

# Webinar

## The Gibraltar Financial Services Commission

### Solvency II Implications for Non-Executive Directors (NEDs)

28<sup>th</sup> May 2015



Kathryn Morgan, Director of Regulatory Operations

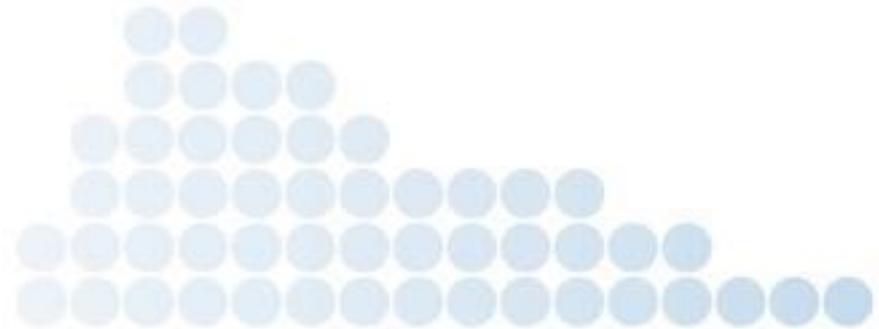


Ken Hogg, Solvency II Project Manager

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## Agenda

- Welcome
- Views of an experienced Non-Executive Director (NED)
- Presentation: Solvency 2 and the NED
- Question & answers



# Views of an experienced Non-Executive Director (NED)

Seamus Creedon



What does a good ORSA look like?

How have boards ensured that risk management policies are embedded within the firm?

How have boards ensured that internal audit is independent of executive, is focused on appropriate areas, and has full access and authority?

How have boards successfully challenged firms' internal control and compliance reports and findings?

How have boards provided suitable challenge to the actuaries?

What actions should NEDs be considering now to ensure that they will be ready for S2?

Lessons learnt?

# Presentation: Solvency 2 and the NED

# Objectives

- Reminder of responsibilities under Solvency II
- Actions expected of NEDs
- What does good look like
- Recognition of group structures

# Reminder of objectives of Solvency II

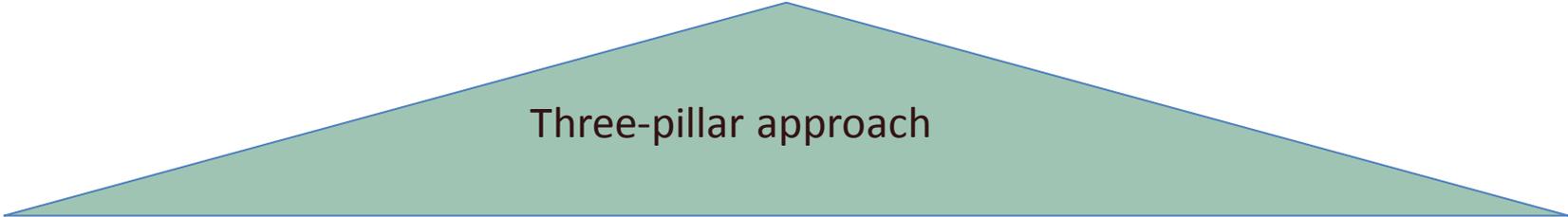
# Solvency II – The Vision

- Solvency II will set out new, strengthened EU-wide requirements on capital adequacy and risk management for insurers with the aim of:
  - increasing policyholder protection;
  - reducing the possibility of consumer loss; and
  - reducing market disruption in insurance.

# What Solvency II will deliver

- Good quality capital.
- Technical provisions that reflect the reality of the liabilities.
- Robust SCR standard formula calibrations that reflect the true economic cost of the risks.
- Forward looking risk identification and improved management of same.
- Emphasis on enhanced transparency of firms' financial positions and risk management approaches.
- Tougher requirements for Groups.

# The Three Pillars:



Three-pillar approach

## Pillar 1:

### Quantitative requirements

- Balance sheet (including technical provisions)
- Minimum capital requirement (MCR)
- Solvency Capital Requirement (SCR)

## Pillar 2:

### Quantitative requirements and supervisory review

- Governance, risk management and required functions
- Own risk and solvency assessment
- Supervisory review process

## Pillar 3:

### Reporting, disclosure and market discipline

- SFCR and RSR
- Disclosure
- Transparency
- Support or risk-based supervision through market mechanisms

Market-consistent valuation  
Risk Based requirements

Business governance  
Risk-based supervision

Disclosure  
Transparent markets

# Responsibilities of NEDs

# Solvency II References to NEDs

- The Solvency II Directive text refers to the administrative, management or supervisory body. For our purposes this means the Board.

