Standard Life

Policyholder Protection

Standard Life International

EU legislation - Solvency II

The introduction of Solvency II brought into effect European-wide capital requirements that are more sensitive to the levels of risk being undertaken by a particular company, and provides appropriate incentives for good risk management. Primarily this concerns the amount of capital that EU insurance companies, such as Standard Life International (SL Intl), must hold to reduce the risk of insolvency, in order to provide improved consumer protection.

Under Pillar 1 of Solvency II there are two distinct capital requirements: the Solvency Capital Requirement ('SCR') and the Minimum Capital Requirement ('MCR'). The SCR and MCR both represent capital requirements that must be held in addition to the technical provisions (comprised of policyholder liabilities plus a risk margin).

SCR

There is a prescribed list of risk groups that the SCR has to cover. The ones applicable to SL Intl are Life underwriting risk, Market risk, Counterparty default risk, and Operational risk.

The standard formula SCR is calculated using prescribed stress tests. The capital requirement for each individual risk is determined as the difference between the net asset value (taken as assets less best estimate liabilities) in the unstressed balance sheet and the net asset value in the stressed balance sheet. These individual risk capital amounts are then aggregated using a specified method to allow for diversification between the risks.

The following table details the 1-in-200 year stresses that are applied as part of the Market risk component of the SCR. The concept of a 1-in-200 year event over a one-year time period means that there is a 0.5% probability of a risk event impact being equal to or greater than the stress result.

Risk Drivers	SCR shock (as at March 2021)
Interest Rate risk	Increase/decrease in interest rates
Equity risk	Equity prices fall (22%-59% shock depending on equity type and market conditions)
Property risk	25% fall in property prices
Spread risk	Stress to value based on credit quality
Currency risk	25% movement up/down in exchange rates
Concentration risk	Formula based on total exposure and credit quality

MCR

The MCR is a lower, minimum level of security. It is designed to be the solvency threshold and corresponds to the level of capital, below which the insurance company is exposed to an unacceptable level of risk. Supervisory intervention will follow a breach in MCR.

For life insurance business, the formula is based on technical provisions and capital at risk on death, multiplied by specified factors. These factors vary according to whether the business is with profits, unit-linked or without profits.

SL Intl's position

As at year end 2020 SL Intl's SCR was €446.6million, below which SL Intl or the regulator would take action, but this was more than double the MCR. SL Intl had available capital of €589.6million, which is well in excess of its SCR of €446.6million (ratio of available capital to SCR of 132%). By holding more excess capital than SCR, the situation where SL Intl would be unable to pay customer obligations is extremely unlikely. Even after a 1-in-200 shock, SL Intl should still be in the situation where there are more assets than liabilities and should be able to meet customer obligations.

SL Intl is part of the Phoenix Group. At the half year 2021 the Group had circa 13million policies and £304bn assets under administration, as well as a Solvency II Surplus of £5.1billion and Solvency II ratio of 166%.

Q1) What happens if an insurer goes below the minimum solvency requirement?

In the event that the SCR is not complied with, or there is a risk that it may not be complied with within three months, the insurer would have to notify its regulatory authority (in the case of SL Intl, the Central Bank of Ireland). Within two months of any non-compliance with the SCR, an insurer would have to submit a realistic recovery plan to the supervisory authority who would require the insurer to take the necessary measures to achieve, within six months from when it was unable to comply with the SCR, the re-establishment of the level of assets required to cover its SCR or the reduction of its risk profile to ensure compliance with its SCR. In exceptional circumstances, where the supervisory authority is of the opinion that the financial situation of the insurer will deteriorate further, it can also restrict or prohibit the disposal of the insurer's assets.

FSCS

Q2) Now that the UK has left the EU, what is the current position with SL Intl and FSCS compensation?

Following the end of the Brexit transition period, SL Intl has entered the UK's Temporary Permissions Regime (TPR) as a cross-border services provider, which means that it does not yet have an establishment in the UK; is deemed authorised in the UK; and may continue to sell the International Bond from Ireland to UK customers. The TPR allows EEA-authorised firms that were passporting into the UK at the end of the Brexit transition period (31 December 2020) to continue operating in the UK within the scope of their previous passport permission for a limited period. As SL Intl is in the TPR and does not yet have a UK establishment (e.g. an operationalised branch), our understanding is that access to the FSCS continues to be available to new UK resident customers (who are eligible claimants) from 1st January 2021.

Once SL Intl sets up a UK establishment (such as an operationalised branch) any new policies issued from Ireland after that date are unlikely to have access to the FSCS under current rules – it would only be policies issued from the UK branch to UK residents that would be covered. To ensure the offshore nature of the International Bond, it will continue to be issued from outside the UK, meaning that new business written from the date of the UK establishment is unlikely to have FSCS access. To avoid doubt, our current understanding is that policies issued before the date of the establishment of the UK branch would continue to be protected contracts of insurance

Please note, the implications of the UK's exit from the EU in terms of financial services are unclear, and we will continue to keep you updated on this point, including if there are any changes to our understanding of the rules.

Q3) If there was fraud or mismanagement by a third party investment provider which resulted in a loss of policyholder funds, would clients be able to claim under the FSCS?

The underlying investments held in the bond are owned by SL Intl and not by the policyholder – meaning those investments are SL Intl's assets. Therefore, if an investment in an external fund manager was lost due to fraud, there would be no claim under the FSCS because SL Intl is not currently an eligible claimant due to the large company rules.

STRUCTURE OF THE BOND

Q4) If SL Intl were to become insolvent, would clients' funds be protected? E.g. are the funds held in segmented accounts within the Bond?

The underlying investments held in the bond are owned by SL Intl and not by the policyholder – meaning those investments are SL Intl's assets. Whilst SL Intl does not ring-fence the assets in the same way as a fund manager may be required to, it does have to ensure it maintains sufficient assets to cover its "technical provisions". Therefore, in the unlikely event of SL Intl becoming insolvent, its liquidator would be obliged to distribute the assets in accordance with the priorities established by law. The liquidator would take control of all assets, whether held directly by the insurer, or held by custodians on behalf of the insurer, and then distribute them to the creditors of the insurer in accordance with the priorities established by law.

Q5) Why does SL Intl own the underlying investments rather than the client?

This structure reflects how investments in insurance policies are held. The insurer owns the underlying assets, and the benefits the policyholder receives via the bond will be linked to the value of the underlying assets.

Important Note

The information provided in these FAQs is intended as a general guide only, based on SL Intl's understanding of current legislation. It is not, and is not a substitute for, legal advice. We recommend that you take Irish legal advice if you have any doubts or concerns as to what may happen if SL Intl becomes insolvent.

www.standardlife.co.uk/International-Bond

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