Module K Unit 23

COMMERCIAL GENERAL INSURANCE

Purpose

At the end of this unit the participant should understand the enhanced regulatory and governance requirements and responsibilities that arise from operating a Commercial General Insurance company with a Category 3 licence.

Assumed knowledge

An understanding of the law and regulations applicable to a captive insurer as these form the foundation of regulation for a category 3 insurer upon which more specific requirements are applied. In particular an understanding of the GFSC Guidance Note in respect of Producer Owned Insurance Companies ("POIC's").

Summary of learning outcomes
1. Explain the additional reputational and regulatory exposures of a Category 3 insurer.
2. Explain the guidance and additional actions required with regard to a POIC.
3. Explain the solvency requirements for a Category 3 insurer.
4. Explain the required content of an Own Risk Solvency Assessment ("ORSA").
5. Explain the requirements of Part 7 (Conduct of Business) of the Insurance Business Rules and Guidance, 2021.
6. Explain the role of the Channel Islands Financial Ombudsman in relation to the operation of a Category 3 insurer and complaints arising therefrom.
7. Explain the importance of external legal advice and its application to the operation of a Category 3 insurer.

Module K Unit 23

COMMERCIAL GENERAL INSURANCE

23.0 INTRODUCTION

There are a number of insurance companies licensed in Guernsey which act as commercial insurers writing on a direct (and non-admitted basis) commercial insurance risks originating from outside of Guernsey. (NB: as a condition of their insurance license they are not permitted to write domestic business in the island.) Unlike a captive which writes first party business, a commercial insurer writes policies to third-parties, predominantly to retail customers but also business to business.

Most commonly, for retail customers the insurance product being written is in respect of risks based in the UK (other territories tend to have more onerous regulations regarding non-admitted insurers) and some may be in respect of personal lines business. This might be for coverage such as motor vehicle breakdown, personal effects insurance, travel protection or family medical cover. Third-party business to business insurance products can be written globally into countries where non-admitted insurance is permissible and example classes of such business are prize indemnity insurance and Kidnap & Ransom cover.

Where insurance policies are being bought by members of the public rather than by companies the regulatory oversight and scrutiny is much higher as the GFSC considers that the reputational risk to Guernsey and therefore regulatory risk of these companies is much higher than compared with captives.

Commercial General Insurers operate under a Category ("Cat") 3 insurance license.

It is important that an insurance manager recognise the different requirements of managing a Cat 3 licensed insurer when compared to a Cat 5 licensed Captive insurance company. The former is much more onerous and requires more rigor particularly with regard to compliance monitoring and governance by the board. The responsibilities of the Compliance Officer are much more onerous and there needs to be regular reporting to the board on all compliance matters and appropriate action taken to address any breaches or trends of concern such as the level of customer complaints.

The following are the key differences that the manager needs to aware of and ensure are built into the operation and procedures of the company.

23.1 REQUIREMENTS UNDER A CATEGORY 3 LICENCE

All of what is covered by the rest of this course material applies to the operation of a Category 3 insurer but there are certain provisions therein as well as some additional requirements, all of which are discussed below. Please refer to the original text in this course for a full understanding.

23.1.1 Unit 6A The Regulatory Environment

- 6.2.2 Public Disclosure of Insurer Information

  Some Cat 3 insurers seek a waiver, with the GFSC, to withhold or redact or summarise all or any part of the information required, from this requirement on the basis that "disclosure would enable competitors of the insurer to gain undue advantage" However, it is not unusual for a Cat 3 to create a website on which to post the requisite information and disclosures.

- 6.3 Cyber Security Rules and Guidance 2021

  The application of these Rules and Guidance is even more essential for a Cat 3 insurer due to the need to ensure there is appropriate protection of personal data in place, especially where personal information is held by the insurer, but also to ensure that continuity of customer services can be maintained.

- 6.5.2 Guidance Note for Licensed Insurers on Reinsurance

  It is essential that a Cat 3 insurer is adequately capitalised and where appropriate purchases reinsurance protection from reinsurers with strong security ratings from well recognised rating agencies so as to ensure that the insurer has the liquidity and financial capacity to be able to pay all claims on a timely basis. The construction, maintenance and application of a robust Policy for the Purchase of Reinsurance is most important element of the insurer's risk management strategy.

- 6.8.1 & 6.8.2 Producer Owned Insurance Companies (POIC)

  It is not unusual for a Cat 3 insurer to be a POIC as this type of insurer is often established and owned by insurance brokers who wish to exercise more control over the delivery of insurance products to their customer base and participate in the underwriting performance of the book of business.

  The key issue for the shareholder/broker and the insurer is the management of conflicts of interest and in particular the addressing of the disclosure of the ownership of the insurer by the broker to the customer. This must be declared to the potential insured before they purchase the insurance policy and in a manner that is fair and transparent. It is essential that a broker always makes recommendations to their customers based on the most suitable policy and not recommendations that will simply generate the most underwriting profit.