## e.g. Article 40

**Member states shall ensure that the administrative, management or supervisory body of the insurance or reinsurance undertaking has the ultimate responsibility for the compliance by the undertaking with the laws, regulation and administrative provisions adopted pursuant to this Directive.**

# Pillar 1 – Implications

- **Need to Understand:**

- **Own Funds**

- Quality required (ie loss absorbing) when choosing own funds, and transitional arrangements.

- **Technical Provisions (TPs)**

- Risk margin.

- **Solvency capital requirement (SCR)**

- Requirements to bear in mind with standard formula, partial or full Internal Model.

- Understanding and approval of requests for use of Undertaking Specific Parameters.

- Plans to ensure compliance with requirements, and their sensitivity

# Internal Models (IM)

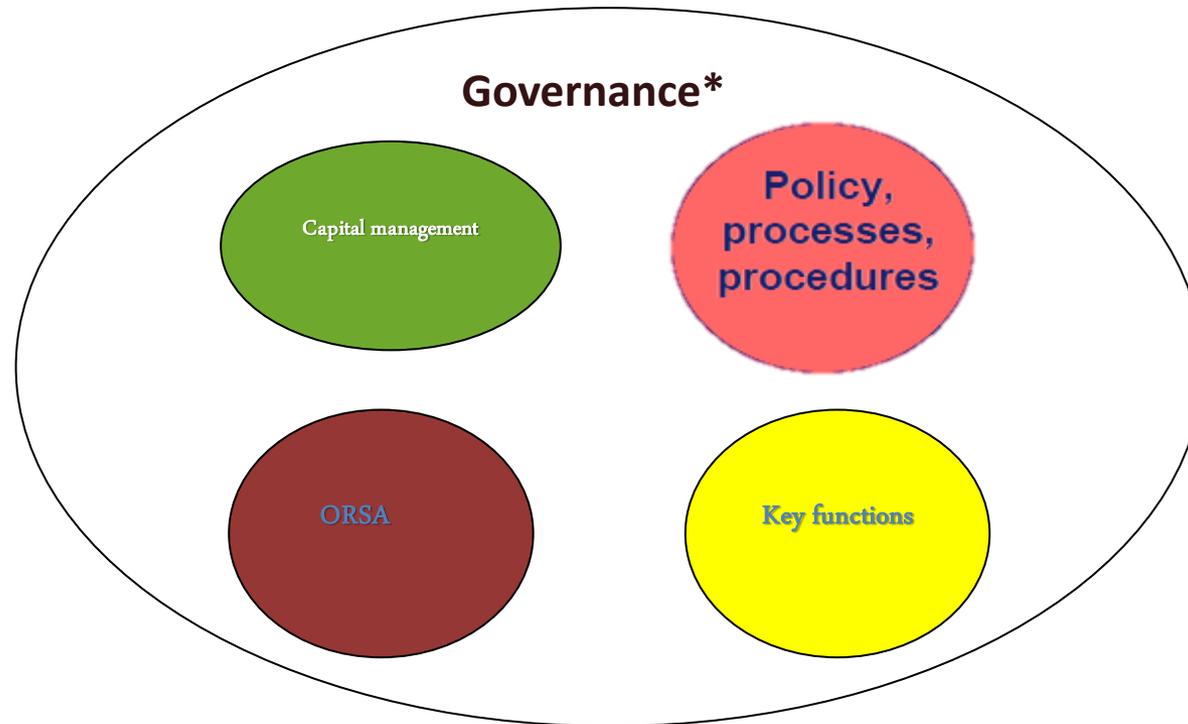
## Directive - Articles 116 and 120

- NEDs must demonstrate an understanding of the IM and discuss the results regularly in Board meetings.

## Other responsibilities include:

- Approving the application for the IM
- Ensuring the IM operates properly
- Confirming the IM appropriately reflects the risk profile
- Approving the transition plan from standard formula to IM

# Pillar 2: Governance Building Blocks



- The building blocks of governance in Solvency II reflect best practices already found within well governed firms. And although they may not represent entirely new ideas or practices, the Directive strengthens their holistic nature, more clearly tying various aspects of ongoing governance to risk and capital management.
- \*The building blocks do not cover all of the areas of Governance

# Governance and Key functions

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## Risk Management Function

- ✓ Monitor and assist in the effective operation of the risk management system.
- ✓ For partial/full IM users, also involves design, implementation, testing, validation and documentation of model.

