



Guernsey Financial
Services Commission

EVOLVING INSURANCE REGULATION

**A CONSULTATION PAPER ON THE REVISION OF THE
REGULATIONS, RULES AND CODES FOR LICENSED INSURERS**

24 September 2013

The Guernsey Financial Services Commission invites comments on this consultation paper and your comments should be submitted by no later than 16 December 2013.

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Executive summary

1. The Guernsey Financial Services Commission is proposing that a number of the insurance Regulations, Rules and Codes it administers should be revised in order to keep pace with emerging international standards in insurance regulation.
2. This Consultation Paper will outline proposed changes to a number of the regulations, rules and codes governing insurance business in Guernsey. These changes are intended to bring Guernsey in line with new international standards in insurance regulation, as set out by the International Association of Insurance Supervisors (“IAIS”) in the Insurance Core Principles of October 2011 (“the ICPs”). The core principles can be found on the IAIS website at [Insurance Core Principles - IAIS - International Association of Insurance Supervisors](#).
3. There are four key areas in which the ICPs have evolved significantly and these are: Solvency and Capital requirements, Corporate Governance & Internal Controls, Public Disclosure and Group Supervision. This paper addresses the first three of those areas but the Commission does not currently propose to implement a group supervision framework for insurers given that it does not currently operate as an insurance group supervisor.
4. The key aims of the proposals in this consultation paper are to:
 - meet international standards;
 - provide internationally comparable levels of protection to retail customers of insurance products;
 - enhance the clarity and transparency of the regulatory requirements;
 - further develop the Commission’s risk based approach to supervision;
5. The Commission is committed to meeting international standards to ensure the continuing credibility of Guernsey as an international financial services centre. We are also committed to introducing rules, on a proportionate basis, to implement those standards which take proper account of the economic wellbeing of the Bailiwick and the firms which operate in it.
6. The Commission has developed these proposals in discussion with industry and acknowledges, with thanks, the involvement of the members of the Guernsey International Insurance Association Regulatory & Technical Committee.

Solvency

7. The Commission is proposing significant revisions to the current solvency regime for Guernsey insurers. This new regime will be risk based to be in line with international developments in insurance regulation.

8. The proposed solvency regime will be based upon ICPs 14 Valuation, 15 Investment, 16 Enterprise Risk Management and 17 Capital Adequacy. The guidance within these ICPs makes it clear that the risk tolerance of the supervisor should inform all areas of its solvency regime, from the setting of regulatory capital levels to the triggers for supervisory intervention.
9. This paper sets out the Commission's overarching risk tolerance strategy for insurance licensees. In the Commission's opinion the most significant risks are the potential detriment to policy holders and the potential harm to the reputation of the Bailiwick. The capital requirements, level of supervision and strength of potential interventions will be set with these risks in mind.
10. Briefly, the Commission considers the failure of commercial life insurers to pose the highest risk to policyholders and the reputation of the Bailiwick, followed by commercial general insurers and reinsurers. Captive (re)insurers are held to pose a relatively low risk to policyholders and the reputation of the Bailiwick. Some entities, such as transformer cells or catastrophe reinsurance cells that are fully collateralised and which cater for sophisticated investors and insurance buyers pose the lowest level of risk.
11. Also included in this paper is an example of the Commission's proposed ladder of intervention which sets out at which levels of regulatory capital the Commission will intervene and the nature of such intervention at each level.

Corporate Governance

12. The Commission is proposing that the current Licensed Insurers' Corporate Governance Code be withdrawn and replaced with a new set of Rules. These Corporate Governance Rules have been drafted with specific reference to ICP 7, Corporate Governance and ICP 8, Internal Controls. To a large extent the principles dealt with in these rules are compatible with those contained in the Finance Sector Code of Corporate Governance; however, the ICPs are more detailed and more specific to insurers.
13. The rules have been drafted as overarching principles followed by rules and guidance. Whilst the guidance has been drawn from the ICPs it has been tailored as appropriate to the Guernsey insurance market.
14. Whilst updating corporate governance standards these rules will not pose material additional obligations on insurers. By issuing rules rather than a code the Commission believes that the enforceability of the requirements can be more effectively demonstrated, important in ensuring that as well as meeting, we are seen by our international counterparts to meet the global standards required of all regulators.

Public Disclosure

15. The Commission is proposing to amend the current Insurance Business (Public Disclosure of Information) Rules, 2010 in order to bring them more in line with the standards set out by ICP 20, Public Disclosure. There is an increasing focus on public disclosure as a means to achieve greater transparency and discipline within financial markets. The proposed changes will increase the disclosure requirements for the largest commercial insurers.
16. It is not the Commission's intention to require the release of commercially sensitive information nor unduly increase the time and cost of compliance. The Commission acknowledges that there will be an increase in administrative costs inherent in complying with the proposed requirements, however the intent is to minimise these as much as possible. To this end, the Commission proposes to satisfy as many of the requirements of ICP 20 as possible using information licensed insurers already provide within their financial statements and annual returns.
17. There will be some de minimis exemptions to these proposals. In addition captive insurers will be exempt as there is no public interest need for disclosure.

Group Supervision

18. Recent events have demonstrated that solo supervision of entities forming part of a group is insufficient to fully assess the risks the entity in question, policy holders and the economy as a whole are exposed to. The systemic risks such financial services groups pose can be considerable. With this in mind, the Commission has considered the requirements of ICP 23 on group supervision, ICP 25 on supervisory co-operation and coordination and ICP 26 on cross border co-operation and coordination on crisis management and proposes the following measures.
19. Broadly speaking, the requirements of ICPs 23, 25 and 26 can be divided into those that apply to both home and host supervisors, and those that apply to home supervisors only. Guernsey does not currently serve as the home jurisdiction for any insurance group. Furthermore, the Commission does not intend to be the home supervisor for any insurance group due to the costs inherent in building the required infrastructure.
20. Under the Commission's proposals licensed insurers that are parts of groups would be required to provide the Commission with relevant group information as and when required. The Commission will proactively make contact with the group-wide supervisors of entities that are significant to the Guernsey market. The Commission will also cooperate with other group wide supervisors upon request, including the sharing of sensitive data, provided the Commission is able to satisfy itself that said supervisor has equivalent Data Protection and Security policies and procedures in place. In this way the Commission will fulfil the heightened expectations of host supervisors.

Timetable

21. This consultation is open for a period of twelve weeks until 16 December 2013.
22. Following this consultation period the Commission will evaluate and collate the responses and will issue a summary of the comments received together with the resulting draft rules and guidance during the first quarter of 2014. It is proposed that the new solvency rules will be effective for financial years commencing on or after 1 January 2015.
23. Responses should be sent to:

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Risk Based Solvency

24. The Commission has, for some time, practised a risk based approach to many aspects of insurance supervision in areas such as the ‘risk gap’ for captives, on-going monitoring and the planning of on-site visits and has kept pace with international standards in these areas utilising an approach that is proportionate to the nature, scale and complexity of the Guernsey insurance market. The Commission’s objective is to strike a balance between protecting both policyholders and the reputation of the Bailiwick on the one hand and imposing unduly onerous levels of regulatory capital and compliance costs on the other hand.
25. Whilst the Commission is committed to meeting the ICPs it is accepted that it may not be possible to fully observe every standard within every ICP and that the risk of failing to do so is acceptable and manageable. It is important that the solvency regime reflects the Commission’s view of risk and whilst the framework has been designed around the ICPs there are areas where, for reasons of simplicity and practicality, it may not strictly comply with all aspects of the ICPs. An example of this would be the requirements for valuation of assets and liabilities under ICP14. The ICP requires that the valuation of assets and liabilities reflects the risk adjusted present values of their cash flows. For Technical Provisions this is referred to as the current estimate. A margin over the current estimate should then be added back in to reflect the inherent uncertainty of the liabilities. The Commission considers that it is acceptable for insurers to simply follow internationally accepted accounting standards when valuing assets and liabilities rather than setting specific requirements which may require them to be recalculated for regulatory purposes. For the majority of Guernsey insurers the differences will be immaterial. In any case it is anticipated that accounting standards and the ICPs will eventually converge.
26. ICPs 14 to 17 deal with various aspect of a risk based solvency regime. The guidance material within these ICPs makes it clear that the level at which regulatory capital requirements and solvency control levels are set together with the levels of intervention that are triggered will depend upon the risk tolerance of the supervisor.

Risk Tolerance

27. There are two main aspects to consider in assessing the Commission’s risk tolerance with respect to the failure of insurers and reinsurers – the risk to policyholders and the risk to the reputation of Guernsey as a finance centre. Both risks will vary depending upon the type of insurer or reinsurer involved.
28. The Commission has different levels of risk tolerance for different types of insurer as follows:
 - a. The Commission has a low tolerance for the failure of Commercial Life Insurers, who present a high risk of policyholder loss and reputational detriment. These insurers should be subject to the most robust solvency framework in line with international standards.