- 6.14 Notifications required to the GFSC

  Commercial insurers writing business of unrelated parties must notify the Commission of.:

- any new line of business to be written;
- any change to reinsurance arrangements which reduces the reinsurance protection;
- any change of business plan which reduces the solvency margin to less than125% of PCR

.

23.1.2 Unit 6B Solvency

- 6.1.4 Capital adequacy Part 4

  The PCR is the capital required to ensure that the licensed insurer can meet its obligations over the next 12 months with a probability as defined by the following specified confidence levels:

  Category 3 - For Commercial General Insurers - the PCR is determined at a 99.5% confidence level;

in comparison to

Category 5 - Captive (Re)insurers - the PCR is determined at a 90% confidence level.

- 6.1.8 Part 8 – Risk Management and Own Risk Solvency Assessment

Own Risk Assessment
(1) The licensed insurer must perform an Own Risk and Solvency Assessment ("ORSA") comprising:

(a) the licensed insurer's own assessment and calculation of its solvency requirements, an Own Solvency Capital Assessment, ("OSCA");

(b) the licensed insurer's assessment of risk management; and

(c) the licensed insurer's assessment of the adequacy of capital resources to meet future capital
requirements.

(2) Subject to (3), all licensed insurers are required to perform an ORSA.

(3) A licensed insurer meeting at least one of the following criteria is not required to perform an ORSA –

(a) a licensed insurer classified as a Category 6 licensee;

(b) a licensed insurer which is dormant with no outstanding insurance liabilities;

(c) a licensed insurer that would otherwise be required to perform an OSCA only and whose board of directors considers the PCR to be sufficient. In such cases, this should be clearly stated either in the documentation submitted with the annual return or in separate correspondence. Any such statement should be accompanied by the supporting rationale for this decision; and

(d) a licensed insurer notified in writing by the Commission.

(4) Unless otherwise notified in writing by the Commission, a licensed insurer meeting at least one of the following conditions need may limit their assessment to an OSCA only:

(a) a Category 1 licensed insurers writing life business with an MCR below £350,000;

(b) a Category 2 licensed insurer with an MCR below £7,500,000;

(c) a Category 3 licensed insurer with an MCR below £1,500,000; @ see note below

(d) a Category 4 licensed insurer with an MCR below £7,000,000;

(e) a Category 5 licensed insurer; and

(f) a Protected Cell Company.

(5) An ORSA must be performed at least once a year.

(6) A licensed insurer must recalculate the ORSA if the risk profile of the licensed insurer deviates significantly from the assumptions underlying the last performed assessment.

(7) A licensed insurer must include in its ORSA all reasonably foreseeable and relevant material risks including, as a minimum –

(a) underwriting risk;

(b) credit risk;

(c) market risk;

(d) operational risk;

(e) liquidity risk; and

(f) any additional risks arising due to membership of a group.

@ the preparation of an ORSA is an important risk management tool and the GFSC encourage preparation even when the MCR of the Cat 3 insurer is below the threshold where an ORSA becomes mandatory.

23.1.3 CONDUCT OF BUSINESS ("COB")

The COB rules are contained within Part 7 of the Insurance Business Rules, 2021, and are applicable to all Cat 3 licensed insurers with respect to retail customers. They require that policyholders/clients are treated in a fair and transparent manner and treated fairly. The following information details the requirements of the COB rules at a high level, however, please revert to the Rules on the GFSC website to gain a deeper understanding of its detailed requirements.

Licensed insurers captured under the COB rules must:

- act with due skill, care and diligence and have policies and procedures in place to ensure that employees and agents meet high standards of ethics and integrity when dealing with customers;
- establish and implement policies and procedures on the fair treatment of customers and adopt the fair treatment of customers as an integral part of their business culture, with policies and procedures supporting this objective being properly embedded within the organisation;
- seek to avoid or properly manage any potential conflicts of interest;

- have arrangements in place when dealing with intermediaries to ensure the fair treatment of customers and have procedures in place to verify that the intermediaries have the appropriate qualification, knowledge and ability to distribute the licensee's products; incorporating a terms of business agreement completed and signed by the intermediary;

- ensure that the interests of different types of consumers are considered when developing and distributing insurance products;

- promote products and services in a manner that is clear, fair and not misleading;

- provide timely, clear and adequate pre-contractual and contractual information to customers and take reasonable steps to ensure that a customer is given appropriate information about a product in order that the customer can make an informed decision about the arrangements proposed;

- ensure that any product documentation includes key features information as required by the COB rules;

- must consider the customer's disclosed circumstances, irrespective of whether the advice is being given by the licensee or an intermediary;

- service policies appropriately through to the point at which all obligations under the policy have been satisfied and ensure the provision of relevant information to customers throughout the life of the policy;

- ensure that any Information provided on an ongoing basis, including changes in policy terms and conditions or amendments to the legislation applicable to the policy;

- ensure timely, fair and transparent claims handling and claims dispute resolution policies and procedures are in place.