NEDs  Ensure that policies are clear, embedded and accessible.

## Internal Audit Function

- ✓ Evaluate effectiveness of internal control system and other elements of governance.
- ✓ Report to management on weaknesses and recommendations.

NEDs  Ensure independence and authority of Audit Function.

## Compliance Function

- ✓ Identify, assess, monitor and report the compliance risk exposure.
- ✓ Assess appropriateness of undertaking's compliance procedures.

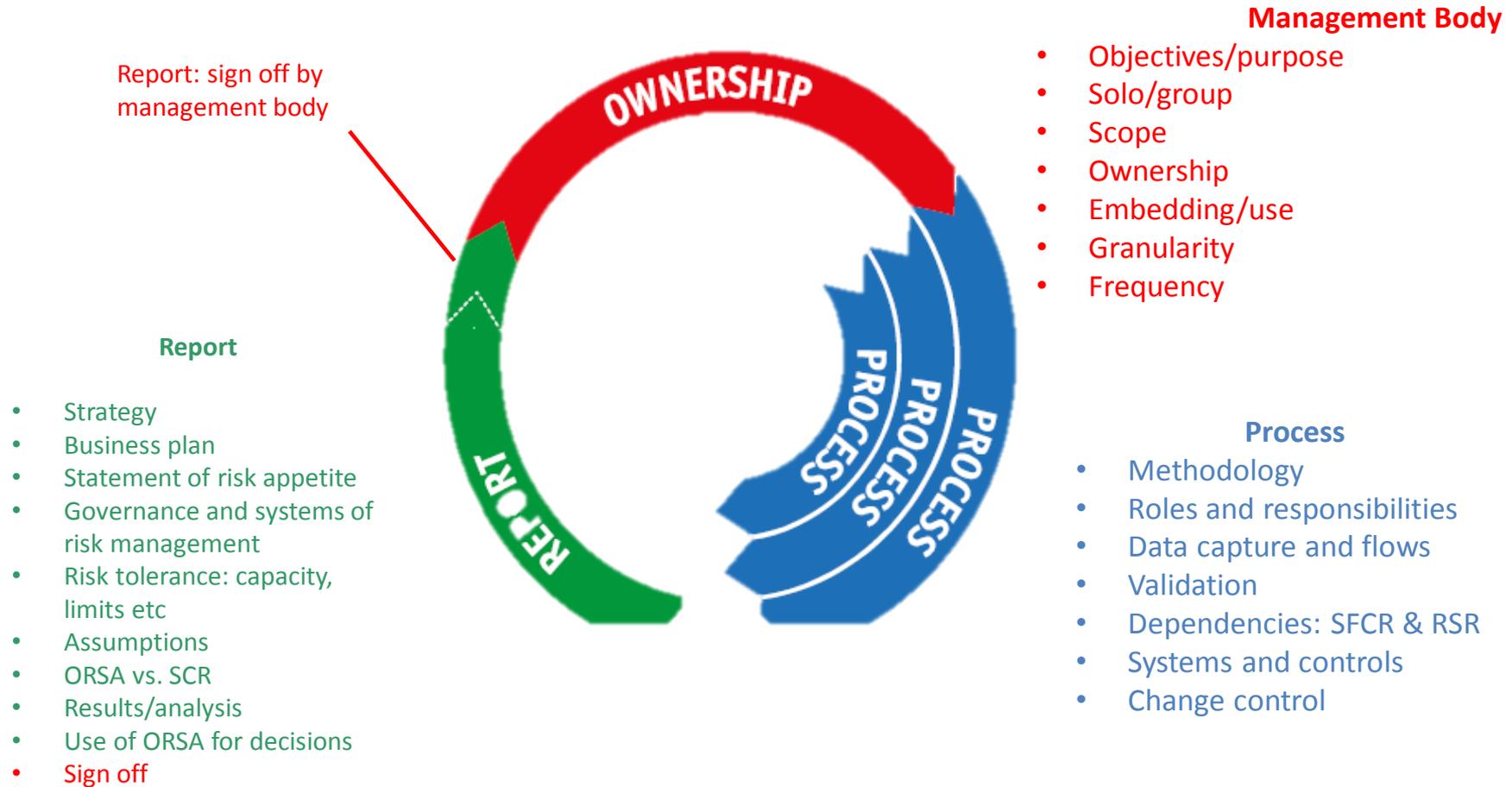
NEDs  Challenge internal control and compliance reports and findings.

