

# CHALLENGE OR OPPORTUNITY?

## GUERNSEY'S NEW SOLVENCY REGIME

SEPTEMBER 2008

### INTRODUCTION

In March 2008 the Guernsey Financial Services Commission (GFSC) introduced the concept of Own Solvency Capital Assessment, or OSCA for short. The intention of this new capital regime is for the board of a (re)insurer to assess the appropriate solvency margin required in respect of all the risks (not just insurance risk) that it faces. This follows growing international recognition that directors of (re)insurance companies are themselves in the best position to assess their own solvency requirements. The assessed solvency required will be subject to a minimum which is based on the current margin of solvency calculation now known as the Minimum Solvency Capital Assessment (MSCR).

### APPLICATION

The OSCA is a company's own assessment of the appropriate solvency margin and therefore considered to be the appropriate level of capital required by the company. The GFSC has issued general guidance regarding areas of risk to be considered and expected assumptions to be included within the assessment, but ultimately it remains the responsibility of the board. However the GFSC may intervene if it is felt that the assessment and supporting rationale are inadequate.

The OSCA is required to be submitted with the annual insurance return, the first of which will be due for companies with a year end on or after September 30, 2008. An OSCA is also required for new business submissions on or after September 30, 2008 or when notifying of any material change to the business plan.

It is expected that an OSCA will take the form of a report with an executive summary followed by a discussion of the board's view of the risks faced by the company and the underlying assumptions and rationale supported by any calculations used in determining the solvency margin required. This has the potential to become a long, drawn out process, with the possibility of multiple iterations.

### THE WILLIS SOLUTION - WILLIS DYNAMIC RISK ASSESSMENT MODEL (DRAM)

To assist our client boards in assessing the solvency levels required in a structured process, Willis has created a dynamic capital assessment model that will be submitted to each board for consideration. The model reflects global best practice and responds to the unique characteristics of captives, but provides a formalised basis for the assessment of risk.

The model incorporates all risks identified by the GFSC and has been cross referenced with the risks detailed in the new Corporate Governance Code of Conduct issued by the GFSC in March 2008.

DRAM applies statistical technology to the financial statements and underwriting accounts of the company to determine the level of capital required in key risk areas such as:

- Underwriting
- Reserving
- Investment
- Liquidity
- Credit

The model allows the board to apply weightings to the various risk factors affecting the captive, and calculates the level of capital required based on those weightings. Because the model is dynamic, it will enable the directors to assess the impact of the weightings used, and to adjust the weightings if considered appropriate.

The Willis logo is displayed in white serif font on a dark blue rectangular background. The background of the entire page features a dramatic sky with a bright light source, possibly the sun or moon, creating a lens flare effect and illuminating the clouds.

Other areas of risk such as Regulatory, Operational and General should be considered by the board and an appropriate level of capital applied to reflect the particular set of circumstances of each company.

The results of these individual capital assessments are amalgamated and any concentration or diversification of risk identified and taken into account in determining the OSCA.

Assumptions used in arriving at the risk weightings are documented and the results presented in report form for submission to the GFSC.

It is intended that this model will be presented to boards during the last quarter of 2008. If adopted, the final model will be populated for discussion and approval at the same time as the financial statements are presented to the board for consideration.

The model has been demonstrated to the GFSC and reflects feedback received. Should a board decide not to adopt the Willis model then an alternative assessment will have to be undertaken.

## **THE IMPACT OF OSCA**

The introduction of the OSCA will promote detailed consideration at board level of the risks faced by each company. By quantifying the capital required for each risk it is expected that the more significant risks will receive greater focus by the board.

The OSCA does not currently replace the MSCR or the Risk Gap Capital Assessment, however, it is anticipated that the adoption of the OSCA will create greater flexibility with respect to the level of capital held in captives and provide opportunities to write additional business.

It is anticipated that over time an industry standard model will evolve that will ensure consistency of approach across the industry. In the meantime directors will need to consider the requirements of the OSCA and assess whether the Willis model is appropriate to be applied to their company.

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