Financial Services Commission

Solvency 2
Frequently Asked Questions

24 March 2016
Gibraltar Financial Services Commission

Pillar 1

Log of changes
Q1.9 Revised response

Q1.1: Will the GFSC grant any concessions on the capital requirements for specialist run-off vehicles?

Article 100 of the Directive is unambiguous regarding capital, noting that member states shall require that insurance and reinsurance undertakings hold eligible own funds covering the Solvency Capital Requirement (SCR). This applies to all firms, whether in run-off or not.

Any proposed extraction of capital from a run-off firm needs to ensure that the above position is not threatened.

Articles 88 to 112 of the Delegated Regulation (EU) 2015/35 provide for some proportionality as to how the SCR should be calculated, but not in the level or amount.

Q1.2: What happens if a firm is in breach of its Minimum Capital Requirement (MCR) or its SCR?

In both cases the firm must inform the GFSC immediately if it identifies a breach or a risk of non-compliance in the following three months.

	SCR breach	MCR breach
What needs to be submitted	Realistic recovery plan	Short-term realistic finance scheme
Deadline for submission	2 months	1 month
Timescales for restoration (from date of observation)	6 months + option for GFSC to extend by 3 months. If EIOPA identifies an exception adverse situation it could be extended by up to 7 years.	3 months
Progress reports to GFSC	Every 3 months	N/A
Transitional arrangements	If firm meets Solvency I capital before Solvency II comes into effect but does not meet the SCR in the first year, timescale for restoration is extended to 31 December 2017. If any progress report shows that significant progress has not been made, transitional deadline is withdrawn.	None

Assessment of submissions / next steps	In the case of a breach of the MCR a withdrawal of the authorisation is mandatory under Article 144(1) if the non-compliance is not remedied within three months. See draft RTS (link here) on recovery plan, financial scheme and supervisory powers in deteriorating financial conditions which sets this out in detail

Q1.3: The GFSC has historically regarded 200% of S1 as a suitable proxy for SCR under Solvency 2. Is this still the case?

We sent a letter to Directors of all insurers in May 2013 setting out areas where we intended to focus our attention. In our letter we stated:

For open market insurers the GFSC will always impose additional capital requirements on licensing, which will take account of likely SCR requirements. Often the prospective capital requirements that the GFSC has imposed have been in the region of 200% of the current solvency Premium or Claims basis calculation or 150% of the Minimum Guarantee Fund, whichever is the higher.

While SCR calculations submitted to us confirm that 200% of Solvency I is generally a reasonable proxy for the standard formula SCR, we are aware that for many reasons the SCR can be considerably greater or lower depending on the risk profile of the insurer. It is also important to consider the change in own funds between the current solvency basis and Solvency 2, so that an appropriate comparison is made.

We have requested that all insurers submit a forecast SCR in a standard template. This will help us and firms to better understand how the standard formula SCR and own funds compare to the corresponding Solvency I amounts.

Q1.4: When and how should a firm apply for Undertaking Specific Parameters (USPs)?

The GFSC is now accepting applications from firms for the use of USPs. Accordingly, firms are reminded to ensure that their application complies with the supervisory approval procedures set out in “Commission Implementing Regulation (EU) 2015/498”, 24th March 2015 (link here)

As part of its decision making process, we will be considering the reasons why a firm has decided to apply to use USPs and whether they have been applied consistently across a firm’s business.

We will also, per Article 4.3 of the above regulation, be requesting a balance sheet with a date matching that of the data used in performing the USP calculations. This will allow us to take a more considered view of the possible impact of a firm's successful implementation of USPs on its business given that the latest request for such data was in November 2014.

Q1.5: Applying for use of Partial or Full Internal Models

In the case of firms wishing to apply for the use of a partial or full internal models, please contact our team at s2@fsc.gi to arrange a meeting to discuss their application.

Q1.6: What is the approval process and what are the expected timelines?

EIOPA has published draft ITS which set out the supervisory approval process; these can be found here.

Q1.7: How should a motor insurer allocate claims reserves between motor liability and motor non-liability claims, given the impact on the final SCR of possible different approaches?

