CONSULTATION PAPER
ON PROPOSALS FOR

A GREEN INVESTMENT DISCOUNT FOR LIFE INSURER CAPITAL REQUIREMENTS

OCTOBER 2020

Guernsey Financial Services Commission

Contents

Appendices

1. Executive Summary

1.1. Consultation Overview

1.1.1. The Guernsey Financial Services Commission (the "Commission") is issuing this Consultation Paper on proposed amendments to the Insurance Business (Solvency) Rules, 2015 (the "Solvency Rules") that would reduce the capital requirements applicable to spread risk for the green assets of life insurers (the "Green Discount"). This would be subject to measures, such as a hard limit in the capital requirement reduction due to the Green Discount, which should ensure policyholder interests are still protected.

1.1.2. The purpose of the Green Discount is to encourage green, sustainable investment by life insurers, as long-term investors, and thereby help promote positive environmental outcomes.

1.1.3. The goal for this Consultation Paper is to elicit feedback on the scope, structure and design of the proposed Green Discount amendments.

1.2. Affected and Interested Parties

1.2.1. These proposals would directly affect long term insurance licensees and applicants, and are of particular interest to members of the wider green investment community, as well as consumers of green investment products.

1.2.2. Some of the issues and questions raised within this Consultation Paper may also be of interest to general insurance licensees, industry bodies, insurance regulators, and the wider public.

1.3. Providing Feedback

1.3.1. Responses to this Consultation Paper are requested by 10 November 2020.

1.3.2. A complete list of the Consultation Paper questions appears in Appendix B. An exposure draft of the proposed amendments to the Solvency Rules appears in Appendix C.

1.3.3. Feedback may be provided online through the Consultation Hub section of the Commission's website, https://consultationhub.gfsc.gg/

1.3.4. We welcome and strongly encourage respondents to provide feedback or comment. Responses are most useful when they:

- directly address a specific issue or question,
- provide a rationale and support for the opinions expressed, and
- suggest alternative solutions in the event of disagreement.

Both positive comments and constructive suggestions for improvement are equally valued. Feedback from as large a number of affected and interested parties as possible, including from individual licensees and their industry bodies, is important to the Commission, as the responses and views put forward are key to the onward development of any amending rules following this consultation.

2. The Commission's Mission Statement and Green Approach

2.1.1. The Commission seeks to regulate and supervise financial services in the Bailiwick of Guernsey with integrity, proportionality, and professional excellence, and in doing so help uphold the international reputation of the Bailiwick of Guernsey as a finance centre.

2.1.2. The Commission is committed to developing climate finance through regulatory tools and support to the finance sector throughout the transition towards a low carbon economy, as part of its green approach[1]. The proposals set out in this Consultation Paper form part of that approach.

3. Consultation Background

3.1.1. In October 2018, the Commission issued a Discussion Paper[2] on green insurance. The paper considered how the Bailiwick could become a supportive jurisdiction for green insurance, and how the Commission might support the development of green insurance through regulatory change. For the purposes of that paper, green insurance was broadly defined as "*...any insurance product that reduces, or mitigates against, climate change.*"

3.1.2. A consistent theme that was explored in the Discussion Paper was the suggestion by the Commission that regulators needed to do more to enable insurers to purchase green assets. The reasons for this were:

- long-term green assets are suitable to meet long-term liabilities,
- green bonds may be mispriced, as rating agencies and market participants utilise historic data that may not fully take account of the changing nature of green finance, as governments move towards a greener economy, and
- regulators have a responsibility over financial stability, which includes the need to help mitigate the adverse financial impacts of climate change.

3.1.3. A subsequent Feedback Statement[3] was issued in September 2019. Feedback received was broadly supportive of the development of green insurance, including feedback received from the Guernsey International Insurance Association. This feedback was supportive of initiatives to promote green finance, such as a reduction in capital requirements for green assets, while cautioning that policyholders should not be exposed to unnecessary risk from this. The Commission naturally agrees with this statement, and this Consultation Paper has been developed with this in mind.

[1] More information about which can be found at https://www.gfsc.gg/green-approach
[2] See "Green Insurance in Guernsey – Discussion Paper, October 2018"
[3] See "Green Insurance in Guernsey – Feedback Statement, September 2019"

4. Purpose and Scope

4.1. Purpose

4.1.1. The purpose of this Consultation Paper is to introduce a specific approach for green assets into the Solvency Rules, to incentivise increased investment in green assets by life insurers.