## Actuarial Function

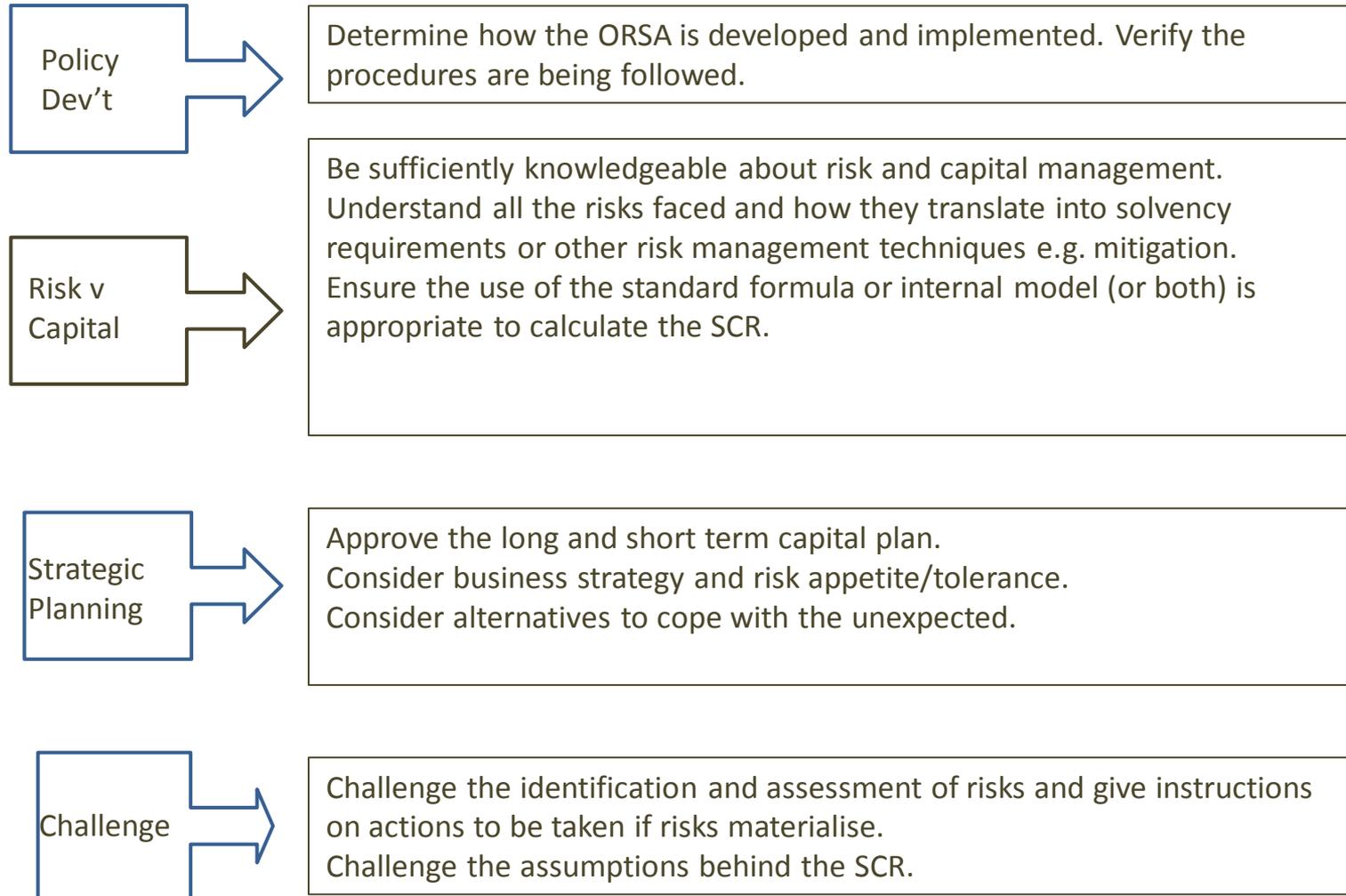
- ✓ Coordinate calculation of TPs
- ✓ Assess sufficiency of TPs, including appropriateness of methodologies, assumptions and data.