- b. The Commission has a medium tolerance for the failure of Commercial General Insurers since the extent of the impact upon policyholders of a general insurer failure will be less devastating than that of the failure of a life insurer.
 - c. The Commission has a low/medium tolerance for the failure of Commercial Reinsurers. Retail customers require a higher level of protection than sophisticated buyers of reinsurance who have the ability to make their own comparative assessment of prospective reinsurers. The direct effect on policyholders is less significant when a reinsurer fails.
 - d. The Commission has a high tolerance for the failure of Captive insurers and reinsurers since there is no risk to members of the public and only a low risk of reputational issues arising out of such a failure.
29. The Commission proposes that, for the purposes of the quantitative aspects of the statutory solvency requirements, captives should be distinguished from commercial insurers and that a proportionate approach should be taken to the qualitative aspects of the regime. In other respects the insurance laws will continue to apply to captives in the same way as for all other insurers.
30. In the interests of transparency, each category of insurer must be clearly defined. It is appreciated that there are some insurers for whom it is not possible to fit precise definitions and these will be dealt with on a case by case basis. The key determinant will be whether there is any risk to unrelated parties. The Commission proposes the below definitions:
- Category 1 – Commercial Life (Re) Insurer: a long-term insurer with any element of unrelated party business.
 - Category 2 – Commercial General Insurer: a general insurer with any element of unrelated party business
 - Category 3 – Commercial General Reinsurer: a reinsurer providing reinsurance to a commercial insurer, whether or not part of the same group, and with no direct business.
 - Category 4 – Captive (Re)Insurer: an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities or associations, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities.
 - Category 5 – Special Purpose Entities: Transformer cells, catastrophe cells, fully funded entities.

31. For the avoidance of doubt, the Commission does not regard a reinsurer that is owned by a commercial insurer as a captive; in fact, the IAIS definition of a captive specifically excludes such entities.

Regulatory Capital requirements and the ladder of intervention

32. ICP 17, Capital Adequacy requires the supervisor to set solvency control levels which trigger different degrees of intervention by the supervisor. The upper control level is a level above which the supervisor does not intervene on capital adequacy grounds. The lower level is the level below which no insurer is regarded as viable to operate effectively and which, if breached, the supervisor would invoke its strongest actions.
33. The upper control level is required to be defined such that assets will exceed liabilities with a specified level of safety over a defined time horizon. This is referred to as the calibration of the solvency requirement (see below).
34. The concept of an upper and lower range for the regulatory capital requirements is now well established internationally and is used in a number of jurisdictions including the EU, Switzerland, Canada and Australia.
35. The Commission proposes two regulatory capital requirements, the Prescribed Capital Requirement (“the PCR”) and the Minimum Capital Requirement (“the MCR”).
36. Broadly speaking, the Commission would not require action to increase capital held or reduce risks undertaken if the insurer’s capital remains over the PCR. However, this would not preclude the Commission from intervening or requiring action by the insurer for other reasons, such as weakness in the risk management or governance of the insurer. The PCR will be set at a level that allows intervention at a sufficiently early stage such that there would be a realistic possibility of rectifying the situation.
37. The MCR is the intervention point at which the Commission would invoke the strongest action and represents the level below which no insurer is regarded as being viable to operate effectively.
38. The PCR and MCR represent two solvency control levels on the Commission’s proposed ladder of intervention. Solvency control levels are regulatory capital levels at which intervention by the Commission would be triggered. The strength of such intervention will vary with the point on the ladder at which it occurs.
39. If the insurer’s capital were to fall below the level of the PCR the Commission would require some action by the insurer to either restore capital levels or reduce the level of risk undertaken. The extent of the action required will depend upon, inter alia:
- The extent to which the capital has fallen below the PCR,
 - The nature, scale and complexity of the Licensee’s risks,
 - The nature of the insurer’s policyholders; the Commission will act swiftly to protect retail customers, and

- The extent of the risk to the reputation of the Bailiwick.
40. The actions that the Commission would require of the insurer will depend upon the level of risk posed by the capital deficiency and the extent to which those risks can be managed and mitigated without risk to policyholders.
 41. The MCR represents the intervention point at which the Commission would invoke the strongest action. The PCR cannot be less than the MCR and therefore the MCR represents the lower bound for the PCR.
 42. Capital resources eligible to meet the PCR may not be eligible to meet the MCR. Therefore, it is possible for capital resources to be sufficient to meet the PCR but insufficient to meet the MCR.
 43. Appendix 1 shows the details of the proposed Supervisory Ladder of Intervention. This ladder is somewhat based on a supervisory guide to intervention published by the Canadian regulator OSFI.
 44. The Commission will generally follow the processes described in the ladder but reserves the right to deviate from this approach, as it may deem necessary or appropriate to meet its objectives.
 45. The circumstances outlined at each stage of the ladder may be considered alone or collectively as an indication of which stage each licensee has reached. These are non-exhaustive lists and the Commission may take other factors into consideration as necessary. In the interests of transparency, the Commission will indicate to a licensee whenever it considers that it is at any stage on the ladder other than normal operations.

Calibration of the Solvency requirements

46. The Commission proposes to use the Value at Risk (“VaR”) as the risk measure to calibrate the PCR. The Value at Risk (VaR) measures the potential loss over a defined period for a given confidence interval. For instance, if an insurer has a one-year 99.5% VaR of £2 million, there is no more than a 0.5 per cent probability that the available capital resources of the insurer will fall in value by more £2 million over the next 12 months. Although it has several short comings as a coherent risk measure, the VaR has become an internationally accepted method of defining solvency requirements.
47. For commercial life (re) insurers (Category 1), it is proposed that the required confidence level to which the PCR is calibrated is set at 99.5% VaR over a one year time horizon. This means that the insurer should hold sufficient regulatory capital to cover the loss caused by a one in two hundred year event.
48. For commercial general (re) insurers (Categories 2 & 3), the Commission tested a confidence level of 97.5% as part of the Capital Impact Assessment. Initial results showed that 9 out of 27 commercial participants would have insufficient capital resources to meet the PCR calibrated at this level. However, on further investigation,

six of the initial nine participants that failed could meet the PCR if credit was taken for existing recourse agreements, solvency modifications and loan approvals.

49. The Commission seeks stakeholder feedback on whether to adopt a 97.5% confidence level for commercial general (re) insurers or increase the level of safety to policyholders to 99.5% to be in line with emerging international standards. The Commission tested the impact on solvency of increasing the confidence level to 99.5% as a post Assessment exercise. The results indicated that only four additional commercial participants would have capital resources less than 100% of the PCR. However, each of these participants could implement simple changes to enable them to meet the PCR without additional capital being required. The Commission will carefully consider any comments received in this regard as a result of the consultation and will also consider transitional provisions.
50. The confidence level adopted for commercial (re)insurers in many other jurisdictions is set at 99.5%. It is difficult to justify a confidence level lower than that which would be required in the jurisdictions in which the customers of most of the Commercial insurers are based. In addition, the potential reputational damage that could result from the failure of a commercial insurer could be increased if it were also reported that Guernsey's solvency standards are lower than those that are generally required internationally. For these reasons the Commission strongly advocates adopting a confidence level of 99.5% for Commercial insurers.
51. For captive insurers (Category 4), it is proposed that the required confidence level to which the PCR is calibrated is set at 90% VaR over a one year time horizon, which is equivalent to a one in ten year event. This is because a captive's time horizon is dependent on its parent's requirements which may change over time. The captive is not able to take a very long term view since it is only able to respond to the needs of its parent and the risks offered to it. The parent company will need to consider the implications for the capitalisation of the captive depending upon the risks being offered to it at any particular time. For these reasons the Commission considers that a captive need not be capitalised to the same level as a commercial insurer with third party policyholders.
52. The risks to be included will be limited to underwriting risk, counterparty default risk and market risk. For long term insurers, underwriting risk will cover mortality, longevity, disability/morbidity, lapse, expense and catastrophe risks. For general insurers, underwriting risk will cover premium and reserve risks. For all insurers, market risk will cover risks relating to changes in the value of interest rates, corporate spreads, exchange rates, equities, property and derivatives. For all insurers, counterparty default risk will relate to (re)insurance receivables, reserves, loans, cash and cash equivalents, money market investment funds, other on-balance sheet assets and off-balance sheet assets.
53. The Commission does not intend to include concentration risk, operational risk or liquidity risk in the calculation of the PCR. Analysis of QIS5 applied to captives demonstrated that the effect of ignoring operational risk is minimal and concentration

risk is an unduly dominant source of capital requirement. It is therefore proposed such risks are considered as part of the OSCA or ORSA process depending on the licensee type. The proposals for ORSA and OSCA are outlined later in this paper

54. The Commission intends that the PCR for general insurers be determined by multiplying a risk exposure measure (such as net premiums or reserves) by a prescribed capital factor. In contrast, the Commission intends the market risk capital requirement and underwriting risk capital requirement for long term insurers to be determined by considering the change in the value of assets and liabilities following prescribed stresses. The capital factors and the stresses are calibrated by the Commission at the specified confidence levels.
55. Diversification factors are then applied within each risk and then to the overall result. Due to this allowance for diversification it is possible that, for some companies, the PCR may be lower than the MCR which does not allow for diversification. Therefore, the MCR will represent the lower bound of the PCR.
56. The Commission is of the view that if there are prudential reasons for doing so, it may, in writing, determine a supervisory adjustment to be included or deducted from the PCR of a licensee.
57. The Commission considers that the MCR should be determined taking into account three characteristics: simplicity and auditability, calibration and safety net. Simplicity can be interpreted in both the calculation and the input data. Auditability is whether the calculation is based on data available in the audited annual accounts. Calibration means that for the majority of firms the PCR is greater than the MCR to enable a functioning ladder of intervention. The MCR is to provide an ultimate safety net to protect policyholders against unacceptable levels of risk.
58. For general insurers, the existing margin of solvency requirement is calculated as 18% of net earned premium during the previous financial year or 5% of loss reserves, whichever is the higher. For life insurers, the margin of solvency requirement is calculated as 2.5% of policyholder liabilities.
59. The advantage of retaining the existing margin of solvency formulas is they are simple to understand, calculate and communicate. However, they are not risk based and make no allowance for diversification. Also for general insurers, the capital factor for premium risk, which is implicitly calibrated at a 94% confidence level, is inconsistent with the calibration of the reserve risk factor, which is implicitly calibrated at a 69% confidence level.
60. Another option is to link the MCR to the PCR; however, an MCR determined as a percentage of a result stemming from a complex model is not regarded by the Commission to be simple. In discussion with industry the preference was for a simple MCR which could be calculated on a stand-alone basis.