4.1.2. Key to these proposals is a proviso that policyholders continue to be unequivocally protected.

4.1.3. It remains the responsibility of each insurer to determine its approach to green assets, in line with the standard requirements relating to fiduciary duties and robust corporate governance.

4.2. Scope

4.2.1. The Commission is proposing to allow life insurers to apply a Green Discount, reducing the capital requirement applicable to spread risk for the green fixed income assets they hold.

4.2.2. Life insurers adopting this approach would be expected to adapt their policies, procedures and controls to ensure that investment in green assets is made in a prudent manner. There would also be limits on the reduction in capital requirement from the Green Discount, to ensure policyholder interests continue to be protected.

4.2.3. These proposals are limited to the capital requirements for green fixed income assets. The scope of this Consultation Paper excludes wider considerations of green finance or the insurance solvency framework. There is also an ongoing discussion about whether regulatory capital standards unduly disadvantage life insurers, by constraining their ability to buy productive assets such as equities. This Consultation Paper does not seek to resolve these issues.

4.2.4. Details of the proposed amendments can be found in section 5. The Commission's rationale for how these proposals have been drafted, and a number of questions for respondents to consider, have also been included.

4.3. Issues for this Consultation

4.3.1. There are technical challenges in delivering the above approach[1]. Past data does not completely capture the risk-return profile of green assets, or the impacts of climate change on asset values. This is for a number of reasons, including:

- Advances in technology have meant that some green assets, in general, are more robust than was historically the case;

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[1] The challenges experienced by regulators and financial institutions in assessing the risk profile of green, non-green and brown assets were discussed in more depth in a May 2020 Technical Document issued by the NGFS:

"A Status Report on Financial Institutions' Experiences from Working with Green, Non Green and Brown Financial Assets and a Potential Risk Differential", May 2020, Network for Greening the Financial System

- Society's interest in green assets has increased considerably, in the wake of greater public recognition of the impacts of climate change; and
- The green asset market has matured considerably, although it remains a more nascent market, with lower liquidity, than other global bond markets. An example of this can be seen in the growth in the number of constituents in the ICE BofA Green Bond Index (as a proxy for green bond issuance) over the last four to five years.

4.3.2. An alternative to the use of historical data in assessing the potential risk-return profile and default patterns of green assets is to consider the use of scenarios. However, this approach, apart from being resource intensive, is ultimately subjective and dependant on unknown future outcomes.

4.3.3. Another technical challenge is taxonomy. Many commentators seek a drilled-down taxonomy, not least to avoid arbitrage. It will be sometime, however, before global consensus on such a detailed taxonomy is achieved.

4.3.4. There are also non-technical challenges. Some regulators do not have, or seek, a green mandate. There is the question of whether a special approach to green assets should link to an inter-related approach to brown assets. This question is unlikely to receive an answer soon, not least due to the geo-political implications. Some commentators might ask whether there is any need to enable insurance companies to buy green assets given that private sector demand already exceeds supply; at least at present.

4.3.5. The Commission recognises these problems. It is of the view, however, that they will not be resolved soon. In that case, little in this area may be done in the meantime to facilitate the purchase of green assets by insurance companies. This would be a lost opportunity to mitigate climate change, and time is running out.

4.3.6. There are potential solutions. In practice, regulators are periodically obliged to make judgements on technical issues in the face of imperfect information. A broad–based approach to taxonomy, tempered by specific regulatory oversight, is a practical way forward. Meanwhile brown assets and green assets are different categories requiring answers and not necessarily at the same time. Demand may currently exceed supply of green assets but that may not be the case in the medium term.

4.3.7. The Commission recognises that this new approach is innovative. It is hoped that life insurers will make use of the approach in Guernsey. However, even if this turns out not be the case, the Commission may by its action encourage other regulators to follow its example.

5. Proposed Amendment Design

5.1. Application

5.1.1. The proposed amendments for the Green Discount would only be applicable to Category 1[5] and Category 2[6] insurers, as defined in rule 6 of the Solvency Rules. This would be subject to the insurer meeting all of the requirements set out in the amendments.

5.1.2. General insurers have been excluded from these proposals, due to their shorter investment time horizon and greater liquidity constraints when compared with life insurers. These characteristics lead general insurers to have investment portfolios that primarily consist of cash or liquid fixed income securities. Such an investment policy is not necessarily optimal for the inclusion of green bonds, given their potential price volatility and the fact that they may trade in less liquid markets.