In the UK market, where most Gibraltar motor insurers operate, a comprehensive motor insurance policy provides property damage cover for an insured's own vehicle along with third party liability cover. Third party liability cover would indemnify the insured against claims from third parties in respect of both bodily injury and property damage. The GFSC would expect these policies and claims to be unbundled into the appropriate Solvency 2 lines of business. This impacts both reporting and also standard formula calculations.

Specifically, third party liability claims, both property and bodily injury, should be allocated to line of business 4 "Motor Vehicle Liability" or 26 "Non-proportional Casualty" and own property damage should be allocated to line of business 5 "Other Motor" or 28 "Non-proportional property". Where only one of the risks is considered material, the technical provisions guidelines state that the unbundling of the obligations is not required. Where the risks within "Other Motor" cannot be shown to be immaterial, and to ensure that motor business is treated consistently, firms should be unbundling their motor business into the appropriate Solvency 2 lines of business.

Firms should be able to split their motor claims by [own property damage] and [third party property damage and third party liability] and apply an appropriate split to the premiums in order to report in line with Solvency 2 rules.

PPOs should be treated as a "motor vehicle liability" when they are uncertain, but move to a "non-life annuity" once they become settled. This is consistent with the relevant EIOPA material.

This allocation is for reporting and standard formula calculation purposes.

Q1.8: How should PCCs be treated when calculating the SCR and does each cell need to meet its SCR?

PCCs are not explicitly mentioned in the Solvency 2 Directive. However, the assets in individual PCC cells are not available to meet claims arising other than from that cell, and therefore fall within the scope of the 'ring-fenced funds' concept within Solvency 2. Ring-fenced funds are assets which cannot be made available to meet risks outside the ring-fenced fund.

Within the PCC each cell would constitute a separate ring-fenced fund. The standard formula for the SCR requires the calculation of a notional SCR for each cell unless it is not material to the overall calculation. Non-cellular assets of the PCC may also form part of a ring-fenced fund should there be any restrictions on how those assets could be used.

As per the regulations and guidance covering ring-fenced funds, there is no requirement for each cell to hold sufficient own funds to meet the notional SCR from that cell. However, the excess own funds within a cell may not be used to meet the SCR from any other cell or from the core. Therefore, in practice either:

- each cell would need to be capitalised to meet its notional SCR.

or

- the non-cellular assets would need to be available to fully absorb losses. The non-cellular assets would then need to also meet any shortfall in each cell as well as any SCR arising from the core.

Where the firm is relying on cell limitation clauses to justify a low notional SCR for a cell, we would expect firms to be able to justify why they believe these clauses are effective under stressed conditions.

Finally, the MCR is calculated for the PCC as a whole, based on the aggregate SCR. It does not need to be met at a cell level.

Q1.9: Is there any flexibility under the use of the standard model to use premiums net of commissions figure given that many local insurers offer net-

rated products? EIOPA simply defines premiums as Premiums net of reinsurance.

Premiums should be treated as set out in Article 116(5) of the Delegated Regulation (EU) 2015/35, taking into account any guidance issued by the GFSC. The Article states that only certain reinsurance premiums should be deducted. Our default position is that premiums (gross of acquisition expenses) should be used in the calculation of the SCR. Where a firm believes that there are circumstances specific to its operations that could result in an alternative treatment (e.g. net premiums), then the firm should seek professional advice and engage directly with us. We will review each approach on a case by case basis. The proposed treatment would require to be supported by, and evidenced in, underlying agreements and contracts.

Q1.10: In QIS 5 various methods were available to value premium and reserve risk. Following the release of the final guidelines pursuant to the application for use of USPs, is it correct that there are only three methods to choose from?

For the calculation of the USPs, insurers can select one of the standardised methods prescribed in Annex XVII to the Delegated Regulation (EU) 2015/35. Should a firm wish to seek approval to make a change to the standard formula, including its parameters, not falling within the standardised methods for USPs, the (partial) internal model route would apply.

Annex XVII includes one method for non-life premium risk and two methods for reserve risk.

Q1.11 What transitional arrangements are available if a firm cannot meet its SCR by the start of Solvency 2?

The GFSC has made it clear it expects all insurers to meet their SCR with effect from 1st January 2016.