61. The Commission intends the MCR to remain a simple calculation. For life insurers, the MCR will remain at 2.5% of non-linked policyholder liabilities. For general insurers, the MCR will be based on a percentage of either premium written or technical provisions, whichever is the higher. It is proposed to amend the premium based calculation from net earned premium to net written premium over the past 12 months to better reflect the risks that the company has already taken on. It is also proposed to recalibrate the capital factors to 12% of net written premium and 12% of claim reserves. This is to ensure consistency in the level of protection provided to policyholders, which is broadly equivalent to an 85% VaR over one year, and to enable a functioning ladder of intervention between the MCR and the PCR.
62. The Commission is of the view that if there are prudential reasons for doing so, it may, in writing, determine a supervisory adjustment to be included or deducted from the MCR of the licensee.

Acceptable Capital Resources

63. ICP 17, Capital Adequacy, requires the supervisor to determine which capital resources are eligible to meet regulatory capital requirements.
64. Adjustments will be made to the value of certain assets and liabilities on the statutory balance sheet to arrive at the regulatory balance sheet. For example, subordinated loan liabilities will be excluded from the regulatory balance sheet and their value included in regulatory capital requirements to meet the PCR and MCR. Also intangible assets will be excluded due to their uncertain realisable value in times of financial distress.
65. The Commission also proposes that off-balance sheet assets where the likelihood of payment if needed is sufficiently high according to specified criteria will be eligible to meet the PCR. Such off-balance sheet assets include, for example, letters of credit and issued but unpaid share capital. It is proposed that only letters of credit that meet certain criteria (such as being irrevocable, issued for the benefit of the insurer and provided by a recognised bank in a recognised territory) will be eligible to meet the MCR.
66. The Commission proposes to repeal the Insurance Business (Approved Assets Regulations) 2008 and the Insurance Business (Asset and Liability Valuation) Regulations 2008. Assets will now be dealt with by applying appropriate capital factors to them rather than by specifically approving certain types of assets.

The Accounting and Regulatory Balance Sheets

67. ICP 14, Valuation, requires a total balance sheet approach to the determination of capital resources. This is an overall concept, rather than a specific methodology, which recognises the interdependence between all assets, all liabilities, all regulatory capital requirements and all capital resources. A total balance sheet approach should

ensure that the impacts of all relevant material risks on an insurer's overall financial position are appropriately and adequately recognised.

68. Valuation of assets and liabilities will be required to be undertaken on the basis of recognised accounting standards. The Commission currently recognises IFRS, UK GAAP and US GAAP. The Commission recognises that convergence between the accounting standards and the ICP is still some way off but sees no benefit in imposing specific valuation requirements in the interim since the differences are not material for Guernsey insurers. The larger insurers are already reporting under IFRS.
69. The Commission is mindful to keep the solvency regime reasonable and proportionate for the Guernsey market. Even if the Commission were to propose specific valuation requirements the statutory balance sheet and the regulatory balance sheet would not be materially different for most companies and would not justify the resources needed to carry out two sets of calculations.

Underwriting (Premium and Reserve) risk – General Insurance

70. All general insurers will consider premium risk and reserve risk. The Commission will expect general insurers to consider catastrophe risk as part of their OSCA. The Commission will include catastrophe risk in future industry wide stress tests.
71. The Commission will set capital factors for each class of underwriting risk. The capital factors determine the amount a particular risk contributes to the PCR and will be expressed as a percentage of an exposure value (such as net premiums or net reserves). The capital factors will be calibrated to the confidence level adopted.
72. Premium risk is forward looking and will be based on net written premium on business expected to be written over the next twelve months rather than, as at present, past earned premium. It relates to the risk that net written premiums, relating to policies expected to be written (or renewed) during the forthcoming financial year, will be insufficient to fund the liabilities arising from that business.
73. Reserve risk deals with the risk of business already written and will be based on technical provisions including the outstanding claims reserve, incurred but not reported provisions, unearned premium and unexpired risk reserves.
74. Both premium and reserve risk will be segmented into various classes of insurance; property, casualty, health etc. with each attracting a specific capital factor. An allowance for diversification between classes of insurance can then be allowed. The allowance for diversification will depend upon the confidence level i.e. a lower confidence level leads to a higher allowance for diversification.

Underwriting Risk – Long-term insurance

75. Underwriting risk for long-term insurers will address mortality risk, longevity risk, morbidity/disability risk, lapse risk, expense risk and catastrophe risk.
76. Long term insurers will calculate the capital required by considering the change in the value of assets and liabilities following prescribed stresses. Each stress will be considered in isolation. Allowance will be made for diversification and management actions such as amending future bonus rates.
77. The scenarios used to assess underwriting risk will be similar to those used by other internationally recognised solvency regimes such as Solvency II many of which are already adopted by some insurers in their OSCA.

Market Risk

78. Market risk deals with the capital requirements associated with the exposure of assets and liabilities to movements in the financial markets.
79. All insurers will calculate risk based capital to meet interest rate risk, spread risk, currency risk, equity risk and property risk. However, the method used to calculate the market risk capital requirement will differ for long term insurers and general insurers. Long term insurers will calculate the capital required by considering the change in the value of assets and liabilities following prescribed stresses. General insurers will multiply their net asset exposure by a capital factor. The methods proposed are consistent with that used by insurers to determine the capital relating to underwriting risk and that currently applied by insurers in their OSCAs.
80. The market risk capital requirement is the sum of the capital for each risk less an allowance for diversification. The level of diversification benefit will be less for long term insurers and commercial general (re)insurers than for captive (re)insurers.

Counterparty Default Risk

81. Counterparty default risk relates to the possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of insurance and reinsurance undertakings over the following 12 months
82. Accounts receivable will attract a capital requirement based on the days overdue. Receivables less than 90 days overdue will incur no capital charge, and a 100% capital charge will be applied if receivables are more than 90 days overdue. This is unchanged from existing requirements.
83. Other counterparty exposures not included in market risk will attract capital requirements based on the credit rating of the counterparty. Such exposures include, for example, reinsurers share of reserves, loans, cash and cash equivalents, money

market funds and off-balance sheet assets. Unrated counterparties will be assigned a credit rating band based on specific criteria.

84. Exposures may be netted with liabilities towards the same counterparty subject to meeting specific criteria. Similarly, exposures may also be netted by any collateral held.

Standard solvency workbook

85. The Commission has developed a standard Excel workbook to calculate the PCR and MCR for both general and long term insurers. The workbook is dynamic and can be used by either general insurers or long term insurers. The workbook incorporates the risks described above and allows for correlation and diversification of those risks at the specified confidence level.
86. Insurers will be required to input relevant figures from their accounts into the Assessment workbook. However, they will not need to calibrate the capital factors or stresses themselves as these will have been calibrated by the Commission.
87. The solvency workbook for general and long-term insurers is attached at Appendix 2.

Protected Cell Companies (PCCs)

88. As is currently the case, the MCR of the PCC will be determined at an entity level based on the sum of the notional MCR for each cell and the core. The MCR of the PCC is subject to absolute floor determined at the entity level.
89. Similarly, the PCR of the PCC will also be determined at an entity level based on the sum of the notional PCR for each cell and the core. The PCR of a cell will be capped by the notional MCR of the cell.
90. Any notional MCR or PCR deficit arising in an individual cell must be covered by non-cellular assets. However, a cell may only rely upon the non-cellular assets if a suitable recourse agreement is in place. Where any such notional deficit is not covered in full by the above, the PCC will not be deemed to have met its MCR or PCR.
91. Regulatory capital resources in excess of the notional MCR in a cell are excluded from the regulatory capital resources to meet the MCR of the PCC. Similarly, regulatory capital resources in excess of the notional PCR in a cell are excluded from the regulatory capital resources to meet the PCR of the PCC.
92. A separate workbook has been development to draw together the cell and core results to arrive at the MCR and PCR for the PCC. This workbook is attached at Appendix 2.

Internal Models

93. It is not expected that many, if any, insurers will wish to utilise their own internal model to determine their regulatory capital requirements. Those that do would be required to meet the costs incurred by the Commission in validating and approving the model to international standards.
94. The Commission will rely, where possible, on work done by other supervisors on the approval of internal models. A flowchart showing the proposed process is shown at appendix 3.

Minimum Paid-up Capital/Capital Floor

95. The current minimum paid-up share capital is £100,000 for general insurers and £250,000 for long-term insurers. It is not proposed to amend these minimum amounts as they are still reasonable for many captives and non-risk taking life insurers. This is currently referred to in the insurance law as the Minimum Capital Requirement but to avoid any confusion with the MCR it is proposed to refer in future to the Capital Floor. The capital floor for a composite PCC will be £250,000.

Frequency of reporting

96. The Commission has considered the frequency with which the PCR and the MCR should be calculated.
97. Since the MCR represents the boundary below which no insurer should be allowed to operate it is proposed to continue with the requirement that an insurer must, at all times, maintain a margin of solvency at or above the MCR.
98. The PCR should be calculated at the end of each financial year and upon any material change to the business plan.