5.1.3. It is intended for an insurer to be able to apply the Green Discount to any of the permitted calculation methodologies for the Prescribed Capital Requirement[7] ("PCR"); these are currently the Guernsey standard formula, a recognised standard formula[8], or a partial or full internal model.

5.1.4. Use of the Green Discount is proposed to be a voluntary choice made by life insurers, rather than a mandatory requirement. The other proposals associated with the Green Discount would only be required by a life insurer applying the Green Discount.

Question 1: Do you agree that the Green Discount should be limited to Category 1 and Category 2 insurers? If you answered "No", how do you think the proposed amendments could be altered to accommodate other Categories of insurer?

Question 2: Do you agree that the proposed amendments are drafted in such a way that recognised standard formulae and internal models would be able to benefit from the Green Discount?

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[5] Commercial Life Insurers.
[6] Commercial Life Reinsurers.
[7] See rule 48 of the Solvency Rules.
[8] These are standard formulae prescribed by other countries or territories that the Commission permits insurers to use to calculate their PCR, and which are listed in Schedule 4 to the Solvency Rules.

5.2. The Green Discount

5.2.1. The Green Discount would be limited to a reduction in the spread risk capital requirement, which forms part of the calculation of an insurer's PCR.

5.2.2. Spread risk is the sensitivity of the value of assets and liabilities to changes in the level or volatility of credit spreads. Credit spreads are the difference between the yield on a proxy for the risk-free interest rate (such as government bonds[9]) and the yield of credit risky securities (such as corporate bonds) over their term structures.

5.2.3. The Green Discount would allow green assets exposed to spread risk, such as a green bond, to be treated as though they were one credit rating band[10] higher when applying the stresses / factors of the spread risk capital requirement.

5.2.4. As an example, a life insurer applying the Green Discount would be permitted to treat a green bond with a credit rating of A as though it had an AA rating. Under the Guernsey standard formula, this would result in a lower spread stress and default factor being applied when calculating the asset's spread risk capital.

5.2.5. These proposals do not extend to other green asset classes, such as green equities. Life insurers are more likely to hold green bonds to collect interest and principal to meet insurance liabilities, possibly until maturity of the instrument. In contrast, green equities do not provide fixed, known cash flows, may have greater price volatility than green bonds, and are more likely to trade in active markets. Green equities are measured at fair value, and the present regulatory valuation basis and stresses applied follows the market.

Question 3: Do you think the reduction in spread risk capital proposed as part of the Green Discount is appropriate, in light of the other proposals being made?

Question 4: Do you think the Green Discount should be widened to include other green asset classes, such as green equities? If you answered "Yes", what changes do you think could be made to the proposals to accommodate this?

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[9] Another example can be found in the Solvency II standard formula (a recognised standard formula), which requires the use of a risk-free interest rate term structure. Further details of how these are derived can be found at https://www.eiopa.europa.eu/tools-and-data/risk-free-interest-rate-term-structures_en

[10] A credit rating band represents all of the credit rating notches associated with an acceptable rating agency's rating class, tier or category. For example, the "AA" credit rating band would include securities rated: AA+, AA, or AA- by Standard & Poors and Fitch; or Aa1, Aa2, or Aa3 by Moody's; or aa+, aa, or aa- by A.M. Best.

5.3. Definition of a Green Asset

5.3.1. The Green Discount would only be applicable to assets that meet one of an approved list of green criteria.

5.3.2. The green criteria would aim to be consistent, where appropriate, with those set out for investment funds in the Guernsey Green Fund Rules, 2018 (the "GGF Rules")[11].

5.3.3. Should the European Union's taxonomy for sustainable finance be endorsed under the GGF Rules the Commission will look to apply the same changes to the Solvency Rules, provided these are appropriate for insurers to utilise.

5.3.4. The GGF Rules includes a list of exclusion policies, which a Guernsey Green Fund uses to identify the types of assets in which it cannot invest[12]. While the proposals have been consistent with the green criteria of the GGF Rules, we do not propose to set out a definition of what constitutes a brown asset, or a similar exclusionary list. The Green Discount is intended to incentivise life insurers to invest a portion of their investment portfolio sustainably and, as such, has a different aim to the exclusion policies of the GGF. Such constraints could also have unintended consequences for asset allocation decisions, for example by unduly decreasing portfolio liquidity.

5.3.5. Where there is room for interpretation and judgement in determining whether a given asset meets the definition of green in applying a green criterion, as the approved list of green criteria is expanded, there may be merit in defining what is meant by a brown asset. This would be done to limit the risk of regulatory arbitrage or inconsistent application by insurers.