If in exceptional circumstances a firm needs to apply to use the two year transitional period available under Solvency 2 then, per Article 308b, paragraph 14 of Omnibus 2, there are 2 key criteria that need to be met:

1. The GFSC must be satisfied with the firm's plans to ensure it meets the SCR within the period, and
2. The firm currently meets the Required Solvency Margin

We will withdraw its approval to the extension if the firm fails to deliver on the plan mentioned in point 1 above.

Q1.12 What criteria must a firm meet in order to have its dividend request approved prior to Solvency 2? How does this change from 1st January 2016 onwards?

The GFSC has made clear to firms who have requested approval to pay a dividend prior to the start of Solvency 2 that it will not approve such requests if the firm is currently forecasting that it will be unable to meet its SCR under Solvency 2. A firm needs to have a credible plan to deliver the latter, allowing for any dividends payable in the meantime.

In respect of the situation once Solvency 2 is live, firms need to ensure that they meet the detailed criteria described in Article 71 of the Delegated Regulations (EU) 2015/35 with regards to any distributions. It may be that firms need to amend their Articles of Association. One particular aspect of this is that firms should not expect to be able to pay a dividend if it would result in a breach of the SCR.

Q1.13 What are the requirements of a firm's actuarial function, including the issue of independence of validation?

The recent Pillar 1 thematic review has raised concerns about whether all firms have in place plans to ensure that Article 48 of the Directive is satisfied i.e. "The actuarial function shall be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the insurance or reinsurance undertaking, and who are able to demonstrate their relevant experience with applicable professional and other standards."

While we do not expect the majority of firms (or their insurance managers) currently to have this resource in-house, we would expect all firms to have a named actuarial resource lined up (or the name of the relevant firm). Our expectation is that a firm should appoint an external actuary if it does not have the internal capability.

On the issue of independence of validation, who should perform the calculation of the technical provisions is left to each undertaking to decide. That is, provided there is a clear allocation and appropriate segregation of responsibilities, to ensure independent scrutiny and validation of the calculation.

In cases where both calculation and validation of technical provisions is calculated by the actuarial function, the firm should have in place processes and procedures in order to avoid conflicts of interest and to ensure appropriate independence. The degree of segregation of duties needs to be proportionate to the nature, scale and complexity of the risks inherent in the calculation of the technical provisions. The firm needs to ensure, and demonstrate, that the processes of calculation and of validation of the technical provisions are independently performed.

This issue will be discussed further with the newly formed Gibraltar Actuarial Society.

Q1.14 How should PPOs be treated within the standard formula?

Consistently with reporting, PPOs should be treated as “motor vehicle liability” when they are uncertain, and move to a “non-life annuity” once they become settled.

More generally, PPOs are an important yet new feature of the general insurance industry, and the standard formula may not adequately capture the risk for firms with material PPO exposures. Firms should be considering the underlying risk of both uncertain and settled PPOs and the corresponding appropriateness of the standard formula within their ORSA.

PPO exposures tend to take longer to run-off than ordinary lump sum claims; and firms need to make appropriate allowance for this within their calculation of the risk margin in a demonstrable way.

Pillar 2

Log of changes
Q2.3 - Revised response
Q2.4 – Q 2.7 New FAQs

Q2.1: What will proportionality look like in respect of EIOPA's requirement for an internal audit function?

The Delegated Regulation (EU) 2015/35 offers flexibility on this point. Article 271 states that an internal auditor shall not assume any responsibility for any other key management function. However, it then goes on to define a set of circumstances under which this requirement is waived. A person may be permitted to carry out other key functions as well as internal audit:

- where appropriate to the nature, scale and complexity of risks inherent.
- where no conflict of interest would exist.
- where the costs of introducing a unique internal audit function would impose disproportionate costs to a business.

The GFSC can envisage this situation arising within many Gibraltar insurers and will make use of this flexibility if deemed to be appropriate.

A related point is the use of parent or Group internal audit facilities, where these are available to the Gibraltar entity. So long as the above conditions are satisfied, this would be permitted.

Q2.2: Please provide further clarity regarding the structure and format for the ORSA - what does it need to include?

The ORSA supervisory report, as set out in Article 306 of the Delegated Regulation (EU) 2015/35, shall present all of the following:

- The qualitative and quantitative results of the own risk and solvency assessment and the conclusions drawn by the insurance or reinsurance undertaking from those results.
- The methods and main assumptions used in the own risk and solvency assessment.
- Information on the undertaking's overall solvency needs and a comparison between those solvency needs, the regulatory capital requirements and the undertaking's own funds.

