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# Global Corporate Insurance and Regulatory Bulletin

INSURANCE & REINSURANCE INDUSTRY GROUP

October 2013

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# GLOBAL

## GLOBAL – IAIS COMMITS TO DEVELOP A GLOBAL INSURANCE CAPITAL STANDARD BY 2016

On 9 October 2013 the International Association of Insurance Supervisors (IAIS) announced its commitment to developing global insurance capital standards by 2016. It hopes the new rules will be ready for testing in 2017.

The rules will provide that insurance groups with an active international presence must adhere to a risk-based global insurance capital standard.

The new rules, which would represent the first time a standard has been rolled out globally will form part of the ComFrame which is the IAIS blueprint for supervising international insurers.

The IAIS is currently planning to develop the regime by 2016, carry out tests in the subsequent year and roll the regime out for a two year trial period before implementing it in 2019.

Industry think-tank The Geneva Association has pledged to help IAIS develop the new standards. However, it considers the current timescale to be too ambitious, citing the fact that development and implementation of global standards within the financial sector have taken many years to develop.

The IAIS press release can be found here.

## ASIA

### HONG KONG – FROM SELF-REGULATION TO A LICENSING REGIME

The Hong Kong legislative consultation proposals to establish a new Independent Insurance Authority (IIA) have been described by the government as the most significant reform initiative for the Hong Kong insurance sector since 1983. The proposals, if enacted, will effectively re-write insurance law in Hong Kong, including the following key concepts:

(a) Creation of the IIA – The IIA will replace the existing Office of the Commissioner of Insurance (OCI) and will be vested with wide regulatory powers, not unlike those of local financial regulators such as the Securities and Futures Commission (SFC) and the Mandatory Provident Fund Schemes Authority (MPFA). The IIA's powers will include inspecting, investigating, and imposing disciplinary sanctions on insurers in the event of misconduct.

(b) A registered licensing regime – The regulatory role of the IIA will apply to any person carrying out "regulated activities" involving insurance, and any such person will (subject to certain exceptions) need to be licensed.

Regulated activities are proposed to include negotiating, arranging, inviting or inducing a person to enter into an insurance contract, as well as settling or making an insurance claim, or changing the terms of an insurance contract.

The Government plans to finalise a bill to amend the Insurance Companies Ordinance (Cap. 41 of the laws of Hong Kong) by the end of 2013, with the aim of introducing the new regime in 2015.

It is clear that the new regime will have significant implications for insurers and the insurance industry in Hong Kong. We will provide additional commentary as the legislative process proceeds.

## PHILIPPINES – REFORM INCREASES INSURANCE CAPITAL REQUIREMENTS IN PREPARATION FOR ASEAN 2015

The Philippines has made amendments to the country's Insurance Code to provide for increased capital requirements.

The changes provide that the total of the paid-up capital, retained earnings, unimpaired surplus and revalued assets must meet the following minimum levels:

- from 30 June 2016 – PHP550 million (US$12.7 million);
- from 30 June 2019 – PHP900 million (US$21 million); and
- from 30 June 2022 – PHP1.3 billion (US$30 million).

The new rules also contemplate the Insurance Commission applying more stringent risk-based capital rules if it determines that this is necessary.

These changes follow the trend of a rapid increase of the minimum capital requirements in recent years, which have risen as follows:

- 2013 (current level) – PHP250 million (US$5.8 million);
- 2012 – PHP175 million (US$4 million);
- 2011 – PHP125 million (US$3 million);
- 2010 – PHP100 million (US$2.3 million);
- 2009 – PHP75 million (US$1.7 million); and
- 2007 – PHP50 million (US$1.1 million).

The stated objective is to strengthen domestic insurance companies by enforcing enhanced capital requirements, thereby giving a greater buffer and resilience to shocks. This, it is hoped, will better equip Filipino insurers for the removal of competitive barriers in the lead up to greater integration of the member-economies of the Association of Southeast Asian Nations (ASEAN) in 2015.

