified such recognition by identifying the uncertainty around the ICS in terms of final form, timing and likelihood of implementation. Those in favour of seeking SII equivalence expressed the view that the SII standard was more commercially relevant at this point in time.

b) *What is the business case for your business for rejection or pursuit of equivalence (as applicable)? Please share the outcomes of any cost/benefit analysis which may have been conducted.*

Three insurance managers stated that they would not support SII equivalence. The business cases made focused on:

- the uncertainty created by an SII application and the uncertainty of a positive assessment;
- the regulatory, compliance and capital costs of SII equivalence and the likelihood that such cost burden would ultimately be borne by the wider insurance industry, beyond only commercial general insurers, whatever the initial intention might be to limit scope; and
- the likelihood that existing and prospective business would be deterred from the jurisdiction - one manager gave examples of specific deals which might be

called into question in the event of the implementation of a SII equivalent regime.

Two insurance managers responded in support of SII equivalence. The business cases made included the following arguments:

- both managers made the case that, with a SII equivalent regime, potential future fee income from rated reinsurance management would outweigh potential lost income from existing more niche reinsurance business such as PORCs and POICs (if such business was in scope of the SII regime). One manager provided specific estimates;
- the current impact of EU member state national regime restrictions on reinsurance from non-equivalent regimes; and
- the inevitability of increased compliance costs whether via Solvency II equivalence, changing accounting standards, ICS or other regulatory measures.

One insurance manager stated that it was too early to make a definitive pronouncement on SII equivalence but was supportive of further development to establish the scope of application and the impact on different categories of insurer.

Three licensed reinsurers responded in support of SII equivalence. These insurers highlighted current restrictions on their ability to write contracts directly with certain EU cedants and the risk of further extension of restrictions throughout Europe and globally. SII equivalence is seen as the solution to this issue.

One insurer indicated that it would not support SII equivalence. Concerns were raised with respect to:

- a downgrading in the perception of the quality of regulatory standards of any non-SII equivalent regime under a bifurcated approach;
- second order impacts of equivalence such as scarcity of skilled resource; and
- the risk that the scope of equivalence might extend beyond that originally intended to include not only reinsurers but also direct general and life insurers.

Owing to the lack of consensus amongst its membership GIIA has not taken a position on Solvency II equivalence.

No respondent offered a detailed cost/benefit analysis of the impact of SII equivalence on their business.

c) *Do you believe there is a case for equivalence when considering the broader Guernsey insurance industry?*

Responses received largely mirrored the competing views of the future described in the DP.

The majority of respondents recognised that SII equivalence would benefit the Guernsey commercial general insurance sector. Those not in favour of SII equivalence, however, expressed scepticism about the potential for future growth in this sector and the uncertainty and threat posed by pursuit of equivalence to other existing lines of business. Taking this view, captive and other niche insurance vehicles will continue to evolve and play a significant part in the future of the Guernsey insurance industry.

Those making the case for equivalence present the captive business as stagnant and PORC/POIC business of marginal benefit to the jurisdiction. Taking this view, commercial reinsurance is seen as key to the future growth of the insurance industry in the Bailiwick.

d) *Does the cost of achieving equivalence, both in terms of the cost of doing business and the potential effect on regulatory fees, influence your answer?*

e) *If so what do you consider would be a reasonable cost?*

Increase in costs, as indicated above, was a key area of concern amongst the majority of respondents not supporting equivalence.

There is general agreement that, in the event of a decision to seek equivalence, framework development and implementation costs should be met by those firms set to benefit. One respondent did, however, suggest that ongoing costs of supervision might be more broadly shared across industry and suggested a possible degree of increase.

No respondent attempted to estimate the reasonable cost of equivalence but one indicated the opinion that costs were likely to be far greater than expected.

Some members of GIIA suggested that the States of Guernsey and/or the promotional bodies might contribute to costs.

f) *Please describe any assumptions which have been made in forming your response.*

Assumptions made were reflected in individual responses received.

g) *If you are in favour of equivalence, is this opinion based on an assumed modified version of the Solvency II requirements? If so please indicate the specific modifications to the Solvency II rules upon which support of equivalence would be contingent?*

Those respondents in favour of equivalence generally pointed to the Bermuda model as a starting point. One response received, however, suggested the adoption of an unmodified version of SII.

h) *If you are not in favour of equivalence, is this opinion based on an assumption of a strict replication of the Solvency II rules? If so, would any specific modification to the Solvency II rules change your position on equivalence?*

One insurance manager opposed to the pursuit of SII equivalence indicated preparedness to contemplate an equivalence regime on the condition that:

- only large general reinsurers were within scope; and
- costs were effectively ring-fenced.

No other suggestions with respect to specific modification were received.

i) *What might, in your assessment, be the views of the EU authorities?*

Four respondents (three managers and an insurer) indicated that an approach to the European authorities would likely be dismissed on ground of the immateriality Guernsey insurance sector to the EU. Further arguments were made that any proposed carve out of the majority of the Guernsey insurance business from scope would be unacceptable

Three respondents (one manager and the two reinsurers) indicated a view that the application would be positively received based on a perceived drive for global expansion of SII, Guernsey's good international standing and the likely high level of preparedness of the jurisdiction in event of assessment.

