

Insurance Newsletter

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**Financial Services
Commission**

Solvency II Update

The timetable through to the implementation of Solvency II is now becoming clearer. This Newsletter is intended to set out the current known timetable and provide information for Gibraltar licensed insurers on key milestones and matters that insurers should consider while making preparations for the introduction of this important regulatory development and the actions that the FSC will be undertaking.

The Solvency II Directive

The implementation date for Solvency II has been confirmed as 31 October, 2012.

The Solvency II Directive was adopted by the European Parliament on 22 April, 2009 and endorsed at the Economic and Financial Affairs Council (ECOFIN) meeting on 5 May 2009. It will be officially adopted at a forthcoming meeting once all translated texts have been finalised and is expected to be published in the EU official journal in the last quarter of 2009. A provisional edition of the text may be found at the European Parliament website:

<http://tinyurl.com/solv2dir>

Key Dates

CEIOPS Level 2 Consultation papers (Phase 2)	– July to September, 2009
CEIOPS Level 2 Consultation papers (Phase 3)	– November to December, 2009
Quantitative Impact Study 5 (QIS5)	– June to November, 2010
CEIOPS finalises common reporting forms	– December, 2010
European Commission finalises Level 2 measures	– December, 2011
CEIOPS work on Level 3 Guidance	– Late 2009 to September, 2012

Level 2 Implementing Measures

The European Commission has requested that the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) provide final, fully consulted advice on Level 2 implementing measures.

On 26 March, 2009 CEIOPS released for consultation its first set of advice. The consultation period for these papers ended on 8th June, 2009. The documents may be found at:

<http://tinyurl.com/solv2ceiops>

On 2 July CEIOPS released a further twenty four consultation papers. These were followed by three amended and one new paper issued on 21 July. The consultation period for all these papers will end on 11 September, 2009. Documents may be found at:

<http://tinyurl.com/solv2consult>

Details of all consultation papers, including proposed Phase 3 consultation papers that are to be released in November 2009 which show the article within the Directive to which they relate and the expected consultation period, are shown in the Appendix to this Newsletter.



Level 2 implementing measures are expected to be finalised following Quantitative Impact Study 5 (QIS5) – see below – and be in place at least 12 months before the new regime becomes operational.

Level 3 Guidance

CEIOPS has also been asked to develop technical standards that provide common EU-level guidance on how to implement the new legislation. This work will commence in the second half of 2009. Draft guidelines will be published for consultation in the first half of 2011. Final guidelines are intended to be in place 9 months prior to Solvency II being implemented.

Quantitative Impact Studies

Quantitative Impact Study 4 (QIS4) commenced in April 2008 and was completed in July 2008. The results of that study were set out in a CEIOPS report issued in November, 2008. The report may be found on the CEIOPS website at:

<http://tinyurl.com/solv2qis>

The European Commission is expected to ask CEIOPS to conduct a fifth quantitative impact study to test the advice that CEIOPS has provided on Level 2 implementing measures. A draft QIS5 technical specification and calibration paper is expected to be published by June, 2010. It is anticipated that QIS5 will be undertaken between August and October, 2010.

QIS5 may be undertaken by all insurers and the FSC recommends that all Gibraltar licensed insurers that will be subject to Solvency II undertake this study as part of the insurer's preparation for Solvency II implementation. Although there is no requirement for insurers participating in QIS5 to have completed the QIS 4 exercise the FSC encourages insurers that did not do so to complete the exercise now.

Internal models

CEIOPS published a "Stock-taking report on the use of Internal Models in Insurance" in January, 2009. The report may be found at:

<http://tinyurl.com/solv2models>

CEIOPS issued Consultation Paper 37 "the procedure to be followed for the approval of an internal model" in March, 2009 and an addendum was published on 2 July.

Captive insurers and reinsurers

The final Directive text requires the solvency regime to take account of the specific nature of captive insurance and reinsurance undertakings. This includes the use of simplified methods and techniques to calculate technical provisions, in order to ensure the actuarial and statistical methodologies referred to in the Directive are proportionate to the nature, scale and complexity of the risks supported by the captive.

The Directive now refers to the absolute floor of the Minimum Capital Requirement for captive reinsurance undertakings, being not less than a minimum of €1m, which is currently the Minimum Guarantee Fund for captive reinsurers.

