

GFSC Solvency II Position Statement



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Ian Morris

The GFSC and States of Guernsey Commerce and Employment Department published a joint Solvency II position statement recently in which they confirmed that there are no current plans to seek equivalence under Solvency II.

Solvency II Equivalence

Equivalence is a process whereby reinsurers from non EU countries will be treated equally to reinsurers from EU countries for solvency purposes. Equivalence does not mean that the Solvency II regime has to be adhered to precisely in the non EU country but rather that the general principles are followed (such as supervisory powers and solvency assessment).

Solvency II impact on smaller entities

There is considerable uncertainty relating to the impact of Solvency II on small and medium companies such as captives. For example, the CEA (the European insurance and reinsurance federation) published a report in January based on their experience of the fifth Quantitative Impact Study (QIS5). This expressed concerns that the current proposals for the Solvency II regulatory regime are too burdensome, too complex and too expensive for small companies.

Industry view in Guernsey

Guernsey is the largest captive domicile in Europe and its insurance industry has welcomed the confirmation from the local authorities. Industry participants had been concerned that moving towards equivalence, without clarity over the consequences for captives, could have created significant problems.

Implications

The statement means that the current operation of captives in Guernsey can continue as at present. However, it does mean that when acting as reinsurers there may be adverse capital implications for an EU insurer reinsuring to a Guernsey entity. The extent of this issue will depend on a range of factors. Fronting insurers have always imposed restrictions on captives to seek to ensure that the captive can repay any liabilities as due. Various means exist, such as letters of credit, to satisfy the capital requirements of a fronting insurer. To the extent that a fronting insurer is able to take credit for the security of the captive (using an internal model) or the captive is a small part of the fronting insurer's operations, there may be no material impact.

However, the capital requirements for an EU insurer adopting the standard model could be more onerous. The final terms of the EU standard model are not yet determined. If reinsurance to non EU insurers carries significant adverse solvency requirements, this may limit their willingness to work with entities based in non EU jurisdictions such as Guernsey.

Opportunities

While the absence of equivalence may bring some challenges, there may be opportunities for certain businesses to operate more efficiently outside the potentially onerous requirements of full compliance with Solvency II. This may particularly apply to any area where Solvency II is perceived as unduly onerous (e.g. for smaller entities such as captives).

IAIS Standards

International insurance standards are being revised to take account of emerging best practice in relation to risk based solvency. In October 2010, the International Association of Insurance Supervisors (IAIS) adopted six revised Insurance Core Principles (ICPs) and the complete set is due for IAIS adoption in October.

Guernsey is committed to meeting international standards but the position statement confirms that any changes will take account of and be tailored to the needs of its insurance industry.

Accounting standards

Changes are expected to the format of accounts prepared under either International Financial Reporting Standards (IFRS) or UK Generally Accepted Accounting Practice (UK GAAP).

Conclusion

Guernsey's regulatory regime is expected to change as a result of Guernsey's commitment to meet evolving IAIS risk-based solvency standards and the impact of new accounting standards. The authorities and industry are committed to ensuring that the changes introduced are proportionate to the needs of the insurance industry in Guernsey. For further information and assistance please contact Ian Morris (imorris@bwcigroup.com).



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