## TAIWAN – OUTBOUND REAL ESTATE INVESTMENT BY INSURERS EXPECTED TO INCREASE

Taiwanese insurance companies – which could previously only buy domestic property – have been permitted to invest in real estate outside Taiwan since May 2013. A number of Taiwanese insurers have since purchased or indicated interest in purchasing overseas real estate and it is widely anticipated that the amount of outbound investment will continue to increase. Commentators have estimated that Taiwanese insurers may have up to US$10 billion to invest in overseas property.

Taiwan limited its insurers from investing in domestic real estate in November 2012 to curb high commercial property prices. At that time, insurers accounted for as much as 40 percent of all commercial real estate transactions in Taiwan and had caused property prices to reach highs not seen since 2005.

The restrictions on domestic property investments have since been eased. However, Taiwanese insurers already own around one-third of the Grade A office buildings in Taiwan and are limited in their ability to purchase more, for instance by the remaining restriction that they may only invest in real estate with a yield of more than 2.875 percent. As domestic rental yields are in the order of 2.3 to 2.5 percent, further domestic acquisitions are unlikely.

Real estate is a focal point for Taiwanese insurers who are attracted by its long-term nature and predictable rental yields. Historically Taiwanese insurers have been particularly focused on investments in office properties, which are seen as easier to manage.

The Taiwanese Financial Supervisory Commission has suggested six cities in which Taiwanese insurers may like to purchase properties: New York, London, Toronto, Frankfurt, Shanghai and Ho Chi Minh City. However, cities in Europe and the U.S. may be difficult in practice for Taiwan's insurers to invest in because of regulatory restrictions and the high levels of capital gains tax.

## UK/EUROPE

### UK – EIOPA ISSUES SOLVENCY II GUIDELINES

In March 2013 the European Insurance and Occupation Pensions Authority (EIOPA) launched a public consultation on guidelines relating to preparation for Solvency II. EIOPA issued the Guidelines on preparing for Solvency II in all official EU languages on 31 October 2013.

The original deadline for implementing Solvency II was 1 January 2014 (with a transposition date of 30 June 2013); as this has now become an unrealistic deadline, on 2 October 2013 the European Commission published a legislative proposal for a second 'Quick-Fix' Directive postponing the application date for Solvency II to 1 January 2016. The deadline for transposing the rules into national law has shifted to 31 January 2015.

The Guidelines cover the following areas:

- Systems of governance.
- A forward looking assessment of undertakings' own risk (based on Own Risk & Solvency Assessment (ORSA)).
- Submission of information.
- Pre-application for internal models.

The purpose of the Guidelines is to provide support to both national supervisors and undertakings in their preparations for Solvency II. Through publication of the Guidelines, EIOPA intends to significantly increase preparedness of both supervisors and insurers for Solvency II and aim to ensure that National Competent Authorities (NCAs), insurance companies and groups take active steps towards implementing key elements of Solvency II in a consistent and convergent way.

The Guidelines follow EIOPA's opinion on interim measures regarding Solvency II issued in December 2012. They foresee a gradual application through "phasing in" provisions and accordingly there will be different expectations for 2014 and 2015.

Once the Guidelines have been issued, NCAs will need to report to EIOPA regarding their compliance or intention to comply within two months. NCAs will subsequently be required to submit a progress report to EIOPA regarding implementation of the Guidelines in February 2015.

The Solvency II Framework Directive has required adaption and these changes are being implemented through Omnibus II. Omnibus II is currently in negotiations between Parliament and Council, and the European Council has announced that it will consider Omnibus II at the plenary session to be held between 10 and 13 March 2014. The Directive was originally due to be considered during the plenary session to be held between 3 and 6 February 2014.

The Commission was reluctant to introduce a second 'Quick-Fix' Directive and has stressed that the dates have been moved for the "last time". However, the Directive itself makes no reference to this and as the Commission does not have the power to make the trilogue parties agree it remains to be seen whether this will indeed be the last time the implementation date is pushed back.

Link to press release can be found here.