Capital Impact Assessment

99. In Q1 of 2013 the Commission, in conjunction with industry, carried out a capital impact assessment whereby a number of general insurers were required to complete the solvency workbook. The Commission has analysed and evaluated these results and a report is attached as Appendix 4.
100. The Commission does not propose to carry out a capital impact assessment for long-term insurers since there are too few similar companies for the results to be meaningful. However, the Commission will continue to work with the long-term insurers and will be pleased to receive completed workbooks during this consultation exercise.
101. As a result of this Assessment the Commission has made the following adjustments to the proposed solvency framework for general insurers:

- The MCR has been adjusted from 18% of premium or reserves to 12% of premium or reserves. The increase to 18% of reserves, from the current 5%, proved to be extremely onerous for many captives and, at 18% the implicit confidence level is 94% which is much higher than would be required internationally¹.
- Letters of credit that meet specific criteria will be eligible to meet the MCR.
- Deferred acquisition costs are retained as eligible capital resources.
- The correlation matrix used to determine diversification adjustments for captive insurers has been reviewed and amended to allow for some limited correlation.

Level of Supervision

102. The Commission will focus its limited resources on those insurers who pose the greatest risk. This will involve more regular reporting to the Commission and closer regulatory surveillance. Those insurers that pose the least risk will receive less detailed scrutiny with the onus being placed on the board and General Representative to report relevant matters to the Commission. The Commission will review the level of information required to be submitted with the annual return so that it is proportionate to the risk posed by each type of insurer.

Enterprise risk management (“ERM”) and the ORSA

103. ICP 16 requires the supervisor to establish enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.
104. ERM involves the process of identifying, assessing, measuring, monitoring, controlling and mitigating risks in respect of the insurer as a whole. An ERM typically adopts a total balance sheet approach whereby the impact of the totality of material risks is fully recognised on an economic basis. A total balance sheet approach reflects the interdependence between assets, liabilities, capital requirements and capital resources, and identifies a capital allocation, where needed, to protect the insurer and its policyholders and to optimise returns to the insurer on its capital.
105. Since 2003 the Licensed Insurers’ Corporate Governance Code has required insurers to assess and manage their risks. The Code was revised in 2008 to include more detail on relevant risks which insurers are expected to address. In 2008 the Commission also introduced a requirement for insurers to complete an Own Solvency Capital Assessment (“OSCA”) on at least an annual basis.

¹ See paragraph 62 above.

106. The OSCA should determine the economic capital required by the insurer taking into account its risk tolerance and business plans. The OSCA should also consider the capital required over a longer time horizon than that required when calculating the regulatory capital. This time frame will vary depending upon the type of insurer and, for a captive, will depend very much on the parent company's time horizon.
107. The Commission reviewed the functioning of the OSCA process in Guernsey in 2011 and found it broadly fit-for-purpose. The Commission proposes that the requirement continues with one category exception.
108. The category exception covers large direct life insurers. This category will be required to apply an ORSA rather than an OSCA. The purpose of an ORSA is to assess whether the insurers risk management and solvency position is currently adequate and likely to remain so. It should encompass all reasonably foreseeable and relevant material risks. The ORSA should consider the impact of future changes in economic conditions or other external factors and should include appropriate stress testing. This approach is a critical part of ERM compliance.

Actuarial involvement

109. Currently only long-term insurers are required, under section 40 of the Insurance Business (Bailiwick of Guernsey) Law, 2002, to appoint an actuary and this will continue. ICP 8 on internal controls requires that, for all insurers, there is an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements. An appointed actuary is not a specific requirement of the ICP. Other requirements in relation to the actuarial function will be addressed in Corporate Governance Rules (see below).

Legislative Changes

110. In order to introduce the proposed solvency regime the following legislative amendments will be necessary:
 - i. The Insurance Business (Bailiwick of Guernsey) Law, 2002:
 - o Amend section 30 to refer to Solvency Rules rather than schedule 2
 - o Amend section 32 to refer to the Capital Floor rather than the Minimum Capital Requirement and amend the Glossary in Schedule 5 accordingly
 - o Repeal Schedule 2
 - o The above amendments can be made by Ordinance in accordance with section 85
 - ii. Repeal the Insurance Business (Approved Assets) Regulations, 2008

- iii. Repeal the Insurance Business (Asset and Liability Valuation) Regulations, 2008
- iv. Introduce new Solvency Rules as permitted by sections 38A and 38B of the Insurance Business (Bailiwick of Guernsey) Law 2002

The Commission will continue to work with industry to finalise the wording of the Solvency Rules in line with the proposals put forward in this paper.

Corporate Governance

111. Currently, licensed insurers are subject to the Licensed Insurers' Corporate Governance Code (the "CGC"), last revised in March 2008. Revisions to the ICPs in October 2011 made it necessary for the Commission to compare the existing codes and guidance relating to corporate governance with the standards and guidance set out in the revised ICPs. The relevant ICPs are ICP 7, Corporate Governance and ICP 8, Internal Controls which set out the requirements for insurers to have a corporate governance framework which includes effective risk management and control functions.
112. Due to the extent of the revisions that would be required to bring the CGC into line with the new ICPs it is proposed to withdraw the existing CGC and replace it with new rules based upon the ICPs. This avoids the need to draft a code otherwise unique to Guernsey, which in itself would be difficult to justify. In issuing rules rather than a code the Commission believes that the enforceability of the requirements can be more effectively demonstrated since rules would be directly enforceable whereas breaches of codes can only be taken into account by the Commission.
113. The Commission has considered whether the Finance Sector Code of Corporate Governance ("FSCGC") would meet the requirements of the ICPs. However, whilst there is some commonality in the overarching principles, the Commission does not believe that the FSCGC would meet the requirements since there is insufficient detail regarding internal controls.
114. The proposed rules are structured with an overarching principle followed by rules and guidance. The rules are drawn from the standards contained within ICPs 7 and 8. The guidance is also drawn from the ICP guidance but has been tailored as appropriate for the Guernsey insurance market. The proposed rules are shown in **bold** with guidance shown below each rule. The proposed rules will apply to all insurers licensed under the Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended.
115. The rules would be subject to the overarching principle of proportionality so that each Board would apply them in a manner appropriate to the nature scale and complexity of the insurer's business.
116. The Commission proposes to withdraw the requirement for insurers to verify the extent of adherence to the Rules as part of the annual return.
117. For Commercial insurers the governance structure will be considered as part of the Commission's on-going supervisory activities; in particular when a problem or breach occurs which can be attributed to poor corporate governance.
118. Governance issues for captives will be considered from time to time on a thematic basis.

119. The draft Corporate Governance Rules are attached as Appendix 5.
120. It is proposed that the new Corporate Governance Rules would be published in the first quarter of 2014 to take effect from 1 January 2015.

Public Disclosure

121. The Commission is mindful of the increasing focus on public disclosure requirements as a means to achieve greater transparency and discipline within financial markets. The proposals within this section of the consultation apply to all commercial insurance and reinsurance companies regardless of the type of business written but subject to certain de minimis criteria outlined below. They do not apply to captive insurance companies.
122. The new ICP 20 contains more detailed requirements for public disclosure compared to the previous ICP 26. The IMF last assessed Guernsey’s regulatory and supervisory regime for Insurance in 2010 and gave a “Partially Observed” rating for compliance with the previous ICP 26. This assessment rating was given taking into consideration the Insurance Business (Public Disclosure of Information) Rules, 2010 (“the Rules”).
123. The Rules currently require the insurers to make audited financial statements available to policy holders, professional advisers and to others with a valid interest.
124. These proposals take into consideration the information already being supplied by the insurers, both within their financial statements and to the Commission as part of the annual return, and seeks to make the most effective use of this information in meeting the requirements of the new ICP 20.
125. The Commission proposes to update the Rules require all relevant insurers to prepare a briefing document to disclose the required information to the extent that it is not already disclosed in the financial statements. The briefing document of a group entity may refer to information presented in the group accounts, as long as that information adequately portrays the relevant circumstances of the specific group entity and the group accounts are publicly available.
126. There will be no requirement for the auditors to audit the information in the briefing document.
127. Information to be included in the briefing document is attached at Appendix 6.

Disclosure policy

128. Although not required to be disclosed in the briefing document, insurers should form a disclosure policy which should:
 - a. detail who is responsible for drafting the disclosures along with those who are responsible for reviewing the disclosures;
 - b. set out processes for completion of the various disclosure requirements and for review and approval by the administrative, management or supervisory body before disclosure;

- c. outline their view on information already available in the public domain that they believe is equivalent in nature and scope to the information requirements public disclosure document;
- d. set out their view on the specific information they intend not to disclose; and
- e. set out additional information voluntarily.

Non-disclosure of information

129. Insurers need not disclose specific information in the briefing document if:

- f. to disclose such information would enable the competitors of the insurer would gain undue advantage;
- g. there are obligations to policy holders or other counterparty relationships binding an insurer to secrecy or confidentiality.

Insurers should not set up obligations to policy holders or other counterparty relationships binding them to secrecy or confidentiality in order to avoid disclosure of information.

130. The Commission proposes that if an insurer considers the disclosure of any information to be detrimental to its business, it may apply to the Commission for consent to withhold that information.

Exemptions

131. The Commission considers it appropriate that very small insurers are exempted from the requirement of public disclosure. Such insurers have little impact on market discipline and the public disclosure requirements will be of little benefit to their policy holders. Therefore it is proposed that insurers that meet any of the criteria below will be exempt from complying with the public disclosure requirements:

- h. the insurer's annual gross written premium income does not exceed £5 million; or
- i. the total of the insurer's technical provisions, gross of the amounts recoverable from reinsurance contracts, does not exceed £25 million; or
- j. the company is a reinsurer, or
- k. the company is a captive (re)insurer.