Question 5: Do you agree that the green criteria used in the Solvency Rules should be consistent, where appropriate, with those used in the GGF Rules?

Question 6: Do you agree that the EU Sustainable Finance Taxonomy should be considered by the Commission for endorsement under the Solvency Rules?

Question 7: Should the Solvency Rules include either a list of exclusion policies, or a definition of what constitutes a brown asset?

[11] See Schedule 2 to the Guernsey Green Fund Rules, 2018, as amended.
[12] See Schedule 3 to the Guernsey Green Fund Rules, 2018, as amended.

5.4. Limits on the Green Discount

5.4.1. To ensure policyholder interests continue to be protected, it is proposed that limits are applied to the amount of benefit an insurer can attract from the Green Discount.

5.4.2. The Solvency Rules require an insurer at all times to hold regulatory capital resources greater than or equal to its PCR[13]. Compliance is assessed using a PCR Ratio[14], which is calculated by dividing the insurer's regulatory capital resources by its PCR. A PCR Ratio above 100%[15] indicates the insurer meets its PCR. Insurers are expected to maintain an appropriate buffer above this, based on its own assessment of the insurer's risk profile and economic capital.

5.4.3. Life insurers that apply the Green Discount would benefit from a reduced PCR, because of the adjustments to the spread risk capital requirement described in 5.3. It is proposed to limit the maximum benefit an insurer would be able to claim from the Green Discount to a 15% reduction in the insurer's PCR, as compared to the insurer's PCR before applying the Green Discount. The impact of this limit on the resultant PCR Ratio will vary, dependent on the relative value of the PCR.

5.4.4. It is also proposed that an insurer would not be able to make any further use of the Green Discount where its regulatory capital resources would fall to 105% or lower of the insurer's PCR before applying the Green Discount. This represents the first point at which, exclusive of other factors, the Commission would ordinarily engage with an insurer regarding its solvency[16]. An insurer that breaches this threshold would be required to consider what remedial action is necessary, and notify the Commission of the occurrence of such an event.

5.4.5. A hypothetical illustration of how the limits from 5.4.3 and 5.4.4 might operate can be found in Appendix A.

5.4.6. An insurer applying the Green Discount would be expected to monitor its PCR inclusive and exclusive of the Green Discount. It is not proposed for the insurer to be required to report its non-green PCR calculation to the Commission as part of regulatory submissions, unless the Commission specifically requested that information.

Question 8: Do you agree that the maximum benefit for the Green Discount should be limited to a 15% reduction in the PCR? If you answered "No", what value do you think should represent the limit? (10%, 20%, 25%, or another value)

Question 9: Do you agree that a 105% non-green PCR ratio represents an appropriate intervention threshold level?

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[13] See rule 9 of the Solvency Rules.
[14] The term PCR ratio is not defined within the Solvency Rules. It is calculated within the regulatory solvency assessment spreadsheet issued on its website, and is referred to in guidance issued by the Commission.
[15] Or any other value that the Commission specifies in writing for any particular insurer, class of insurers, or insurers generally.
[16] Refer to "Stage 1 – Early Warning" from the Guidance Note on Supervisory Ladder of Intervention.

5.5. Green Considerations for Risk Management and Internal Controls

5.5.1. It is proposed that insurers applying the Green Discount are required to consider explicitly how increased green investment, and use of the Green Discount, affects a number of aspects of their business and operations, including the insurer's internal controls, risk management framework and quantification of economic capital.

5.5.2. The amendments look to achieve this by requiring insurers that apply the Green Discount to consider explicit changes to several policies and documentation. In each case insurers are required to establish and maintain these under the current iteration of the Solvency Rules. These include the insurer's:

- investment policy,
- risk management policy, and
- own risk solvency assessment, including the insurer's own solvency capital assessment.

The insurer in each case would be required to make explicit considerations relating to Green Assets, use of the Green Discount, and the risks related to each.

5.5.3. An insurer applying the Green Discount would also be required to consider how they value green assets, given these may trade in less active markets and require increased judgements in determining their fair value.

Question 10: Do you agree that insurers applying the Green Discount should make explicit considerations of it in its valuation, investment, and risk management policies, and in the ORSA?

Question 11: Do you think all insurers, not just those adopting the Green Discount, should be required to make explicit considerations around climate change risks and green / sustainable investment in the documents listed in question 10?

