

OFFSHORE GROUP OF INSURANCE SUPERVISORS



**PRINCIPLES PAPER
OCTOBER 2001**

CAPTIVE SOLVENCY REQUIREMENTS

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Solvency can be sub-divided into:-

- Minimum Statutory Requirements
- Risk Gap requirements

Minimum Statutory Requirements

In many domiciles, the minimum solvency requirement is calculated as a percentage of the licensed insurer's premium income (net of reinsurance premiums), usually at a level between 15% and 20% of earned net premium income. One of the disadvantages of this approach is that the Solvency Margin is calculated only in respect of the current year's programme, which may not provide sufficient margin in respect of possible under reserving of prior years' open liabilities. Accordingly, the supervisor may require a licensed insurer to maintain a minimum margin of solvency being the greater of, either the percentage of premium income or of outstanding claim liabilities. Alternatively, the Supervisor may require a licensed insurer to maintain a margin of solvency substantially above the minimum level.

In any event, in practice the Supervisor should require / encourage a licensed insurer to maintain a margin of solvency significantly above the minimum level, to reflect the exposures of both the current and historic open years' liabilities.

Risk Gap Requirements

From a prudent point of view, the Supervisor should require that a licensed insurer maintains a minimum level of Approved Assets equal to –

- the underwriting fund (representing prior years' insurance liabilities), plus
- a suitable percentage of the underwriting fund, as a safeguard against deterioration in claims, plus
- the current year's risk gap (calculated as a reasonable view of the licensed insurer's worst case aggregate exposure, less premium income and if appropriate. Less projected investment income).

Investment of Assets

The Directors of a licensed insurer have a responsibility to ensure that its assets are invested prudently, in line with its exposures and liabilities. In this respect, two considerations are the spread of the overall portfolio and the rate of return.

Where the size of funds allows, a licensed insurer should normally invest in a range of institutions and instruments, in an attempt to ensure that the failure of one investment will not precipitate the failure of the company. It is a question of directors' judgment whether or not it is prudent to deposit or invest a large proportion of the funds of a

licensed insurer in loans to the parent group. The Supervisor may require a licensed insurer to invest no more than a certain percentage of its assets in any one investment or loan.

In making any loans, the Directors of the licensed insurer should ensure that they are places on normal economic terms that are closely related to the usual –

- market rated for the perceived risk exposure;
- length of term for that type of investment;
- cancellation / repayment terms

An interest-free loan with no repayment terms should not be regarded as a prudent investment.

Technical Provisions and Other Liabilities

The Directors of a licensed insurer have a responsibility to ensure that the technical provisions and other liabilities are valued in a prudent and consistent manner.

The technical provisions valuation methods would vary depending upon the classes of business written and the supervisor should investigate and thoroughly understand how the provisions have been determined.

Outside consultants, eg. Actuaries, should be utilized if the supervisory staff lack specific expertise. This is particularly relevant for life and non-life long-tail business.

Use should be made of analysis techniques such as “triangulations”.

Exposure assessment should be an important part of the supervisory checks. The Supervisor should look prospectively at total aggregate exposures, worst case expected losses and compare these results to the funds available.

IAIS

The Supervisor should meet any standards, guidelines and principles brought out by IAIS.