## UK – SCHEMES OF ARRANGEMENT BY GENERAL INSURANCE FIRMS

The Prudential Regulation Authority (PRA) recently issued a consultation on its draft supervisory statement, advising the stance the PRA will take with solvent insurance firms proposing schemes of arrangement.

The purpose of the statement is to explain some of the factors that will be taken into account by the PRA when judging whether, in promoting a scheme, an insurer is acting in a manner consistent with the PRA's statutory objectives of safety, soundness and policy holder protection. The PRA's primary concern is to make sure that insurers are able to meet claims from policyholders when they fall due and that those wishing to exit the market do so in a fashion that provides an acceptable level of continuity of cover to the policyholder.

Although schemes of arrangement proceed under the Companies Act 2006 and not the Financial Services and Markets Act 2000, the PRA has an interest in the proposed use of schemes by insurers because of its objective to secure an appropriate degree of protection for policyholders.

The PRA takes a different stance towards insolvent and solvent insurers looking to secure a scheme of arrangement:

***Insolvent insurers***

The PRA recognises that when a scheme of arrangement is used by an insolvent insurance company it may be compatible with its statutory objectives. The use of a scheme in these circumstances could be in the interest of the policyholders in general as it may maximise the pool of assets available for distribution amongst creditors or allow for a quicker distribution. The PRA's starting point for firms that do not meet the regulatory capital requirements, are insolvent or where other doubts as to their ability to meet claims exist, will be that the use of a scheme may be compatible with its statutory objectives.

***Solvent insurers***

The PRA considers the use of schemes by solvent insurance companies highly unlikely to be compatible with its statutory objectives. If a firm meets its capital expectations and is able to meet policy claims as and when they fall due, a scheme of arrangement is likely to disadvantage policyholders. This is because the binding nature of the compromise reached under the scheme is such that policyholders may have their cover terminated against their wishes, or have their claims settled at less than their full value. The PRA is concerned that the use of a scheme in such circumstances could distort the traditional shareholder/creditor hierarchy by effectively allowing shareholders to extract capital from the firm at the same time policyholders are subject to a binding compromise in respect of actual or potential future claims. The PRA's starting point for firms that meet the regulatory capital requirements will be that the use of a scheme is unlikely to be compatible with its statutory objectives.

When an insurance firm is considering a scheme of arrangement the PRA will expect it to provide details of the proposed scheme before any application to the Court and in enough time to allow the PRA to assess the proposals. Following its review of the scheme the PRA expects to inform the Court in all cases whether it has any objections to the proposed scheme.

Link to PRA consultation can be found here.

## US/AMERICAS

### US – ADDITIONAL REGULATORS PARTICIPATING IN THE NAIC'S PROCESS FOR DEVELOPING AND MAINTAINING THE NAIC LIST OF QUALIFIED JURISDICTIONS

The 2011 revisions to the Credit for Reinsurance Model Law and Regulation of the National Association of Insurance Commissioners ("NAIC") require assuming reinsurers to be licensed and domiciled in a "qualified jurisdiction" in order to be eligible for certification by a state as a "certified reinsurers," which will be permitted to post reduced collateral for credit for reinsurance. The NAIC's Reinsurance (E) Task Force has developed a "Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions" (the "Process"). States that adopt the Model Law must consider this list when approving qualified jurisdictions. Reinsurers domiciled in qualified jurisdictions will then be eligible to apply to those states to become certified reinsurers. In our September 2013 bulletin, we reported that the Bermuda Monetary Authority was the first foreign insurance regulatory authority invited by the NAIC to participate in an expedited review under the Process. More recently, the NAIC has announced that the Prudential Regulation Authority of the Bank of England ("PRA"), the Swiss Financial Market Supervisory Authority ("FINMA") and the German Federal Financial Supervisory Authority ("BaFin") have also accepted the NAIC's invitation to participate in an expedited review under the Process. Interested parties were given until November 6, 2013 to submit comments regarding the NAIC's consideration of PRA and may submit comments regarding NAIC's consideration of FINMA and BaFin by November 13 and November 15, respectively.

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