5.6. Disclosure to Policyholders

5.6.1. It is proposed that an insurer would be obliged to explain its approach in applying the Green Discount to purchasers of its products.

5.6.2. Such disclosures would include an explanation of the impact on the insurer's risk profile from applying the Green Discount, such that policyholders would be able to make an appropriately informed decision before taking out a policy.

5.6.3. It is acknowledged that there are arguments against such disclosures, given the increasing volume and complexity of disclosure literature policyholders are receiving from financial institutions. This can dilute the effectiveness of disclosure and increase the compliance burden placed on licensees. The proposed disclosures are therefore intended to be proportionate to the nature, scale and complexity of the insurer, and the needs of its policyholders.

Question 12: Do you agree with the proposed requirements around disclosure to policyholders where insurers apply the Green Discount?

5.7. Notification to the Commission

5.7.1. Before applying the Green Discount, an insurer would be required to provide the Commission with prior written notification. This is because the Commission would consider such a change material to the insurer's business plan, given the potential implications on the solvency position of the insurer.

5.7.2. As part of the notification, the insurer would be expected to provide sufficient documentation to demonstrate it would be able to adhere to the requirements imposed by the amendments.

5.7.3. Any new applicants for an insurance licence that wished to apply the Green Discount would be required to state that fact within their application documentation, and similarly demonstrate how they would meet the requirements imposed by the amendments.

Question 13: Do you agree with the items to be included within the proposed notification to the Commission for the Green Discount?

5.8. Other Amendments

5.8.1. As part of these amendments, it is also proposed that some language used within the Solvency Rules is amended, so that the rules are referenced consistently throughout. This will align the Solvency Rules to other rules issued by the Commission. It is not anticipated to change the interpretation of the rules, nor alter the application of any of the rules.

6. Next Steps

6.1.1. This Consultation will be open for a period of five weeks, with a closing date for responses of 10 November 2020.

6.1.2. Responses should be submitted through the Commission's Consultation Hub, which can be found at https://consultationhub.gfsc.gg/. Guidance on how to provide feedback can be found in section 1.3 of this paper.

6.1.3. Following the consultation period, the Commission will collate and consider responses provided. A feedback statement will be issued on the responses received, with a view to the future publication of the amendments to the Solvency Rules in final form.

Appendix A – Illustration of How Green Discount Limits Would Operate

The below is an illustration of how the limits for the Green Discount would be applied for a hypothetical life insurer who wishes to invest in green bonds.

A.1. How is an Insurer's Capital Adequacy Normally Assessed?

Insurers are required to hold Regulatory Capital Resources greater than, or equal to, its Prescribed Capital Requirement. Compliance can be assessed using a "PCR Ratio", summarised as:

$$PCR\ Ratio: \frac{Regulatory\ Capital\ Resources}{Prescribed\ Capital\ Requirement} \geq 1.0\ (or\ 100\%)$$

"Regulatory Capital Resources" are the economic value of an insurer's equity (assets less liabilities).

The "Prescribed Capital Requirement" is the amount of capital resources an insurer needs to hold to meet its obligations over a 12-month time horizon at a defined probability (dependent on the insurer's category). This is calculated using either a standardised regulatory formula or an internal model that assesses the risks to which an insurer's business is exposed.

For example, the Guernsey standard formula for the Prescribed Capital Requirement requires an assessment of the capital for several risk categories (market, counterparty default, and underwriting risks), adjusted for the likelihood of those risks occurring simultaneously. Each of those risks is made up of several components; spread risk, for example, forms part of market risk.

A.2. What is the Green Discount?

The "Green Discount" being proposed applies when a life insurer is calculating the spread risk component of its Prescribed Capital Requirement. The stresses applied to the corporate bonds an insurer holds are based on each security's credit rating; lower credit ratings (such as B) require more capital to be held against them.

The Green Discount would allow life insurers to treat a green bond, exposed to spread risk, as though it were a credit rating band higher than its actual rating. For example, this would allow a green bond with an actual credit rating band of A to be treated as though it had a credit rating band of AA.

While this incentivises insurers to invest in green bonds, it creates the danger that an insurer could take too much risk by allocating too large a portion of its portfolio to assets with an inherently higher credit risk. To prevent insurers taking excess risk in applying the Green Discount, it is proposed two limits are put in place:

1. The difference between the Prescribed Capital Requirement before and after applying the Green Discount cannot be more than a 15% reduction. This is illustrated in A.3.
2. If the PCR Ratio before applying the Green Discount falls to 105% or lower, the insurer must stop using the Green Discount and consider what remedial actions it needs to take. This is illustrated in A.4.