NEDs  Review, understand and challenge reports produced by Actuarial Function.

# ORSA – What are the key elements?



# Challenge, Challenge, Challenge



# Pillar 3: Reporting requirement overview

Information to be received by the Supervisory Authority (FSC)

## Report to supervisors and public disclosure at predefined points

### Regular Supervisory report (RSR) Art. 35(1)

All information necessary for the purposes of **supervision**

- Qualitative report
- Quantitative reporting templates
- Annual and quarterly

### Solvency and Financial Condition Report (SFCR) Art. 51

**Publicly disclosed** information

- Groups and solos
- Qualitative report
- Quantitative reporting templates
- Annual

**Art. 35(2)(a) (ii) and Art. 54(1) – upon occurrence of predefined events**

**Art. 35(2) (a) (iii) – during enquiries regarding the situation of an undertaking**

What does good look like?

Firstly, globally poor governance has been at the root of most failures in the financial sector in recent years (see Sharma report).

Solvency II aims to raise the bar for insurers

# What does good look like?

Examples of key positive indicators of Board engagement with Solvency II:

- Providing critical challenge to management eg around any residual non-compliant aspects of GN14, and the robustness and delivery of Solvency II plans
- Documentation of discussion and decisions
- Ownership of key policies and the risk framework eg outsourcing
- Using the FLAOR/ORSA as a tool for evaluating the forward looking risks to the business, not a compliance report for FSC's benefit
- Engagement with dry run data submissions to FSC
- Assessment of appropriate balance of skills and experiences amongst directors

# Assessment of skills and experiences

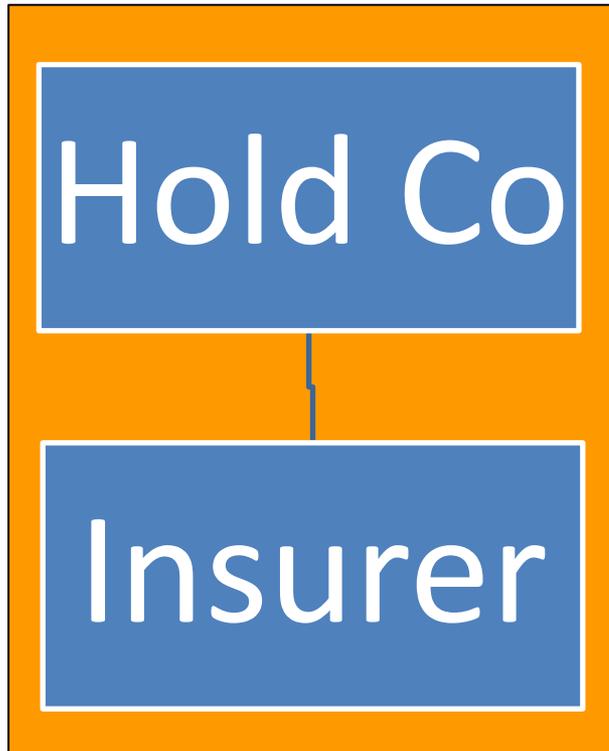
Example of good practice:

- A skills & experience grid to evaluate the depth and breath of all directors against backdrop of what Solvency II requires of Boards
- Plot each director against the required skills and experience
- Identify shortfalls or areas where cover is inadequate
- Agree action plan to address above eg training and/o recruitment

# Groups

# Group requirements to be met

Simplest form of Group (both entities in Gibraltar)



Hold Co is an Insurance Holding Co. The 2 entities make up a Group.

Implications:

- Group solvency to be met
- Risk concentration assessment
- Supervision of intra-group transactions
- Supervision of systems of governance of the group, including Group ORSA
- P3 reporting requirements for both group and insurer

Other more complex structures have possible different implications

# Support for NEDs

- What future engagement with the FSC and peers would NEDs find of value?
- Please email FSC at [S2@fsc.gi](mailto:S2@fsc.gi)

- More information can be found on our dedicated web pages:  
<http://www.fsc.gi/firms/solvencyiiapproach.htm>
- If you have any queries relating to Solvency II please get in touch.  
Email: [S2@fsc.gi](mailto:S2@fsc.gi)

# Questions and Answers