- Qualitative information on, and where significant deviations have been identified a quantification of the extent to which quantifiable risks of the undertakings are not reflected in the calculation of the SCR.

EIOPA has issued guidance on the content and scope of the ORSA, building on the preparatory stage guidelines on the FLAOR. The final report is available here.

The GFSC feedback paper following its review of 2014 FLAOR reports is included in our May 2015 feedback paper on Solvency II self-assessments is available here.

Q2.3 When is the next FLAOR submission required?

We required firms to produce and submit an updated FLAOR by the end of 2015 at the latest. We are reviewing each submission and will provide both firm specific and overall market feedback in Q2 2016. We anticipate that this will highlight areas of both good and bad practice as well as areas for future development and inclusion in the Own Risk and Solvency Assessment process. We expect to receive an ORSA submission from each firm at least annually and expect firms to submit a revised ORSA where a firm's risk or business profile has materially changed.

Q2.4 What are the criteria for appointing individuals to the roles of Solvency II key functions?

We require each of the Solvency II key function holders (Risk Management, Internal Audit, Compliance, and Actuarial Function Holders) to be named individuals within the firm and require that the holders of these functions be notified to us.

Under SII, there are fit and proper requirements for all persons performing key functions and notification requirements for the key function holders. Individuals should have the relevant professional qualifications, knowledge, and experience to ensure sound and prudent management principles are met. The EIOPA Guidelines on Systems of Governance expand on these requirements.

The SII fit and proper requirements supplement those already in Gibraltar legislation. The GFSC has published more information around these requirements in the Fit and Proper page of our website and in our earlier Fitness and Propriety Newsletter.

We will shortly be issuing a notification template to firms subject to SII requirements, to record the named individuals appointed to key function holder roles and some basic information on their fitness and propriety.

In most cases we expect the appointed individuals to already be notified to us in some capacity. But in some cases, the most suitable person may not have been in a role that was previously notifiable to the GFSC. Such an individual may be appointed only where a firm is able to justify and evidence this choice against fitness and proprietary expectations and requirements.

We expect firms to have already conducted their own due diligence assessments on appointing an individual to a key function role. Additionally, the GFSC will also carry out its own assessment process, an interview for example, once the notification templates have been received. This may result in further engagement with the firm or the appointed individual. In these assessments we will be mindful of the nature, scale, and complexity of the insurance firm, and we will expect the appointed individual to have the experience and appropriate character to fit the role.

Q2.5. Can the role of key function holder be outsourced?

The key function holder must be a named individual within the firm and cannot be outsourced. However, this does not preclude the outsourcing of some of the work associated with the key function. Where work associated with the key function is outsourced, the ultimate responsibility for the key function will still remain with the named key function holder. We would expect the holder to have sufficient background and experience to be able to coordinate the outsourcing of work and challenge the results.

Q2.6. Can a collective body be appointed as a key function holder? For example, the Board or an insurance management company.

We require the appointment of a specified individual rather than a collective body. This is to ensure the clear allocation and segregation of duties, as required under SII.

Q2.7. Can an individual be appointed to the role of more than one key function?

We are mindful that some small and captive insurance firms have a small internal staff and a strong reliance on outsourcing. Provided that they meet the fit and proper requirements across the different roles and that the distribution of responsibilities is/remains appropriate, it may be possible for an individual to take on the role of more than one key function.

Pillar 3

Log of changes
Q3.14 - 3.15 New FAQs

Q3.1: Does the GFSC intend to publish any guidance on the use of actuaries in quarterly reporting to the GFSC?

The duties of the actuarial function are set out in the Solvency 2 Directive and fleshed out in Article 272 of the Delegated Regulation (EU) 2015/35.

The requirement for the actuarial function to coordinate the calculation of the technical provisions and to assess the appropriateness of the methodology and assumptions apply to the technical provisions included in both annual and quarterly reporting to the GFSC.

Q3.2: What independent validation of SCR/technical provisions/own funds will be expected by the GFSC?