A.3. How would the 15% Maximum Reduction in the Prescribed Capital Requirement Hypothetically be Applied?

Let us suppose that a life insurer wants to take advantage of the Green Discount. It reallocates a portion of its bond portfolio, currently invested in A-rated corporate bonds, to BBB-rated green bonds. The amount of Regulatory Capital Resources are assumed not to change in making this re-allocation.

A hypothetical illustration of this can be seen in the below table:

	Before Re-Allocation to Green Assets	**After** Re-Allocation to Green Assets
Regulatory Capital Resources	£1,000 million	£1,000 million
Prescribed Capital Requirement (with Green Discount)	N/A	£500 million
Prescribed Capital Requirement (without Green Discount)	£500 million	£575 million
"Green" PCR Ratio	N/A	200%
"Non-Green" PCR Ratio	200%	174%

Such a change would ordinarily increase the Prescribed Capital Requirement, because the insurer's investment portfolio is exposed to increased spread risk. This is why the insurer's Prescribed Capital Requirement without the Green Discount has increased by £75 million from that before the re-allocation to green bonds.

The Green Discount allows those BBB green bonds to be treated as though they were A-rated, however. This results in the Prescribed Capital Requirement with the Green Discount being the same as that before the re-allocation.

The difference between the Prescribed Capital Requirement with and without the Green Discount is £75 million, or 15%. This is the maximum benefit the insurer could obtain from the Green Discount; any further green bonds of the insurer would require more capital to be held to compensate for their risks. This thereby limits the overall increase in risk an insurer can take by investing in riskier green bonds.

These changes result in the PCR Ratio after applying the Green Discount increasing by 26%. As the buffer of Regulatory Capital Resources above the Prescribed Capital Requirement increases, all else equal, the larger the increase in the PCR Ratio from applying the Green Discount.

A.4. How would the 105% Intervention Floor for the Non-Green PCR Ratio Hypothetically be Applied?

Let us suppose the same as in A.3., where a life insurer wants to take advantage of the Green Discount and re-allocates its portfolio in a similar manner. Let us suppose that the insurer has a lower PCR Ratio, before applying the Green Discount, than in Scenario A. This is illustrated in the table below:

	Before Re-Allocation to Green Assets	**After** Re-Allocation to Green Assets
Regulatory Capital Resources	£1,000 million	£1,000 million
Prescribed Capital Requirement (with Green Discount)	N/A	£900 million
Prescribed Capital Requirement (without Green Discount)	£900 million	£1,035 million
"Green" PCR Ratio	N/A	111%
"Non-Green" PCR Ratio	111%	97%

Applying the Green Discount in this instance results in a larger reduction in the Prescribed Capital Requirement, of £135 million, as it has a higher starting value. This still falls within the maximum 15% reduction, and is therefore permissible using the limit illustrated in A.3.

While the "Green" PCR Ratio would give the impression that the insurer still meets the requirement, the "Non-Green" PCR Ratio has fallen below 105% (being 14% lower than the "Green" PCR Ratio). In this circumstance, the insurer has taken too much risk by allocating to green bonds and would need to consider what remedial actions were necessary to bring it back into compliance (for example, by switching to higher-rated securities or government bonds).

The 105% floor in the "Non-Green" PCR limit has the effect of preventing an insurer who has a smaller capital buffer, and therefore a lower capacity to take risk, from unduly increasing its credit risk above the risk appetite of the standard solvency model.

Appendix B – Questions for Public Comment

Question 1: Do you agree that the Green Discount should be limited to Category 1 and Category 2 insurers? If you answered "No", how do you think the proposed amendments could be altered to accommodate other Categories of insurer?

Question 2: Do you agree that the proposed amendments are drafted in such a way that recognised standard formulae and internal models would be able to benefit from the Green Discount?

Question 3: Do you think the reduction in spread risk capital proposed as part of the Green Discount is appropriate, in light of the other proposals being made?

Question 4: Do you think the Green Discount should be widened to include other green asset classes, such as green equities? If you answered "Yes", what changes do you think could be made to the proposals to accommodate this?

Question 5: Do you agree that the green criteria used in the Solvency Rules should be consistent, where appropriate, with those used in the GGF Rules?

Question 6: Do you agree that the EU Sustainable Finance Taxonomy should be considered by the Commission for endorsement under the Solvency Rules?

Question 7: Should the Solvency Rules include either a list of exclusion policies, or a definition of what constitutes a brown asset?

