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**Gibraltar Financial
Services Commission**

PO Box 940
Suite 3, Ground Floor
Atlantic Suites
Europort Avenue
Gibraltar
Tel (+350) 200 40283
Fax (+350) 200 40282
E-Mail: jperdoni@fsc.gi
www.fsc.gi
Twitter: @gibfsc

Dear CEO,

Plan of supervisory engagement for 2016 under the Solvency II Directive

As the date of this letter indicates, we have now arrived into the new regulatory regime of Solvency II (“SII”). The Financial Services (Insurance Companies) (Solvency II Directive) Act, which brings the EU Directive live in Gibraltar, came into force on the 1 January 2016. We would like to thank you for your engagement with us over the previous twelve months in the busy period of SII preparations. We similarly look forward to continuing this engagement over the coming months as the Gibraltar insurance industry, and the industry across Europe, works towards greater embedding of this regime.

We wanted to take the opportunity to provide you with an indication of our planned supervisory engagement with you over the course of 2016. The key expected areas of our supervisory review are set out below. These areas do not preclude other specific aspects of review relating to your firm.

1. Capital Adequacy

We will continue to monitor your Solvency Capital Requirement (“SCR”) coverage over the course of this year. Results from year end reviews and year end audits will be seen as key points for engagement, as these results are incorporated into the SII balance sheet.

We note that these conversations will be taking place on a solo and group SCR basis. We refer to insurance groups in more detail in section 6 below.

For firms who have been granted Internal Model or Undertaking Specific Parameter approval we will set out timelines in respect of continued supervisory monitoring. If relevant to you, further information is supplied in the Appendix.

2. Reporting

The SII Directive sets out new obligations for reporting and extends its significance in many areas, not least with regards to group solvency. The majority of firms, having December year ends, will submit both their Day 1 and Quarter 1 Quantitative Reporting Templates (“QRT”)s in May 2016. Firms will report via the Invoke portal upon which all firms have now been configured for their respective deadlines. Some firms were granted limited exemptions from certain quarterly templates and have been informed directly. While much time has been spent on preparing for reporting, firms now face the challenge of embedding these reporting cycles into their business as usual and

demonstrating that their processes are sufficiently robust to meet the requirements of the annual templates that, for most firms, are required in 2017.

The Appendix of this letter sets out the obligations and reporting dates for your firm, based on the date of your year end. For those firms determined to be part of an insurance group under SII, requirements for SII group reporting share similar timelines, albeit with a lag of approximately 6 weeks.

We note that for most firms there are remaining obligations for SI reporting. We will look to use 2016 as a period of transition between the two reporting regimes, and will spend review time on an analysis of change between them.

We remind you that firms are required, under Article 314 of the SII Delegated Regulations, to give a qualitative explanation of the main differences between SII Day 1 valuations and those calculated according to SI, which shall be submitted alongside Day 1 reporting. In order to support this exercise, we may issue you with a one-off reconciliation template for completion.

In the event that firms submit Day 1 SII reporting in advance of finalised audited results, and audited results then demonstrate a significant difference to plan, firms will be required to resubmit Day 1 reporting.

3. Pillar 1 Balance Sheet Thematic Review

We will be carrying out a review on the construction of the Solvency II Balance Sheet.

Due to the public nature of SII reporting and the important part it plays in facilitating appropriate and proportionate supervision, it is crucial that the SII Balance Sheet is constructed in such a way that it produces consistent, comparable and high quality information across the industry. This review will focus on the nature of assumptions used in the calculation of the Solvency II Balance Sheet.

Alongside this review, we will also be circulating an information request on current reinsurance arrangements, to understand the impacts of the current reinsurance programme on the Balance Sheet and SCR. One area of particular focus will be sliding scale and profit commission clauses and how these may behave in both expected and stressed scenarios.

Following the Balance Sheet review we will produce market feedback on our minimum expectations and industry good practice.

4. Own Risk and Solvency Assessment ("ORSA")

We consider the ORSA to be a key aspect of SII. It is through this process that the Board can be engaged on matters of business planning, economic capital considerations and capital planning, risk management and appetite, stress testing, and overall review and governance. The ORSA report is also an important document allowing the communication of key business and risk features to the Board and the regulator.

We are currently in the process of reviewing Forward Looking Assessment of Own Risk ("FLAOR") reports which were required to be completed and submitted to us for 31 December 2015.

We plan to complete the review during Q1 2016 and will be providing feedback in early Q2. As well as market-wide feedback, which we will publish on the GFSC website, we will endeavour to provide you with firm specific feedback.

Over the course of 2016, we expect to see your ORSA process further evolve. You should be aware of EIOPA's ORSA Guidelines, which are further reaching than the preparatory

phase FLAOR guidelines (We remind firms that all sets of Guidelines are now in force and available on the EIOPA website).