We expect firms to demonstrate that the SCR and own funds (including the calculation of technical provisions) have been appropriately calculated and validated. We have recently conducted a thematic review which included insurers' plans regarding external validation. We will shortly consult on our plans in this regard, drawing on the lessons learnt from this review.

By way of background, EIOPA recently stated in a report on the potential role of external audit (available here) that, "In order to make best use of external audit in the context of SFCR, EIOPA is of the view that at individual and group level main elements of the SFCR (balance sheet, own funds and capital requirements) of all insurance and reinsurance undertakings could fall within the scope of an external audit."

Q3.3: Will the GFSC be publishing guidance on Pillar 3 reporting requirements for a mixed activity group?

Article 21 of the Final Report on the ITS on Regular Supervisory Reporting (found here) details the reporting requirements of mixed activity groups.

Such groups are required to submit templates S.36.01.01 to S.36.04.01 relating to intra-group transactions.

Q3.4: Will the GFSC be providing a Pillar 3 reporting tool?

Yes, we have chosen Invoke as our online reporting portal.

All firms will be required to use it for QRT reporting. This topic is covered within the June Solvency 2 Update available here.

Q3.5: Does EIOPA still intend to provide the Tool 4 Undertakings("T4U")?

T4U will no longer be officially supported by EIOPA and will be made open source within the coming months. We encourage all firms to use the Invoke Portal's additional Excel functionality to assist them in their preparation.

Q3.6: What might proportionality look like in respect of the QRTs?

As is made clear in relevant European material, when submitting some of the information required for the QRTs, firms may apply proportionality and materiality principles.

Per Article 7 of the Final Report on the ITS on Regular Supervisory Reporting, in making assessments of materiality, it is acknowledged that quarterly measurements may rely on estimates and estimation methods to a greater extent than measurements of annual financial data.

It is also envisaged in above that firms may apply simplified methods in the calculation of the technical provisions.

Further, it is proposed that local regulators will be allowed to exempt certain firms from certain reporting requirements. This exemption must collectively represent less than 20% of the market. This assessment is performed separately for life and non-life firms. This will be reviewed annually. The GFSC will assess which firms this exemption will apply to, allowing for its risk appetite, and advise relevant firms accordingly. We will hold discussions with firms regarding any such exemptions for the first year of Solvency 2 during quarter 4, 2015.

By way of background, see this link for how market share is determined. This is separately defined for Life and Non-Life.

Q3.7: Is the Pillar 3 dry run in Q2 15 (per Solvency 2 Update September 2014) instead of the EIOPA interim reporting in June, or are they incremental? When is the dry run due date and requirements?

These are the same thing.

During the preparatory stage we have required firms representing 80% of the market to participate in the annual quantitative information dry run, and firms representing 50% of the market to participate in the quarterly quantitative information dry run. We previously advised relevant firms that they were part of the dry run process. The firms in question have been providing this information to us and lessons learned throughout this process will continue to be used to assist the wider industry adoption.

We will be implementing a testing phase through which similar 'dry run' reporting will be required but using the final templates. We envisage running these tests from 1 November 2015 to 29 February 2016. Firms will be contacted to arrange for mutually agreeable deadlines for these submissions via the Invoke portal.

Q3.8: What are the GFSC's expectations with regards to the length and depth of narrative of the Pillar 3 narrative reporting aspect?

The scope can be found in the Delegated Regulation (EU) 2015/35, Chapters XII and XIII.

We will expect relevant information to be provided as described in above. The degree of information that needs to be provided for each section will be a function of materiality. This is defined in Article 291 of the Delegated Regulation (EU) 2015/35.

Q3.9 Does the GFSC expect all firms to report in GBP?

Per Article 1 of the Final Report on the ITS on Regular Supervisory Reporting:

" For the purposes of this Regulation "reporting currency" means:

a. for individual reporting, the currency used for the preparation of the insurance or reinsurance undertaking's financial statements unless otherwise required by the supervisory authority;

b. for group reporting, the currency used for the preparation of the consolidated financial statements unless otherwise required by the group supervisor. "

Q3.10 What exchange rate does the GFSC expect firms to use when reporting under Solvency 2?

Per Article 3 of the Final Report on the ITS on Regular Supervisory Reporting:

"When expressing the value of any asset or liability denominated in a currency other than the reporting currency, the value shall be converted in the reporting currency as if the conversion had taken place at the closing rate on the last day for which the appropriate rate is available in the reporting period to which the asset or liability relates.