Question 8: Do you agree that the maximum benefit for the Green Discount should be limited to a 15% reduction in the PCR? If you answered "No", what value do you think should represent the limit? (10%, 20%, 25%, or another value)

Question 9: Do you agree that a 105% non-green PCR ratio represents an appropriate intervention threshold level?

Question 10: Do you agree that insurers applying the Green Discount should make explicit considerations of it in its valuation, investment, and risk management policies, and in the ORSA?

Question 11: Do you think all insurers, not just those adopting the Green Discount, should be required to make explicit considerations around climate change risks and green / sustainable investment in the documents listed in question 10?

Question 12: Do you agree with the proposed requirements around disclosure to policyholders where insurers apply the Green Discount?

Question 13: Do you agree with the items to be included within the proposed notification to the Commission for the Green Discount?

THE INSURANCE BUSINESS (SOLVENCY) (AMENDMENT) RULES, 20**

Made:

Coming into Operation:

The Guernsey Financial Services Commission (the "Commission"), in exercise of the powers conferred on it by sections 38A and 38B of *the Insurance Business (Bailiwick of Guernsey) Law, 2002*[1] (the "Law") hereby makes the following Rules.

Citation and Commencement

1. These Rules may be cited as the Insurance Business (Solvency) (Amendment) Rules, 20** and amend the Insurance Business (Solvency) Rules, 2015[2].
2. These Rules shall come into force on **.
3. The amendments shall have prospective effect from the day on which the Rule comes into force.

Amendments

4. Delete the word "paragraph" and substitute with the word "rule" in every instance in which it occurs.

[1] No. XXI of 2002 (Ordres en Conseil Vol. XLII(2), p. 766) as amended.
[2] No.31 of 2015.

5. Delete the word "subparagraph" and substitute with the word "rule" in every instance in which it occurs.

6. In this section underlining indicates new text and striking through indicates deleted text.

…

20. The regulatory capital resources must be determined as set out in ~~sections~~ rules 21 to 34. Alternative definitions which may be specified by other regulatory regimes are not permitted.

…

7. In this section underlining indicates new text and striking through indicates deleted text.

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Part 4 – PCR

48. The PCR of an insurer equals –

(a) an amount determined either –

(i) by applying the 'Guernsey standard formula'; or

(ii) by applying a 'recognised standard formula'; or

(iii) by using an internal model developed by the company to reflect the circumstances of the business; or

(iv) by using a partial internal model which is a combination of the approaches specified in (i) and (iii) or (ii) and (iii) above; ~~plus~~ or

(v) by using any one of (i) to (iv) above and modifying it to take account of the Green Discount set out in rule 209, provided the insurer meets all of the requirements set out in Part 9 of these Rules; plus

(b) any regulatory adjustment specified in writing by the Commission.

49. The PCR is the capital required to ensure that the licensed insurer should be able to meet its obligations over the next 12 months with a probability as defined by

the ~~confidence levels specified in subparagraphs (a) to (e).~~ following specified confidence levels –

(a) Category 1 – Commercial Life Insurers – the PCR is determined at a 99.5% confidence level.

…

51. A licensed insurer may use a recognised standard formula applied in full to calculate its PCR in place of the Guernsey standard formula without the prior written approval of the Commission. A list of recognised standard formula is provided at Schedule 4. If the recognised standard formula is not applied in full, except where a licensed insurer applies the Green Discount set out in rule 209, then it will be deemed a partial internal model.

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Part 8 – Risk Management and Own Risk Solvency Assessment

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207. Further reference should be made to the Commission's published guidance on the ORSA.

Part 9 – Green Assets

208. Green Assets are defined as resources controlled by an insurer, as a result of past events, from which future benefits are expected to flow to the insurer and which meet one of the green criteria set out in Schedule 12.

209. A Category 1 or Category 2 insurer that makes investments into Green Assets may apply the following adjustment, or "Green Discount", when calculating their PCR using the Guernsey standard formula, a recognised standard formula, or a full or partial internal model –

(a) for investments in Green Assets that are exposed to spread risk: the stresses and factors applied to determine the capital requirement for spread risk for Green Assets may be those of one credit rating band, or equivalent, higher than the rating assigned them by an Acceptable Rating Agency. No such adjustments may be applied to liabilities. The stresses and factors are set out in either –

(i) Schedule 10;

(ii) the relevant text of a recognised standard formula; or

(iii) the documentation of a partial or full internal model.