- ensure that if the licensed insurer outsources, any of the claims handling processes, it remains ultimately responsible for the provision of fair and transparent claims handling and claims dispute resolution and compliance with the Rules;

- handle complaints in a timely and fair manner and ensure compliance with a written procedure for the effective consideration and fair and proper handling of any complaints relating to the licensed insurer's insurance business, howsoever received

- adhere to the requirement to maintain a complaints register and file reports with the GFSC in accordance with the requirements of the COB rules.

23.1.4 CHANNEL ISLANDS FINANCIAL OMBUDSMAN ("CIFO")

CIFO is the joint operation of two statutory ombudsman roles, established in law by the Financial Services Ombudsman (Jersey) Law 2014 and the Financial Services Ombudsman (Bailiwick of Guernsey) Law 2014.

The primary role of CIFO is to resolve complaints arising from financial services provided in or from the Channel Islands of Jersey, Guernsey, Alderney and Sark.

CIFO handles enquiries from complainants and financial services providers, to help the resolution of issues between themselves, and to intervene in cases based on misunderstandings. It will try to resolve the case by mediation by facilitating the parties to reach a fair settlement. If mediation is unsuccessful, CIFO will investigate the case and issue its decision. If the complainant accepts the decision, it becomes legally binding on both parties. The ombudsman can award compensation, payable by the financial services provider, up to a maximum limit of £150,000.

A Cat 3 insurer must register with and pay a levy to the CIFO to fund the work undertaken by them. See the link below for more information:

https://www.ci-fo.org/for-financial-services-providers/funding/

Customers of a Cat 3 insurer must be made aware of their rights to refer a complaint to the CIFO. Typically, it is achieved by clearly highlighting this disclosure in the policy documentation

If providing coverage for risks situated in the UK, customers must also be made aware that the UK Financial Services Compensation Scheme, see https://www.fscs.org.uk/ is not applicable or available to them.

23.2 CONSTRUCTION OF THE BOARD

There is a regulatory requirement that there be at least one Independent Director on the board of every licensed insurer in Guernsey. For Cat 3 insurers the GFSC recommends that there are two independent directors (although this is not a requirement at the time of this edition of the course (2023)).

It is also important that the constitution of the board is such that they have the necessary skills to operate the company's business plan. This is true for all licensed insurers but it is especially so for Cat 3 insurers due to the exposure to the public. The board must be comprised of persons capable of operating such a company and ensuring that all stakeholders' interests (especially the policyholders) are considered.

In this regard it is important to be able to demonstrate that the shareholders do not have undue influence over the board especially if the Cat 3 insurer is POIC.

23.3 EXTERNAL LEGAL ADVICE

When a Guernsey Cat 3 insurer is providing an insurance product to customers outside of the island it must conduct due diligence to ensure that it is not in breach of the laws and regulations of the territory in which the insured and or the risk is resident.

There are a variety of means of providing insurance coverage on an non admitted basis to customers based in other territories, but it is key to ensure it is carried out in a way which is legal and avoids insurance activities being carried out in a territory where it is not authorised. The consequences of getting this wrong cannot be overstated and include the potential for the directors to be heavily fined, censured and in extreme cases imprisoned.

Competent external legal advice should be obtained to ensure that the business plan, route to market and intended operating procedures of the insurer are compliant not just with Guernsey law and regulation but also that of the territory to which the insurance coverage is to apply.

It is always essential that all underwriting decisions are taken in Guernsey and are well documented so that, if challenged, the company can demonstrate that it has acted in accordance with the law and indeed the legal advice it has obtained.

Self-test questions

Answering these questions will remind the participant as to what has been learnt. Once completed, please check your answers against the relevant text.

1. What are the additional reputational risks for Guernsey that arise from the operations of a Category 3 insurer?
2. Provide two reasons why Cyber Security is so important for a Category 3 insurer?
3. Why is a Policy for Reinsurance so important and what should it contain?
4. What is the threshold in respect of the Prescribed Capital Requirement ("PCR") for notification to the GFSC?
5. When is a Category 3 insurer compelled to perform an ORSA? Name three risks that must be considered in the ORSA?
6. Provide three requirements under Part 7 (Conduct of Business) of the Insurance Business Rules and Guidance, 2021.

Summary of learning outcomes
1. Explain the additional reputational and regulatory exposures of a Category 3 insurer.
2. Explain the guidance and additional actions required with regard to a POIC.
3. Explain the solvency requirements for a Category 3 insurer.
4. Explain the required content of an Own Risk Solvency Assessment ("ORSA").
5. Explain the requirements of Part 7 (Conduct of Business) of the Insurance Business Rules and Guidance, 2021.
6. Explain the role of the Channel Islands Financial Ombudsman in relation to the operation of a Category 3 insurer and complaints arising therefrom.
7. Explain the importance of external legal advice and its application to the operation of a Category 3 insurer.