When expressing the value of any income or expense, the value shall be converted in the reporting currency using such basis of conversion as used for accounting purposes.

The conversion into the reporting currency shall be calculated by applying the exchange rate from the same source as used for the insurance or reinsurance undertaking's financial statements in case of individual reporting or for the consolidated financial statements in case of group reporting unless otherwise required by the supervisory authority."

Q3.11 Which QRTs does a firm have to publicly disclose?

Articles 4 and 5 of the Final Report on the ITS on the procedures, formats and templates for the disclosure of the SFCR (found here) details the templates that must be publicly disclosed as part of a firm's SFCR submission on a solo and group basis respectively. These are a subset of the full set of QRTs which are required for quarterly and annual reporting to the supervisor.

Q3.12 How are firms expected to publicly disclose the SFCR?

Article 301 of the Delegated Regulation (EU) 2015/35 covers the requirements of firms with regards to public disclosure of the SFCR. We will therefore expect all firms to host such reports as follows:

"1. Where insurance and reinsurance undertakings own and maintain a website related to their business, the solvency and financial condition report shall be disclosed on that website.

2. Where insurance and reinsurance undertakings do not own and maintain a website but are a member of a trade association which does own and maintain a website, the solvency and financial condition report shall, where permitted by that trade association, be disclosed on the website of that association."

The current requirement for returns to be filed at Companies House by the GFSC falls away under Solvency 2 due to the above.

Q3.13 When is the first quarterly/annual reporting deadline under Solvency 2?

Please consult our Solvency 2 Reporting Dates spreadsheet available here.

Please note that there is a section for publications relating to reporting and its more technical aspects. This can be found here.

Q3.14 S.01.02.01 "Basic Information – General", what should I enter for "Country of Authorisation"?

Currently firms are expected to use "GB", the identifier of the United Kingdom. However, an update to the EIOPA taxonomy is anticipated in July which will provide for the option "GI", the identifier for Gibraltar.

Q3.15 S.01.02.01 "Basic Information – General", I am receiving an LEI validation error – what could be the cause of this?

Firms are reminded that when entering their LEI into this form they must also use a prefix "LEI/" prior to the LEI number itself.

General

Q4.1: What will proportionality look like for captives?

The degree of proportionality the GFSC will allow will be a function of the risk the firm poses to our objectives. This in turn is related to the nature, scale and complexity of the firm.

The principle of proportionality is enshrined in European law, including Solvency 2. There is, however, only limited explanation of what this shall mean in practice, allowing supervisory authorities the scope to interpret proportionality in a way that appropriately reflects the characteristics of their market. We are committed to applying a proportionate response wherever this flexibility is available to it and where it is appropriate, on a case by case basis.

On capital requirements, as was stated in the answer to Q1.1, article 100 of the Directive is unambiguous regarding capital i.e. member states shall require that undertakings hold eligible own funds covering the SCR. This applies to all firms. Under the latest draft ITS, Article 88 in Chapter V, Section 1 provides for some proportionality in how the SCR is calculated but not in the level or amount.

As regards to the Systems of Governance there is no flexibility in terms of the requirements as outlined in Chapter IX, Section 1 of the Commission Delegated Regulation (EU) 2015/35 i.e. each key function, actuarial/risk management/compliance and internal audit must be in place covering the areas outlined therein. We agree with EIOPA that these lie at the core of “sound and prudent” management. Further clarity is provided in GN14 and in the EIOPA Guidelines on Systems of Governance (at the final report stage at the time of issuing this FAQ).

A proportionate response in this area would be in respect of how the firm delivers against these requirements. For example, outsourcing to Group, an Insurance Manager or to a Professional Service Provider would be acceptable in certain cases. The key feature looked for here would be the way in which the Board maintains control and responsibility for these aspects.

As regards reporting, our response to Q3.6 indicates where there might be room for manoeuvre.

Q4.2: Will proportionality and materiality be defined by EIOPA, or will GFSC set parameters?

We do not expect EIOPA to provide further clarity on these fronts. Our responses to earlier questions (such as 3.6 and 4.1) set out our current view in general terms.

We are interested to hear from industry where further guidance would be helpful.