THE CHANNEL ISLANDS ALTERNATIVE TO SOLVENCY II

by Kate Storey and Danny Cole

November 2015

1 January 2016 will see the EU's Solvency II Directive come into full effect, with requirements for EU insurers to comply with its three pillars on capital and solvency; governance and supervision; and disclosure and transparency of information. Guernsey and Jersey are outside the EU and are therefore not subject to Solvency II. So what are the alternatives that the Channel Islands offer to (re)insurers?

THE GUERNSEY OFFERING

Guernsey took an early stance in 2011 not to seek equivalence under Solvency II. This decisive approach was welcomed by industry against a backdrop of uncertainty created by the delays associated with Solvency II. Guernsey took this decision because Solvency II does not distinguish between different types of insurer and the levels of capital they have to hold, and would therefore place an inappropriately large capital burden on captives, which constitute the major part of Guernsey's insurance industry. It would also be unsuitable for the large numbers of special purpose insurers in Guernsey in the alternative risk transfer space, including issuers of insurance linked securities. Instead Guernsey has committed to fully complying with the Insurance Core Principles of the International Association of Insurance Supervisors (**IAIS**) in the areas of solvency, corporate governance and public disclosure.

As a result, in May 2015 Guernsey introduced a new solvency regime under the Insurance Business (Solvency) Rules 2015 (**Solvency Rules**). The general rule is that a Guernsey licensed (re)insurer must hold capital resources in accordance with three levels: the Minimum Capital Requirement (MCR); the Prescribed Capital Requirement (**PCR**) and the Capital Floor. The Guernsey Financial Services Commission (**GFSC**) maintains a discretion to modify these requirements on a case by case basis.

The Capital Floor is £100,000 for general business and £250,000 for long term business; for protected cell companies (**PCCs**) the Capital Floor only applies to the overall PCC, not to individual cells or the core of the PCC.

For general (re)insurers the MCR is the higher of (a) 12% of gross written premiums net of certain amounts including premium taxes, rebates, commissions and certain reinsurance premiums; (b) 12% of claims reserves and premium reserves, net of reinsurance and amounts reserved to maximum; and (c) the Capital Floor. For life business the MCR is the higher of (a) 2.5% of total reserves, net of reinsurance; and (b) the Capital Floor.

The PCR is the capital required to ensure that the (re)insurer should be able to meet its obligations over the next 12 months with a prescribed confidence level of 99.5% for Commercial Life/General Insurers; 97.5% for Commercial Life/General Reinsurers; and 90% for Captive (Re)insurers.

There is no MCR or PCR for Category 6 (re)insurers – special purpose entities including ILS cells and fully funded entities.

This is clearly very attractive for captives, which only have to hold capital equating to 90% value at risk compared to 99.5% under Solvency II, and for special purpose entities, which are exempt from the Solvency Rules altogether.

Guernsey's regime is also less prescriptive than Solvency II on capital assessment procedures and provides an exemption from public disclosure rules for captives.

THE JERSEY OFFERING

The Jersey Financial Services Commission (the **Commission**) sought early input on Solvency II from those in the insurance sector in Jersey who would be affected by changes to regulatory capital requirements applied in the island. This dialogue, the Commission said, did not identify any regulatory or other reason for implementing Solvency II in Jersey.

Jersey therefore, has chosen not to follow Solvency II (opting for "non-equivalence"). Whilst the Commission will continue to monitor the development of Solvency II, Jersey will focus on following the international standards set by the International Association of Insurance Supervisors (**IAIS**). It is these standards against which Jersey has previously been assessed by the International Monetary Fund.

The solvency margin requirements for Category B permit holders* in Jersey are 17.5% of net premium income for general business, and 2.5% of the value of the long-term insurance fund required to be maintained by the Permit holder or £50,000, whichever is the greater, for long-term business. An initial capitalization of £100,000 is usually required; but the Commission has the ability to amend this, both upwards and downwards, should it feel that this amount is inappropriate in the circumstances of the permit holder's business.

[* A Category B permit is required by a person who carries on insurance business in or from within Jersey and who is not authorized by another jurisdiction to carry on such business lawfully in that jurisdiction]

This article has been written by:

Guernsey
Kate Storey
Counsel
+44 (0)1481 755 620
kstorey@applebyglobal.com

Jersey
Danny Cole
Senior Associate
+44 (0)1534 818 047
dcole@applebyglobal.com

Kate Storey is Counsel and Danny Cole is a Senior Associate in the Corporate Department at Appleby. A copy of this column is available on the firm's web site at applebyglobal.com

This publication is for general guidance only and does not constitute definitive advice
© Appleby Global Group Services Limited 2015