Appendix 1: Supervisory Ladder of Intervention

STAGE – Circumstances	GFSC INTERVENTION
Normal Operations	
<p>Risk based supervisory monitoring activities applying to all licensed insurers.</p> <p>Capital resources are greater than 105% of the PCR.</p>	<p>Standard supervisory measures which may include:</p> <ul style="list-style-type: none"> • Scrutinisation of applications and issuance of licences • Review and assess wide range of requests for regulatory approval – e.g. loans to parent, change of controller • Risk based approach to the on-going monitoring of companies based on information obtained from annual returns • Risk based scheduling of routine on-site examinations <p>The GFSC carries out macroprudential surveillance, analyses industry-wide issues and trends and publishes statistics.</p>
Stage 1 - Early Warning	
<p>Identification of deficiencies in policies or procedures or the existence of other circumstances that could lead to the development of problems.</p> <p>The situation is such that it can be remedied, by a collaborative approach between the Licensee and the GFSC, before it impacts on the financial viability of the Licensee.</p> <p>Capital resources are between 100% and 105% of the PCR.</p>	<p>The GFSC will discuss the concerns with the Licensee and request measures to rectify the situation.</p> <p>Remedial actions will be monitored by the GFSC and may involve requests for additional information and/or follow-up examinations.</p>

STAGE – Circumstances	GFSC INTERVENTION
Stage 2 – Risk to financial viability or solvency	
<p>Risks are identified which suggest weaknesses in the insurer’s systems and controls which could adversely impact upon its future solvency. This may include, inter alia:</p> <ul style="list-style-type: none"> • Evidence of previous non-compliance with solvency requirements • Deterioration in earnings or the profitability of the Licensee's business • Concerns identified regarding the data, methods and assumptions for determining actuarial reserves • Exposure to off-balance sheet risk • Evidence that the Licensee has insufficient liquidity to meet expected claims • Corporate Governance failings leading to deficiencies in management procedures or controls • Other concerns arising from: <ul style="list-style-type: none"> ○ a shareholder controller in financial difficulties ○ systemic issues of non-compliance with regulatory requirements ○ rapid growth ○ qualified report of external auditor ○ increased risk exposure as identified by business plan <p>The situation can be resolved collaboratively but more formal regulatory action may be required to protect policyholders.</p> <p>Capital resources are between 50% and</p>	<p>The GFSC will intensify risk dialogue with the Licensee with the objective of mitigating the increased risk.</p> <p>The Licensee is notified of concerns and required to submit and implement a recovery plan appropriate to the nature, scale and complexity of its risks that will return the Licensee to Normal Operations within a defined period of the underfunding being detected.</p> <p>The scope of on-site examination and/or frequency of on-site examinations may be enlarged or increased.</p> <p>An external party (inspector) may be required to perform a particular examination relating to the adequacy of the Licensee's procedures for the safety of its creditors, shareholders and policyholders, or any other examination that may be required in the public interest, and report thereon to GFSC at the Licensee’s expense.</p> <p>An independent actuary may be required to perform a review of the appropriateness of the Licensee's technical provisions at the Licensee’s expense. The GFSC may require adjustments to the Licensee’s actuarial methods and assumptions.</p> <p>Business restrictions appropriate to the nature, scale and complexity of the Licensee may be imposed. These may be measures and/or actions provided by the Licensee or conditions imposed on the Licensee’s licence covering such matters as:</p> <ul style="list-style-type: none"> • restricting certain transactions that will reduce the capital resources (such as dividend payments, capital repayment, voluntary repayments of the Licensee’s own loans, and the

<p>100% of the PCR.</p>	<p>distribution of with-profit bonuses to policyholders)</p> <ul style="list-style-type: none"> • restrictions on new business • restrictions on investments • restrictions on risky and complex transactions where it is not ensured that they serve to improve the solvency position • other restrictions tailored to the specific circumstances <p>The GFSC will maintain a regulatory 'watchlist' to monitor such companies until they have been rehabilitated.</p> <p>Status of Licensee discussed with other relevant regulatory bodies.</p>
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STAGE – Circumstances	GFSC INTERVENTION
Stage 3 – Future financial viability in serious doubt	
<p>The risks outlined as per stage 2 suggest significant weaknesses in the insurer’s systems and controls which are highly likely to impact upon its future solvency.</p> <p>Capital resources are between the MCR and 50% of the PCR.</p>	<p>The GFSC may enhance the Stage 2 measures where applicable and/or initiate further actions including:</p> <ul style="list-style-type: none"> • modifying the Licensee’s capital requirement • thematic on-site examinations focussing on the particular areas of concern. Such examinations may involve the engagement of external specialists or professionals to assess certain areas such as asset values, appropriateness of actuarial reserves, etc. The Licensee will be required to meet the costs of such examinations • removal and replacement of Directors, Officers or Controllers <p>The GFSC will develop a contingency plan for taking rapid action if necessary due to further changes in circumstances.</p> <p>Status of Licensee discussed with other relevant regulatory bodies.</p>

STAGE – Circumstances	GFSC INTERVENTION
Stage 4 – Licensee not viable/insolvency imminent	
<p>The Licensee has failed to identify and rectify risks to solvency at an earlier stage in the ladder resulting in an unacceptable level of risk:</p> <ul style="list-style-type: none"> • that policyholder obligations will not be paid; and/or • that the reputation of the Bailiwick will be damaged; and/or • that debts cannot be met as they fall due. <p>Capital resources are less than the MCR.</p>	<p>The GFSC notifies the Licensee’s management and board of directors of intended regulatory intervention measures that will be taken unless immediate actions to restore solvency are undertaken. It must be apparent to the GFSC within a short period of time whether the actions initiated by the insurer are likely to rapidly restore its financial position.</p> <p>Such immediate actions include:</p> <ul style="list-style-type: none"> • increase of capital resources or reduction of requirement capital • voluntary transfer of the entire insurance portfolio • partial transfer of the insurance portfolio, resulting in capital resources being above the MCR subsequent to the transaction <p>New business restrictions will be imposed on the Licensee or existing restrictions expanded.</p> <p>The GFSC contingency plan will be implemented.</p> <p>Other relevant regulators are notified of proposed regulatory intervention measures to be applied to the Licensee.</p> <p>The GFSC may apply to the Court for an order to wind up or place the Licensee into administration if the remedial measures do not lead to success in the short term.</p> <p>The GFSC will consider the conduct of controllers, directors, auditors and actuaries in the context of Corporate Governance requirements and, if appropriate, will consider regulatory action against the individuals.</p>

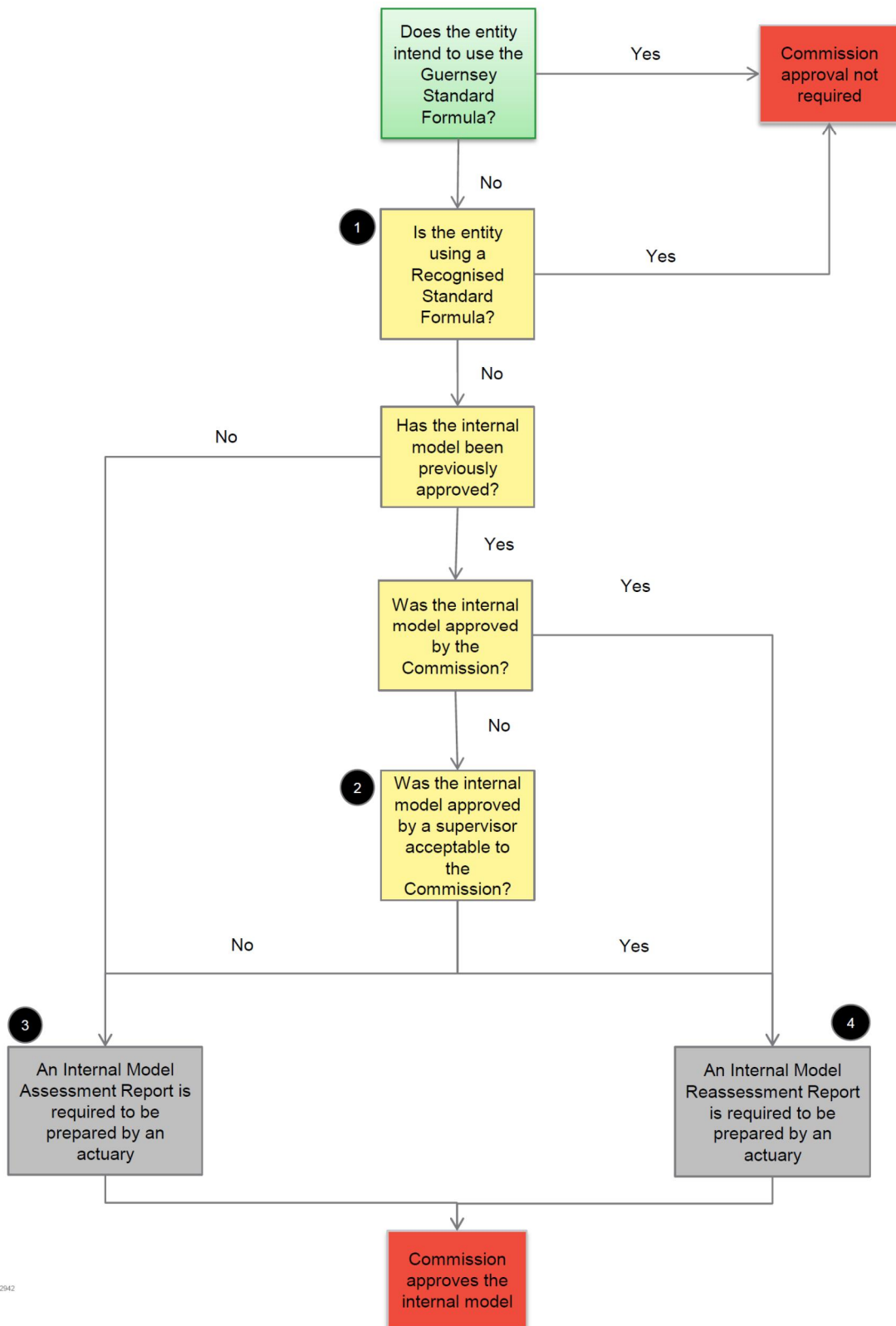
Appendix 2: Capital Assessment Workbooks