Level 2 Implementing Measure Consultation Papers issued by CEIOPS have yet to comment on Captive issues. However, CEIOPS has indicated that advice on captive simplifications will be given at a later stage.



Pillars 2 (Systems of Governance) and Pillar 3 (Disclosure and reporting requirements)

In much the same way as for Pillar 1 (Financial Requirements) CEIOPS will be developing Level 2 Implementing Measures and Level 3 Guidance for Pillars 2 and 3, in the same timeframes. This includes the recently released advice on implementing measures for systems of governance and future work on harmonised reporting formats that is aimed at facilitating comparisons of data across jurisdictions.

While much emphasis has been placed on the Pillar 1 (Demonstrating Adequate Financial Resources) requirements insurers should also reflect on the impact that Pillar 2 and 3 requirements may have on their business.

In relation to Pillar 2 insurers will be required to have in place an effective system of governance which provides for sound and prudent management of the business. They will be required to have effective risk management and internal control systems and maintain effective internal audit and actuarial functions. An insurer will be permitted to outsource functions provided that this does not materially impair its governance system.

As part of its risk management systems an insurer will be required to conduct its own risk and solvency assessment (ORSA). The ORSA will identify specific solvency needs of the insurer taking into account its risk profile and deviations from the standard Solvency II capital requirement. However, the ORSA will not serve to calculate a capital requirement.

In relation to Pillar 3 insurers will be required to publicly disclose, on an annual basis, a report of their solvency and financial condition. The report will contain descriptions of the insurer's business and its performance, its systems of governance and risk management and its capital management, including its Minimum Capital Requirement and Solvency Capital Requirement. Insurers will be permitted to restrict disclosure in cases where disclosure would enable competitors to gain significant unfair competitive advantage or where obligations to policyholders and other counterparties contain a binding undertaking to secrecy or confidentiality.

FSC actions relating to Solvency II

As Gibraltar is not a European Member State the FSC is not eligible to be a member of CEIOPS. Neither is the FSC eligible to be an Observer of the organisation. The interests of Gibraltar are represented by the UK FSA. In order that the FSC, and thence the Gibraltar insurance industry, obtains prompt notice and guidance of relevant developments relating to Solvency II the FSC has agreed with the UK FSA that it will strengthen communications between the two organisations.

The FSC recognises that Gibraltar insurers will increasingly require guidance as to the regulatory expectations that are being placed on them. We intend to undertake more regular communication with the industry, including through contacts with the Gibraltar Insurance Association and its Solvency II Subcommittee. In the meantime the FSC encourages the industry to communicate any comments or concerns that they consider to be relevant in relation to the implementation of Solvency II.

The approval of applications by Gibraltar insurers to use internal or partial models to determine their Statutory Capital Requirements will fall to the FSC. Therefore, the number of such applications is likely to have major resource implications for the FSC. While the FSC is considering how best to meet these resource needs it will require early notification by insurers that intend to apply to use either an internal or partial model rather than the standard model.



The FSC will be devoting much greater resources in the coming three years to training its staff in preparation for the implementation of Solvency II. This will include establishing individuals as specialists in specific elements of Solvency II. We will communicate further with the industry in this regard.

The FSC will also be working closely with the Finance Centre and the Government of Gibraltar to ensure that there is a smooth transposition of requirements set out in the Solvency II directive into Gibraltar legislation.

Conclusion

With the implementation date for Solvency II now set it is important that Gibraltar insurers develop a detailed gap analysis of anticipated shortfalls against the requirements of Solvency II as a basis for establishing their implementation plan.

Although much of the focus to date has been on the development of the solvency capital requirement (SCR) and technical provisions standards through the QIS exercises, increasingly firms should start giving greater attention and priority to the potential implications of the Pillar 2 and 3 requirements for which draft advice is now becoming available.

The FSC will be communicating with individual insurers regarding their Solvency II implementation plans in due course.

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The advice or interpretation given in this publication represents the views of the FSC as to its expectations of how the requirements of the relevant legislation in question are to be complied with and/or how it falls to be applied. This, however, is not intended as a definitive interpretation of the applicable legislation which is ultimately a matter for the courts to determine. You are, therefore, strongly advised to seek appropriate legal advice before any action or decision is taken (if you have not already done so). The FSC does not provide, or purport to offer, legal advice.