We will also be using the ORSA process to facilitate our supervisory approach. We note that as part of our supervisory approach, each licensee receives a level of supervision that will include regular review of their business model, financial situation, and their risks. We expect that the ORSA process will develop to capture sufficient detail in these areas. It is also our expectation that the ORSA process will communicate sufficient granularity of information surrounding business planning.

5. *Systems of Governance*

Over the course of 2015 Systems of Governance (“SoG”) progress was largely monitored on a self-assessment basis. By this stage we expect all policies to be in place and for you to be giving consideration to the greater embedding of these policies.

The self-assessment was carried out against the SII preparatory guidelines. This preparatory phase has now finished, and firms are required to comply with the final Guidelines on SoG. To support your internal assessments we include a template that maps the earlier preparatory Guidelines incorporated into GFSC Guidance Note No. 14 against the final EIOPA Guidelines. Guidance Note 14 has now been repealed.

In order to assess the embedding of SoG we will be reviewing individual policies over the course of 2016. Our review will not only be to ensure that the policy exists, but also that it is applied and adhered to within the business.

Last year, there was a lack of sufficient progress on Groups policies. Our expectation is that these policies will now be in place and we will be following this up as part of the SoG review.

The initial focus of our review is likely to be the policies around Risk Management, the Actuarial Function Holder, Outsourcing, and Groups.

In order to clarify your SoG arrangements for key functions under SII, we will shortly be issuing a notifications template to record the named key function holders and some basic information on their fitness and propriety.

6. *Insurance Groups*

As set out in our November publication ‘Commentary around Solvency II Requirements for Insurance Groups’, SII increases the group obligations for firms and the supervisor. We therefore expect to have more detailed conversations with firms about the activities and income streams of the wider group and the extent they impact the insurance company balance sheet than we have historically.

In this first instance we will look to ORSA reports to contain the information to support this interaction. If this information does not contain the requisite level of detail we will be issuing a separate information request letter. We may require receipt of this group information in advance of finalising our ORSA reviews, to ensure that feedback is appropriately tailored to individual situations.

Where group solvency transitional measures are being utilised, we will be monitoring progress towards meeting group SCR coverage closely against the group’s plans. We expect that such group plans include key milestone dates and critical success factors to allow supervisory engagement. As per the Directive, there is also a requirement for a progress report to be submitted every 3 months to us. It should be noted that, where significant progress is not demonstrated, we may withdraw the use of the transitional

measure. Such a withdrawal would immediately place an insurance group into the supervisory ladder of intervention.

7. *Review focus on Investments and Reserving*

Later in the year we plan to dedicate greater review focus to the areas of investments and reserving.

- Investments and the Prudent Persons Principle

SII does not place strict limits on investments, and instead introduces the Prudent Persons Principle (“PPP”) in Article 132 of the SII Directive. This requires that assets are invested in the best interests of policyholders and in a manner that is appropriate to the nature and duration of the liabilities. It also sets out that assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. Through this aspect of review we will look to understand in greater detail the asset allocation of firms, an articulation of the investment strategy, and how the requirements of the PPP are adhered to.

- Reserving

This aspect of review will focus on the approach, methodology, and resource used to set reserves. This will be wider than an assessment of SII Technical Provision requirements, and will seek to understand the broader reserving philosophy of a firm. In particular, we will be looking in detail at how the booked reserves are set. Where booked reserves differ to the best estimate from the actuarial review, it is our expectation that there is a clear, detailed, and well justified reconciliation between the two figures. We also remind firms of the requirements to reserve at the actuarial best estimate under Solvency II.

Please note that whilst the headings above do not cover all SII requirements, this does not forego your own need to ensure compliance with all aspects of the Directive. We expect you to have in place your own monitoring and self-assessment frameworks capturing all relevant requirements, facilitated by the compliance, risk management and internal audit functions as well as regular Board discussion. These frameworks should promote your firm’s evolution and embedding of SII.

Given the content of this letter and Appendix, and its importance to our engagement with you over the coming months, please can you confirm that this letter has been considered by your Board.

Please do not hesitate to contact your normal Regulatory Officer if you have any questions regarding the above.