Please refer to:

- Regulatory Solvency Assessment – 2013 Consultation Version
- PCC Solvency Summary – 2013 Consultation Version

Appendix 3: Internal Models

Use of Internal Model for Regulatory Solvency Purposes



Use of Internal Model for Regulatory Solvency Purposes

1

Recognised Standard Formulas List

The Commission determines and publishes a "Recognised Standard Formulas" list on the website. The standard formulas included on this list will be those deemed to provide a similar level of policyholder/beneficiary protection for regulatory capital adequacy purposes as provided by the Guernsey Standard Formula. Territories could include the EU (i.e. the Solvency II standard formula), Switzerland (i.e. the Swiss Solvency Test), South Africa, Bermuda, Japan, Australia etc.

2

Internal Model Acceptance Criteria

The Commission determines criteria for obtaining approval to use an internal model in place of the Guernsey Standard Formula. The target criteria will be based on the IAIS core principles and standards. For example, (re)insurers could be required to validate the internal model by subjecting it, as a minimum, to three tests: a statistical quality test, a calibration test and a use test. The (re)insurer could also be required to maintain appropriate documentation of the model

The Commission assesses whether the internal model approval process undertaken by another supervisor is at least as equivalent as would have been undertaken by the Commission.

3

Internal Model Assessment Report

The licensee must submit an Internal Model Assessment Report prepared by an independent actuary. The Internal Model Assessment Report is a comprehensive assessment of the licensee's internal model against the Commission's internal model acceptance criteria.

The cost, fees and expenses of the Commission approving the internal model will be borne entirely by the licensee.

4

Internal Model Reassessment Report

The Commission determines target criteria for obtaining approval to use a pre-approved internal model in place of the Guernsey Standard Formula. The internal model will have been approved by the Commission or another acceptable supervisor for use by another (re)insurance undertaking (which may or may not be part of the same insurance group) or a group-wide basis. The target criteria will be based on the IAIS core principles and standards and focus on the appropriateness of the internal model to the risks of the Guernsey licensee.

The licensee must submit an Internal Model Reassessment Report prepared by an independent actuary. The Internal Model Reassessment Report is an assessment of the internal model against the Commission's internal model reassessment criteria.

The cost, fees and expenses of the Commission approving the internal model will be borne entirely by the licensee. The Commission expects the cost of obtaining approval for a previously approved internal model to be materially less than for a previously unapproved internal model.

Appendix 4: Report on the Capital Impact Assessment

Please refer to Appendix 4: Report on the Capital Impact Assessment for Risk Based Solvency

Appendix 5: Draft Corporate Governance Rules

Statement of Principle

Insurers are required to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of policyholders.

Insurers are required to have, as part of their overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

Proportionality

Each business' approach to corporate governance should reflect its legal and operating structure, as well as the nature, scale and complexity of the business. The GFSC recognises that the differing nature, scale and complexity of businesses will lead to different approaches to meeting the Rules.

Rule 1: Objectives and Strategies of the Insurer

An insurer's Board is required to set and oversee the implementation of the insurer's business objectives and strategies for achieving those objectives, including its risk strategy and risk appetite, in line with the insurer's long term interests and viability.

The Board should adopt a rigorous process for setting and overseeing the implementation of the insurer's overall business objectives and risk strategies. These objectives and strategies should be adequately documented and properly communicated to its Senior Management, Key Persons in Control Functions and all other relevant staff of the insurer.

The Board should ensure that the insurer's overall business objectives and strategies are reviewed at least annually to ensure that they remain appropriate in light of any changes in internal or external business and operating conditions.

The Board should establish clear and objective performance goals and measures, both for the insurer and its Senior Management, to promote the effective implementation of the insurer's business objectives and risk strategies, taking due account of, among other things, the insurer's long term interests and viability.

Rule 2: Allocation of Oversight and Management Responsibilities

An insurer's Board is required to:

- **ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Persons in Control Functions are clearly defined so as to**

promote an appropriate separation of the oversight function from the management responsibilities; and

- **provide adequate oversight of the Senior Management.**

In order to provide effective oversight of the Senior Management, the Board should:

- ensure that there are adequate policies and procedures relating to the engagement, dismissal and succession of the Senior Management, and be actively involved in such processes;
- monitor whether the Senior Management is managing the affairs of the insurer in accordance with the strategies and policies set by the Board, including the insurer's risk appetite, and meeting the performance goals set by the Board; and
- regularly meet with the Senior Management to discuss and review critically the decisions made, information provided and any explanations given by the Senior Management relating to the business and operations of the insurer.

As a part of its regular monitoring and review of the insurer's operations, the Board should review whether the policies and procedures, as set by the Board, are being properly implemented and are operating as intended.

Rule 3: Structure and Governance of the Board

An insurer's Board is required to have, on an on-going basis:

- **an appropriate number and mix of individuals to ensure that there is an overall adequate level of knowledge, skills and expertise at the Board level commensurate with the governance structure and the nature, scale and complexity of the insurer's business;**
- **at least one independent non-executive director;**
- **appropriate internal governance practices and procedures to support the work of the Board in a manner that promotes the efficient, objective and independent judgment and decision making by the Board; and**
- **adequate powers and resources to be able to discharge its duties fully and effectively.**

The Board of an insurer should have a sufficient number of members who have relevant expertise among them as necessary to provide effective leadership, direction and oversight of the insurer's business to ensure it is conducted in a sound and prudent manner.

An independent non-executive director is a person who is not an associate of either the shareholders, the ultimate beneficial owners or the insurance manager. The Commission may, at its discretion, in any particular case, waive this requirement.

Board members should have the commitment necessary to fulfil their roles, demonstrated by, for example, a sufficient allocation of time to the affairs of the insurer and reasonable limits on the number of external Board memberships held.

Board members should avoid commercial or business interests which conflict with that of the insurer. Where it is not reasonably possible to avoid conflicts of interests, such conflicts should be effectively managed. Procedures should be in place to address conflicts of interests which could include disclosure of potential conflicts of interests, requirements for arm's length transactions and where appropriate, prior approval by the Board or shareholders of such transactions.

The Board should review, at least annually, its own performance to ascertain whether members collectively and individually remain effective in discharging the respective roles and responsibilities assigned to them and identify opportunities to improve the performance of the Board as a whole.

The Board should have appropriate practices and procedures for its own internal governance, and ensure that these are followed and periodically reviewed to assess their effectiveness and adequacy.

To support the effective discharge of the responsibilities of the Board, the Board should assess whether the establishment of committees of the Board is appropriate. Where committees are appointed, they should have clearly defined mandates, authority to carry out their respective functions, and the degree of independence and objectivity as appropriate to the role of the committee.

Funding and other resources should be allocated to the Board to enable the Board members to carry out their respective roles and responsibilities efficiently and effectively. The Board should have access to services of external consultants or specialists where necessary or appropriate, subject to due procedures for appointment and dismissal of such consultants or specialists.

The Board may, as appropriate to the nature, scale and complexity of the insurer's business, delegate some of the activities or tasks associated with its own roles and responsibilities. Notwithstanding such delegations, the Board as a whole retains the ultimate responsibility for the activities or tasks delegated, and the decisions made in reliance on any advice or recommendations made by the persons or committees to whom the tasks were delegated.

Rule 4: Duties of Individual Board Members

The individual members of an insurer's Board are required to:

- **act in good faith, honestly and reasonably;**
- **exercise due care and diligence;**
- **act in the best interests of the insurer and policyholders, putting those interests of the insurer and policyholders ahead of his/her own interests;**
- **exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and**
- **not use his/her position to gain undue personal advantage or cause any detriment to the insurer.**

The insurer may include these duties as part of the Board charter or mandate containing the terms of engagement of the individual Board members.

The insurer should be able to demonstrate to the Commission's satisfaction that individual Board members understand the nature and scope of their duties and how they impact on the way in which the member discharges his/her respective roles and responsibilities.

Where a member of the Board has common membership on the Board of any other entity within or outside the insurer's group, there should be clear and well defined procedures that require the member of the insurer's Board to act in the best interests of the insurer, putting the insurer's and policyholders interests ahead of that of any other entity or that of his/her own.

Rule 5: Remuneration Policy and Practices

The insurer's Board is required to:

- **adopt and oversee the effective implementation of a remuneration policy, which does not induce excessive or inappropriate risk taking, is in line with the identified risk appetite and long term interests of the insurer, and has proper regard to the interests of its stakeholders; and**
- **ensure that such a remuneration policy, at a minimum, covers those individuals who are members of the Board, Senior Management, Key Persons in Control Functions and other employees whose actions may have a material impact on the risk exposure of the insurer.**

The Board should collectively have the requisite competencies to make informed and independent judgments on the suitability of an insurer's remuneration policy.