Five remaining respondents expressed no opinion on the likely views of the EU authorities.

j) *Do you have a view on increasing the current regulatory confidence level for reinsurers in Guernsey and if so why?*

Two responding commercial reinsurers indicated no concerns about increasing the one year VaR confidence level to 99.5% (from the current 97.5%). One manager made an argument in support of an increase on the grounds of equivalence with the UK and increased policyholder protection.

Three respondents (GIIA, and two insurance managers) were in favour of an increased level for commercial reinsurers only (i.e. not PORCs or captives etc.). One manager commented that there would be little benefit of an increase for commercial reinsurers if this was not made in conjunction with a SII equivalent regime.

The remaining five respondents made no comment.

k) *Do you think the Commission should regulate reinsurance brokers?*

Broadly there was a no consensus and little argument made around this question by respondents. Three were in favour of regulation and 3 against. One manager and GIIA indicated a view that this questions was largely irrelevant to the current debate on SII and the current very limited extent of local brokerage activity.

l) *How do you view equivalence in terms of a global brand that might support Guernsey as a global insurance centre?*

Broadly respondents answered this question in line with their overall view on SII equivalence. The reinsurers and supporting managers see SII equivalence as essential to building Guernsey's brand as a global insurance centre. Those not in favour, while in some cases acknowledging a possible benefit of the "equivalence brand", did not see this as key, preferring to focus on Guernsey's position as a leading niche player.

3: Commission Response

Conclusion

The Commission recognises that there is no one ‘right’ answer in determining the future of the regulatory insurance solvency scheme in Guernsey; and that different views may legitimately prevail.

As to whether Guernsey should seek equivalence with Solvency II, there are arguments in favour of this solution. Solvency II is increasingly being recognised to be a regulatory regime with credibility beyond the European Union. Equivalence would remove the need for Guernsey to always prove to the world the credibility of its solvency regime. It would specifically help the further development of the ILS sector regime in Guernsey by making ILS distribution easier within the European Union.

On the other hand, there would be material costs to equivalence. These would take two forms. The first is the firm-specific cost; albeit limited only to firms that would operate under Solvency II equivalent standards. The second is the additional cost incurred by the Commission to deliver equivalence. This could be funded either narrowly by those firms seeking equivalence or more widely. Some firms consider these costs worth paying; others do not. As to whether the advantages of equivalence outweigh the disadvantages is a matter of opinion.

Before determining this, it is worth contemplating whether or not the Bailiwick is likely to be considered for equivalence; were it to apply for it. There are several factors at work here. The first is the fact that there is no longer a clear pathway by which to access equivalence - as there was for example for transitional equivalence several years ago. The second is that there is limited insurance business undertaken in Guernsey with regard to the European Union (excluding the UK). The third is that there is no demand from a major insurance group for equivalence. The final point is that any equivalence application is likely to be made more difficult by the questions that will continue to exist for some time around the trading relationship between the UK and the European Union; including within the confines of insurance regulation. All these factors make it unlikely that the European authorities would countenance an equivalence application from Guernsey in the immediate future. The last point means that this position is unlikely to change for several years; that is until after the UK and the European Union have re-aligned themselves in a new stable trading relationship.

Overall, therefore, the Commission is of the view that, whatever the theoretical benefits of equivalence, there is no practical possibility for the Bailiwick to pursue equivalence either at the present or indeed for several years yet. In that case, the Bailiwick should not proceed with an equivalence application.

Turning to the International Capital Standard (ICS), this remains some way off in terms of likely implementation and its design is intended for Internationally Active Insurance Groups (IAIGs) rather than legal entities. The Commission will therefore continue to keep a watching brief on the continued evolution of the ICS.

Nevertheless, and given the international business of much of the Bailiwick's insurance business, it remains important that the Bailiwick is seen to adhere to the IAIS Insurance Core Principles (ICPs). To this end, for example, the Commission is currently consulting on a series of measures that will further align Guernsey with international standards. Although these measures do not in this instance relate to the quantitative solvency standard, the Commission remains open to the possibility of further refinement in its solvency standard as and when appropriate.

By adhering to the ICPs, the Bailiwick also increases the likelihood of being assessed by other countries, such as the US or indeed post-Brexit UK, as having in place an appropriate regulatory regime for insurance.

To conclude therefore, whilst there are reasonable arguments in favour of equivalence, the latter is in practice unavailable to Guernsey at present. Going forward in the immediate term therefore, the focus for the Bailiwick is to track the development of the ICS, ensure compliance with the ICPs; and also seek acknowledgement as appropriate from other supervisors that Guernsey insurance regulation is at least parallel to theirs. In the longer term, the Bailiwick will need to consider more strategic issues around the current re-insurance confidence period as well as further refinements of its solvency regime in light of global developments.