210. Insurers that apply rule 209 must monitor their PCR both inclusive and exclusive of the Green Discount.

211. The maximum benefit an insurer may derive from the Green Discount will be limited to a 15% reduction in its PCR. This will be measured by comparing the PCR inclusive of the Green Discount with the PCR exclusive of the Green Discount.

212. Where the regulatory capital resources of the insurer, under rule 22, fall below the higher of –

(a) 105% of the insurer's PCR exclusive of the Green Discount; or

(b) an amount specified, in writing, by the Commission,

the insurer must not make further use of the Green Discount. The insurer must consider the measures necessary to improve its solvency position in accordance with Stage 1 of the Guidance Note on Supervisory Ladder of Intervention. Such an event, and any proposed measures, must be notified to the Commission immediately.

213. An insurer applying the Green Discount must –

(a) determine and document the valuation policy to be applied to Green Assets, which includes any judgments required in applying the recognition, classification or measurement criteria of the Recognised Accounting Standards applied by the insurer;

(b) modify its investment policy, under rule 190, to explicitly set out the nature, role and extent of investment in Green Assets as part of its portfolio. This should include the green criteria applied, any other positive or negative investment screening criteria used, what controls will be implemented to ensure these are followed, and how any specific risks relating to Green Assets, such as liquidity risk, are managed in the context of the insurer's overall investment portfolio;

(c) ensure that its risk management policy, under rule 195 and rule 197, explicitly incorporates how their risks, in relation to Green Assets and the use of the Green Discount, will be monitored and managed, and how any tolerance limits associated with the Green Discount will be operated to; and

(d) where applicable, consider the risks attributable to Green Assets as part of its ORSA, under rules 198 to 207. This must include incorporating the risks around Green Assets into its OSCA;

in a manner proportionate to its nature, scale and complexity.

214. An insurer applying the Green Discount must disclose that fact in the pre-contractual or contractual information provided to policyholders and potential policyholders, as appropriate to the nature, scale and complexity of the insurer and its use of the Green Discount. Disclosures should state what the Green Discount is and the effect that applying it has on the insurer's risk profile and the calculation of its Capital Adequacy.

215. Use of the Green Discount constitutes a material change of business plan, under subsection 11(2) of the Law, and an insurer must notify the Commission prior to its implementation. As part of that notification, the insurer must make available to the Commission the documents listed in rule 213 and rule 214 and must quantify the impact applying the Green Discount would have on their Capital Adequacy.

216. An applicant for an insurance licence that wishes to make use of the Green Discount must state that fact in its application and must demonstrate how it intends to meet all the requirements.

Schedule 1

Recognised Accounting Standards

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Schedule 3

Glossary of Expressions

In ~~this Regulation~~ these Rules, unless the context requires otherwise –

…

"diversification effects" mean the reduction in the risk of exposure of insurance and reinsurance undertakings and groups related to the diversification of their business, resulting from the fact that the adverse outcome from one risk can be offset by a more favourable outcome from another risk, where those risks are not fully correlated.

"Green Asset" has the meaning given in rule 208.

"Green Discount" means the adjustments to the PCR set out in rule 209 for an insurer that makes investments in Green Assets.

"interest rate risk" means the sensitivity of the values of assets, liabilities and financial instruments to changes in the term structure of interest rates, or in the volatility of interest rates.

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Schedule 11

Life Business Diversification Adjustment

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Correlation Matrix: Catastrophe Risk

For insurers, reinsurers and captive (re)insurers, $Corr_{x,y}$ is defined as

Corr	Life pandemic	Disability/Morbidity pandemic	Mass accident
Life pandemic	1	0	0
Disability/Morbidity	0	1	0
Mass accident	0	0	1

Schedule 12

Green Criteria

For the purposes of Part 9 of these Rules, the following is a list of green criteria, endorsed by the Commission, as standards that can be adopted when considering whether an investment is a Green Asset.

An insurer may only apply Part 9 of the Rules to an asset that would meet the chosen criteria adopted from the table below.

An insurer can only apply one set of criteria for all their investments at any one time and must apply the criteria consistently.

Criteria	**Date added**	**Source**
The Common Principles for Climate Mitigation Finance Tracking	** ** 20**	http://www.worldbank.org/content/dam/Worldbank/document/Climate/common-principles-for-climate-mitigation-finance-tracking.pdf

Dated this day of ***, 20**

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C. A. SCHRAUWERS

Chairman of the Guernsey Financial Services Commission

For and on behalf of the Commission