The Board should ultimately be satisfied that the overall remuneration policy and practices are consistent with the identified risk appetite and the long term interests of the insurer and its stakeholders.

The Board should ensure that in structuring, implementing and reviewing the insurer's remuneration policy, the decision-making process identifies and manages conflicts of interests and is properly documented.

Where any control function is outsourced, the remuneration terms under the agreement with the service provider should be consistent with the objectives and approved parameters of the insurer's remuneration policy.

Rule 6: Reliable and transparent financial reporting

The insurer's Board is required to ensure that there is a reliable financial reporting process, for both public (where applicable) and supervisory purposes, which is supported by clearly defined roles and responsibilities of the Board, Senior Management and the external auditor.

The Board is responsible for having adequate systems and controls to ensure that the financial reports of the insurer present a balanced and accurate assessment of the insurer's business and its general financial health and viability as a going concern. In discharging this responsibility, the Board should carry out specific oversight functions. These functions should include:

- overseeing the financial statements, financial reporting and disclosure processes;
- monitoring whether accounting policies and practices of the insurer are operating as intended;
- overseeing the audit process (encompassing external audit and reviews by internal audit of the insurer's financial reporting controls) and reviewing the auditor's plans and material findings;
- overseeing the processes for hiring, removing and assessing the performance and independence of the external auditor;
- investigating the circumstances relating to the resignation or removal of an external auditor, and ensuring prompt actions are taken to mitigate any identified risks to the integrity of the financial reporting process; and
- reporting to the Commission on significant issues concerning the financial reporting process, including the circumstances relating to the resignation or removal of the external auditor and the actions taken to address or mitigate identified financial reporting risks.

It is particularly important that the Board safeguards and promotes an effective relationship with the external auditor and for this purpose ensures that:

- the terms of engagement of the external auditor are clear and appropriate to the scope of the audit and resources required to conduct the audit and specify the level of audit fees to be paid;
- the auditor undertakes a specific responsibility under the terms of engagement to perform the audit in accordance with applicable auditing standards;

The Board should require that any information regarding internal control weaknesses or deficiencies which the external auditor becomes aware of is promptly communicated to the Board. The Board should ensure that such weaknesses are promptly rectified.

There may, where necessary, be regular meetings between the Board and the external auditor during the audit cycle, including meetings without management present.

Copies of management letters prepared by the external auditor for the insurer should be provided to the Commission.

Rule 7: Transparency and communications

The insurer's Board is required to have systems and controls to ensure the promotion of appropriate, timely and effective communications with the Commission and relevant stakeholders on the governance of the insurer.

Subject to the nature, scale and complexity of the business and to any reasonable commercial sensitivities and applicable privacy or confidentiality obligations, the insurer's communication policies and strategies should include providing to the insurer's relevant stakeholders information such as the following:

- the insurer's overall strategic objectives, covering existing or prospective lines of business and how they are being or will be achieved;
- the insurer's governance structures, such as allocation of oversight and management responsibilities between the Board and the Senior Management, and organisational structures, including reporting lines;
- members of the Board and any Board committees, including their respective expertise, qualifications, track-record, other positions held by such members, and whether such members are regarded as independent;
- processes in place for the Board to evaluate its own performance and any measures taken to improve the Board's performance;
- the general design, implementation and operation of the remuneration policy;

- major ownership and group structures, and any significant affiliations and alliances; and
- material related-party transactions.

The Commission may require more detailed and additional information relating to the insurer's corporate governance for supervisory purposes, which may include commercially sensitive information, such as assessments by the Board of the effectiveness of the insurer's governance system, internal audit reports and more detailed information on the remuneration structures adopted by the insurer for the Board, Senior Management, Key Persons in control functions and major risk-taking staff. The insurer's communication policies and strategies should enable such information to be provided to the Commission in a timely and efficient manner.

Rule 8: Duties of Senior Management

The insurer's Board is required to have policies and procedures to ensure that Senior Management:

- **carries out the day-to-day operations of the insurer effectively and in accordance with the insurer's strategies, policies and procedures;**
- **promotes a culture of sound risk management, compliance and fair treatment of customers;**
- **provides the Board adequate and timely information to enable the Board to carry out its duties and functions including the monitoring and review of the performance and risk exposures of the insurer, and the performance of Senior Management; and**
- **provides to the relevant stakeholders and the Commission the information required to satisfy the legal and other obligations applicable to the insurer or Senior Management.**

Senior Management should implement systems and controls appropriate to the nature, scale and complexity of the insurer to ensure that they can effectively carry out the day-to-day management of the business of the insurer in order to achieve the insurer's business objectives and strategies, and in particular, in accordance with the established levels of risk tolerance and consistent with internal policies.

Senior Management should also ensure that there are adequate procedures for assessing the effectiveness of their performance against the performance objectives set by the Board. Any identified inadequacies or gaps should be addressed promptly and reported to the Board.

Rule 9: Risk Management and Internal Control Systems and Functions

The insurer's Board is required to provide oversight in respect of the design and implementation of sound Risk management and internal control systems and functions.

It is the Board's responsibility to ensure that the insurer has appropriate systems and functions for Risk management and overall Internal controls and to provide oversight to ensure that these systems and the functions that oversee them are operating effectively and as intended.

Rule 10: Systems for risk management and internal controls

The insurer is required to establish, and operate within, effective systems of risk management and internal controls.

The risk management system should take into account all reasonably foreseeable and relevant material risks to which the insurer is exposed.

Regular internal communications and training on risk policies should take place.

Significant new activities and products of the insurer that may increase an existing risk or create a new type of exposure should be subject to appropriate risk review and be approved by the Board and Senior Management.

Material changes to an insurer's risk management system should be documented and subject to approval by the Board.

The internal controls system should be designed and operated to assist the Board and Senior Management in the fulfilment of their respective responsibilities for oversight and management of the company.

Reporting on the internal controls system should cover control deficiencies, weaknesses and failures that have arisen or that have been identified (including any identified by the internal or external auditors or the Commission) and the responses thereto.

An effective internal control system typically includes:

- assurance controls over the accuracy and completeness of the insurer's books and records, accounts and financial reporting;
- appropriate segregation of duties and controls to ensure such segregation is observed;
- appropriate authority levels regarding who can sign for or commit the insurer in order to prevent any major transaction being entered into without appropriate governance review;
- adequate training of employees in respect of controls; and

- periodic testing and assessment of the internal controls system.

Rule 11: Control Functions

The insurer is required to have effective Control Functions with the necessary authority, independence, and resources.

As part of an effective system of risk management and internal controls, insurers should have Control Functions appropriate to the nature, scale and complexity of the insurer, including for risk management, compliance, actuarial matters and internal audit.

The existence of Control Functions does not relieve the Board or Senior Management of their respective governance and related responsibilities.

The Control Functions (other than internal audit) should be subject to periodic internal or external review by the insurer's internal auditor or an objective external reviewer.

An insurer may combine certain Control Functions or outsource a control function in whole or in part where appropriate in light of the nature, scale and complexity of the insurer's business, risks, and legal and regulatory obligations. In cases where an insurer combines or outsources a control function, or part thereof, the Board should satisfy itself that this does not interfere with the function's independence, objectivity, or effectiveness.

Each control function should have the authority and independence necessary to be effective in fulfilling its duties and attaining its goals.

The Board should set or approve the authority and responsibilities of each control function.

The Board should grant the head of each control function the authority and responsibility to report periodically to it or one of its committees. The Board should determine the frequency and depth of such reporting so as to permit timely and meaningful communication and discussion of material matters.

The Board should periodically assess the performance of each control function.

Each control function should have the resources necessary to fulfil its responsibilities and achieve the specific goals in its areas of responsibility.

Rule 12: Risk management function

The insurer is required to have an effective risk management function capable of assisting the insurer to identify, assess, monitor, manage and report on its key risks in a timely way.

The risk management function should establish, implement and maintain appropriate mechanisms and activities to:

- assist the Board and Senior Management in carrying out their respective responsibilities;
- identify the risks the insurer faces;
- assess, aggregate, monitor and help manage and otherwise address identified risks effectively;
- evaluate the internal and external risk environment on an on-going basis in order to identify and assess potential risks as early as possible.
- consider risks arising from remuneration arrangements and incentive structures;
- conduct regular stress testing and scenario analyses for Solvency Purposes;
- regularly report to Senior Management, Key Persons in control functions and the Board on the insurer's risk profile and details on the risk exposures facing the insurer and related mitigation actions as appropriate;
- document and report material changes affecting the insurer's risk management system to the Board to help ensure that the framework is maintained and improved; and
- conduct regular assessments of the risk management function and the risk management system and implement or monitor the implementation of any needed improvements.

The Commission recognises that captive insurers are an integral part of their parent company's risk management function and does not expect them to duplicate functions that are already carried out by the parent. The Board should consider a risk management function that is appropriate to the nature, scale and complexity of the business.

Rule 13: Compliance function

The insurer should have an effective compliance function capable of assisting the insurer to meet its legal and regulatory obligations and promote and sustain a corporate culture of compliance and integrity.

The insurer should have in place a robust and well positioned, resourced and properly authorised and staffed compliance function appropriate to the nature, scale and complexity of the insurer.