Yours sincerely,



Joe Perdoni
Head of Prudential

Mapping exercise between final EIOPA Guidelines on Systems of Governance and earlier issued GFSC Guidance Note 14

Orange highlighting indicates that EIOPA guideline was not explicitly captured in the SII preparatory phase of GFSC Guidance Note 14

GFSC Guideline on Systems of Governance (Guidance Note 14)	EIOPA Guideline on Systems of Governance
2.1 The Board	1. The administrative, management or supervisory body
2.2 Organisational and operational structure	2. Organisational and operational structure
2.4 Decision-making	3. Significant decisions
2.5 Documentation of decisions taken at the level of the Board	4. Documentation of decisions taken at the level of the AMSB
2.3 Key functions	5. Allocation and segregation of duties and responsibilities
2.6 Internal review of the system of governance	6. Internal review of the system of governance
2.7 Policies	7. Policies
2.8 Contingency plans	8. Contingency plans
Remuneration.	
	9. Scope of the remuneration policy
	10. Remuneration committee
Fit and Proper.	
2.9 Fit requirements	11. Fit requirements
2.10 Proper requirements	12. Proper requirements
2.11 Fit and proper policies and procedures	13. Fit and proper policies and procedures
2.12 Outsourcing of key functions	14. Outsourcing of key functions
	15. Notification
	16. Assessment of the fit and proper requirements by the supervisory authority
Risk Management.	
2.13 Role of the Board in the risk management system	17. Role of the AMSB in the risk management system
2.14 Risk management policy	18. Risk management policy
2.15 Risk management function: general tasks	19. Risk management function: tasks
2.16 Underwriting and reserving risk management policy	20. Underwriting and reserving risk management policy
2.17 Operational risk management policy	21. Operational risk management policy
2.18 Control and documentation of risk-mitigation techniques	<i>Also to be captured under EIOPA Guideline 22</i>
2.19 Reinsurance and other risk-mitigation techniques – risk management policy	22. Reinsurance and other risk-mitigation techniques – risk management policy
	23. Strategic and reputational risk
2.20 Asset-liability management policy	24. Asset-liability management policy
2.21 Investment risk management policy	25. Investment risk management policy
2.22 Liquidity risk management policy	26. Liquidity risk management policy
The prudent person principle and the system of governance.	
2.23 Investment risk management	27. Investment risk management
2.24 Assessment of non-routine investment activities	28. Assessment of non-routine investment activities
	29. Security, quality, liquidity and profitability of the investment portfolios
	30. Profitability
	31. Conflicts of interests
2.25 Unit-linked and index-linked contracts	32. Unit-linked and index-linked contracts
2.26 Assets not admitted for trading on a regulated financial market	33. Assets not admitted for trading on a regulated financial market
2.27 Derivatives	34. Derivatives
2.28 Securitised instruments	35. Securitised instruments
Own fund requirements and the system of governance.	
2.29 Capital Management Policy	36. Capital management policy
2.30 Medium-term Capital Management Plan	37. Medium-term capital management plan
Internal controls.	
2.31 Internal Control environment	38. Internal control environment
2.32 Monitoring and reporting	39. Monitoring and reporting
Internal audit function.	
2.33 Independence	40. Independence of the internal audit function
2.34 Internal audit policy	41. Conflicts of interest within the internal audit function
	42. Internal audit policy
	43. Internal audit plan
	44. Internal audit documentation
2.35 Internal audit tasks	45. Internal audit function tasks
Actuarial function.	
2.36 Tasks of the actuarial function	46. Tasks of the actuarial function
2.37 Coordination of the calculation of technical provisions	47. Coordination of the calculation of technical provisions
2.38 Data quality	48. Data quality
	49. Testing against experience
2.39 Underwriting policy and reinsurance arrangements	50. Underwriting policy and reinsurance arrangements
2.40 The actuarial function of an undertaking with an internal model under pre-application	51. The actuarial function of an undertaking using an internal model
2.41 Actuarial reporting to the Board	<i>Requirement stated in Delegated Regulations Article 272(8)</i>
Valuation of assets and liabilities other than technical provisions.	
	52. Valuation of assets and liabilities other than technical provisions
	53. Data quality control procedures
	54. Documentation when using alternative valuation methods
	55. Independent review and verification of valuation methods
	56. Oversight by the AMSB and other persons who effectively run the undertaking
	57. Request to the undertaking by the supervisory authority, for an external independent valuation or verification
	58. Independence of the external expert
	59. Information to be provided to the supervisory authority on the external valuation or verification
Outsourcing.	
2.42 Critical or important operational functions and activities	60. Critical or important operational functions and activities
2.43 Underwriting	61. Underwriting
2.44 Intra-group outsourcing	62. Intra-group outsourcing
2.45 Outsourcing written policy	63. Outsourcing written policy
	64. Written notification to the supervisory authority
Group governance specific requirements.	
2.46 Entity responsible for the fulfilment of the group governance requirements	<i>Responsible will be identified following discussion with relevant Supervisory Authorities</i>
2.47 Responsibilities for setting internal governance requirements	65. Responsibilities for setting internal governance requirements
2.48 System of Governance at group level	66. System of governance at group level
2.49 Risks with significant impact at group level	67. Risks with significant impact at group level
	68. Risk concentrations at group level
	69. Intra-group transactions
2.50 Group risk management	70. Group risk management