The compliance function should have access to and report to the Board on matters such as:

- an assessment of the key compliance risks the insurer faces and the steps being taken to address them;

- an assessment of how the insurer is performing against compliance standards and goals;
- material compliance violations or concerns involving any person or unit of the insurer and the status of any associated investigations or other actions being taken;
- material fines or other disciplinary actions taken by any regulator or supervisor in respect of the insurer or any employee.

The head of the compliance function should have the authority and obligation to promptly inform the Board directly in the event of any major non-compliance by a member of management or a material non-compliance by the insurer with an external obligation if in either case he or she believes that Senior Management or other persons in authority at the insurer are not taking the necessary corrective actions and a delay would be detrimental to the insurer or its policyholders.

The compliance function should establish, implement and maintain appropriate mechanisms and activities, proportionate to the nature, scale and complexity of the insurer, to:

- promote and sustain an ethical corporate culture that values responsible conduct and compliance with internal and external obligations;
- identify, assess, report on and address, by appropriate policies, processes and controls, key legal and regulatory obligations, including obligations to the Commission, and the risks associated therewith;
- hold regular training on key legal and regulatory obligations particularly for employees in positions of high responsibility or who are involved in high risk activities;
- facilitate the confidential reporting by employees of concerns, shortcomings or potential or actual violations in respect of insurer internal policies, legal or regulatory obligations, or ethical considerations; this includes ensuring there are appropriate means for such reporting;
- address compliance shortcomings and violations, including ensuring that adequate disciplinary actions are taken where appropriate and any necessary reporting to the Commission or other authorities is made; and
- conduct regular assessments of the compliance function and the compliance systems and implement or monitor needed improvements.

The Commission acknowledges that the above bullet points may not be relevant for a captive insurer that does not have its own staff.

Rule 14: Actuarial function

The insurer is required to have, or to have access to, an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements. (This rule is not applicable to captive insurers.)

As per the requirements of Section 40 of the Insurance Business (Bailiwick of Guernsey) Law, 2002, a licensed insurer writing long term business is required to appoint an actuary, unless agreed in writing by the Commission (hereinafter referred to as an “Appointed Actuary”).

An insurer writing business other than long term business should ensure that it has access to adequate actuarial skills to evaluate and provide advice to the insurer where required regarding, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements.

The actuarial function should have access to and periodically report to the Board on matters such as:

- any circumstance that may have a material effect on the insurer from an actuarial perspective;
- the adequacy of the technical provisions and other liabilities;
- the prospective solvency position of the insurer.

Written reports on actuarial evaluations should be made to the Board, Senior Management, or other Key Persons in control functions or the Commission as necessary or appropriate or as required by legislation.

Rule 15: Internal audit function

The insurer is required to have an appropriate and effective internal audit function capable of providing the Board with independent assurance in respect of the insurer’s governance, including its risk management and internal controls.

The internal audit function should provide independent assurance to the Board through general and specific audits, reviews, testing and other techniques in respect of matters such as:

- the overall means by which the insurer preserves its assets and those of policyholders, and seeks to prevent fraud, misappropriation or misapplication of such assets;
- the reliability, integrity and completeness of the accounting, financial reporting and management information and IT systems;

- the design and operational effectiveness of the insurer's individual controls in respect of the above matters, as well as of the totality of such controls (the internal controls system);
- other matters which the internal audit function determines should be reviewed to fulfil its mission, in accordance with its charter, terms of reference or other documents setting out its authority and responsibilities.

The Board should grant suitable authority to the internal audit function, including the authority to:

- access and review any records or information of the insurer which the internal audit function deems necessary to carry out an audit or other review;
- undertake on the internal audit function's initiative a review of any area or any function consistent with its mission;
- require an appropriate management response to an internal audit report, including the development of a suitable remediation, mitigation or other follow-up plan as needed.

In addition to periodic reporting, the head of internal audit should be authorised to communicate directly, and meet periodically, with the head of the Audit Committee or the Chair of the Board without management present.

Managed insurers may rely upon the internal audit functions of their insurance manager or their parent company.

Rule 16: Outsourcing of material functions or activities

The insurer is required to retain at least the same degree of oversight of, and accountability for, any outsourced material activity or function (such as a control function) as applies to non-outsourced activities or functions.

In general, outsourcing, whether to external parties or within the same insurance group, should not materially increase risk to the insurer or materially adversely affect the insurer's ability to manage its risks and meet its legal and regulatory obligations.

The Board of an insurer should approve outsourcing of any material function or activity and to verify, before approving, that there was an appropriate assessment of the risks of such outsourcing, including in respect of business continuity and that such outsourcing is subject to appropriate controls.

Outsourcing relationships should be governed by written contracts that clearly describe all material aspects of the outsourcing arrangement, including the rights, responsibilities and expectations of all parties.

Outsourcing arrangements should be subject to periodic reviews. Periodic reporting thereon should be made to management and the Board.

Where the insurer employs a licensed insurance manager, the Board must ensure that the duties, responsibilities and authorities of the licensed insurance manager are clearly set out in a written management agreement.

Rule 17: Annual review

The Board should carry out an annual review of the effectiveness of its corporate governance and internal controls.

Annual review by the Board should include:

- review of the strategic objectives and policies and either amend or readopt them as appropriate;
- evaluation of the progress made towards achieving the strategic objectives and policies;
- review of the composition of the Board to ensure that collectively it still has sufficient knowledge, skills, experience, commitment and independence to oversee the insurer effectively taking into account the size, nature and complexity of the business of the insurer;
- review of performance of the Board and of the senior management;
- requirement for the directors and management to confirm to the Board that any conflicts of interest have been declared throughout the year;
- review of compliance with the underwriting and investment strategies;
- review of the risk assessment and management system to ensure that all significant risks are being adequately measured, monitored and controlled;
- review of the internal control system to ensure it is operating effectively and that any reported deficiencies have been adequately addressed;
- requirement for the Compliance Officer to report to the Board regarding compliance with legal and reporting obligations and generally on a corporate culture of compliance and integrity;
- review of the remuneration policy of the insurer;
- review of the nature and scale of the internal audit function and also the report of the internal auditor (if any);

- review of the nature and scale of the actuarial function and also the report of the appointed actuary (if any);
- requirement for each director to confirm that they have advised the Commission of any material changes to information filed with the Commission on their Personal Questionnaire; and
- documentation of the extent of adherence of the insurer with the corporate governance rules.

Appendix 6: Public disclosure

Information to be disclosed

Profile

The briefing document should include appropriately detailed information about the company profile, including the nature of its business, a general description of its key products, the external environment in which it operates and information on the insurer's objectives and the strategies in place to achieve them.

Corporate Governance

Disclosures should include the key features of the insurer's corporate governance framework and management controls including how these are implemented.

Technical reserves

Disclosure about the financial position of the insurer should include appropriately detailed quantitative and qualitative information about the determination of technical provisions.

Insurance Risk

Disclosure about the financial position of the insurer should include appropriately detailed quantitative and qualitative information on all reasonably foreseeable and relevant material insurance risk exposures and their management.

Financial performance

Disclosure should include appropriately detailed quantitative and qualitative information on financial performance in total and by segmented financial performance. Where relevant, disclosures must include a quantitative source of earnings analysis, claims statistics including claims development, pricing adequacy, information regarding returns on investment assets and components of such returns.

Capital Adequacy

Disclosure about the financial position of the insurer should include appropriately detailed quantitative and qualitative information about capital adequacy. An insurer should disclose information that enables users to evaluate the insurer's objectives, policies and processes for managing capital and to assess its capital adequacy. This information encompasses the generic solvency requirements of the jurisdiction(s) in which the insurer operates and the capital available to cover regulatory capital requirements. If an internal model is used to determine capital resources and requirements, information about the model must be provided, having due regard to proprietary or confidential information.

Financial instruments

Disclosure about the financial position of the insurer should include appropriately detailed quantitative and qualitative information about financial instruments and other investments by class.

ERM and ALM

Disclosure about the financial position of the insurer should include appropriately detailed quantitative and qualitative information about enterprise risk management (ERM) including asset-liability management (ALM) in total and, where appropriate, at a segmented level.

Group transactions

Insurers should provide qualitative and quantitative information regarding relevant operations and transactions within the group.

Intangible assets

If an insurer values intangible assets for solvency purposes at an amount other than zero, they should disclose the nature of those assets and information on the evidence and criteria they have used to conclude that an active market exists for those assets.

Leasing

Insurers should disclose, separately for financial leases and operating leases, a general description of their material leasing arrangements. The requirement is applicable for both lease assets and liabilities.

Holdings in related undertakings

Insurers should include in their disclosure a valuation of holdings in related undertakings.

Other liabilities

When insurers aggregate liabilities into classes, in order to describe the valuation basis that has been applied to them, that aggregation should be based on the nature and function of liabilities and their materiality. Insurers should provide basis for any material aggregation.

Other provisions

Insurers should include information in their disclosure on provisions other than technical provisions and contingent liabilities:

- The nature of the obligation and expected timing of any outflows of economic benefits; and
- An indication of uncertainties surrounding the amount or timing of the outflows of economic benefits.

Employee benefits

Insurers should include in their disclosure an explanation of their obligations with regard to employee benefits. They should also include the nature of the assets and the percentage and amount of each class of asset within the plan, including reimbursement rights.

Other disclosure

Insurers should describe the processes and procedures to deliver reliable financial and non-financial information in a timely manner.

Deferred tax assets

Insurers should include in their disclosure on deferred taxes:

- The amount of deferred tax assets and liabilities and the nature of the evidence supporting its recognition; and
- The amount and expiry date if applicable for deferred tax assets, of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the balance sheet.