Central Bank of Ireland

Response to CBI Consultation Paper 131(“Regulations for pre-emptive recovery planning for (re)insurers”)

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General Comments

1. KPMG welcomes the opportunity to comment on Consultation Paper 131 ("Regulations for pre-emptive recovery planning for (re)insurers")(the "proposed Regulations and Guidelines").

2. Risk management has been deeply embedded into the insurance sector for a long time, however we note that recovery planning in the banking industry is more advanced and are of the view that insurance industry can benefit from some of the lessons learned in the banking industry. Recovery planning for the insurance sector should help to better inform Firms (and their respective Boards) of the risks they face and assist with better protecting themselves from failure through preventative (or reactive) measures, with the ultimate aim of protecting policyholders' interests. Thus, we welcome the introduction of a pre-emptive recovery planning framework for the insurance sector.

3. We agree with your view that it is important that insurers have tools to and means to prevent or reverse a deteriorating financial position in order to protect itself, its policyholders, its shareholders and the wider economy from failure. The inclusion of a recovery planning framework should help further strengthen the existing risk management practices already present in the Irish market.

4. The insurance sector in Ireland is diverse in terms of risk profile, scale and complexity. We note the proposed Regulation and Guidelines are comprehensive in nature and the detail captured in the scenario testing should help better understand the risks faced by (and indeed the mitigants available to) the most complex entities.

    — While the proposed Regulation and Guidelines allow for reduced requirements for captives and branches, we believe consideration should be given to extending these requirements to smaller subsidiaries of certain larger groups, e.g. publicly listed entities with robust monitoring of the group financial position, on the basis that smaller entities are likely to place a significant reliance on group support and seek alternative options in the event of group failure. Notwithstanding that failures can occur for all entities, we believe that consideration should also be given to reducing the requirements for Firms with a low or medium-low PRISM rating to better reflect the nature, scale and complexity of those organisations. For example, consistent with the RSR, a formal assessment could be performed every three years for low or medium-low PRISM rating entities unless a material change in the risk profile has occurred.

5. We have set out some more detailed observations on the proposed Regulations and Guidelines below.

Observations on the Regulations

1. Draft Regulation 2A(2): "*These regulations do not apply to an insurer that is subject to Regulations 13A and 13B of the Solvency II Regulations*". It is unclear to us what Regulations 13A and 13B refer to and we believe this should be further clarified in the draft Regulations.

2. Draft Regulation 3(2): "*Where an insurer provides for a recovery option that involves provision of financial support from another undertaking within a group of which the insurer is part, the insurer shall include in the recovery plan confirmation that it has obtained that other undertaking's written confirmation of the undertaking's willingness and ability to provide such financial support in the scenario contemplated*."

   — The requirement for "written confirmation" could potentially lead to contingent liabilities that would need to be recognised on group undertaking's balance sheet. This could potentially detract from the willingness of the group undertaking to provide such support. A less onerous wording such as "confirmation of the undertaking's ability" may provide the necessary comfort without creating such liabilities.

   — The wording "ability to provide such financial support in the scenario contemplated" could be considered to suggest a requirement that the group undertaking is required to perform an assessment for each of the scenarios tested by the insurer. Given the number of scenarios contemplated by the proposed Regulations this may lead to an increased burden on group undertakings which do not fall under the scope of the proposed Regulations. The wording could be updated to "ability to provide such financial support in scenarios comparable or more onerous to those contemplated by the insurer".

   — Given that Reg. 4(2)(a) requires that the Recovery Plan is updated at least annually, Reg. 3(2) implies that this confirmation should be received from the group on an annual basis. This may in some cases be overly burdensome. We would suggest that confirmation to provide financial support to the Irish subsidiary is only sought when the (re)insurer has information suggesting that the group's willingness or ability has changed. For example, consistent with the RSR, a formal confirmation could be obtained every 3 years unless a material change has occurred.

3. Draft Regulation 4(2)(d):

   — We note that this Regulation says "if the recovery plan has been reviewed" and therefore our understanding is that it is not establishing a requirement that the Recovery Plan is subject to review by the undertaking's internal audit function, external auditor or risk committee. However, we note that the language is somewhat ambiguous, and it is unclear whether such reviews are required.

— Given the likely governance frameworks in place in Firms, our expectation would be that recovery plans would be subject to annual review/approval by Board Risk Committees.

— The reference to an external audit review might be misinterpreted as an expectation to have the Recovery Plan externally audited. We would instead suggest that reference is made to "an independent third party" given the valuable insight that could be gleaned from a risk based or peer review.

4. We have outlined some further comments on different parts of the Schedule below:

Part E – Strategic Analysis: Much of the information required is likely to be contained within other sources, e.g. Solvency and Financial Condition Report, Regular Supervisory Report. Consideration could be given to providing summary information or cross referring to these documents and limiting the necessary information in the recovery plan to those which impact on the viability of the Firm and those required for the execution of the plan itself.

Part F – Recovery Indicators (b)(vi):

— Clarification should be given as to the requirements of indicators that are forward looking in nature. Is the intention here to understand as part of the monitoring process the potential longer-term implications on a Firm's financial position in the event of a deterioration in circumstances since the ORSA or Recovery Plan was prepared? For example, is the expectation around capital indicators that the projected capital position be captured as part of a Firm's monitoring process?

— Is the intent of indicators that are forward looking in nature to allow for changing circumstances of the Firm and to enable an early warning system to be adequately implemented? For example, that a solvency indicator is not 100% SCR coverage say but at a level that would enable pre-emptive action to be taken before 100% SCR coverage would be breached while being cognisant of the impact and timing of implementation of the recovery action?

Part G – Recovery Options:

— The list of Specific Actions focusses on a range of actions including the recapitalisation of the insurer. Such options may not be available in the event of financial stress and consideration could be given to simplifying this list to actions that would improve the financial position, liquidity and operational measures of the insurer.

— The recovery options available to a Firm are likely to depend to a large extent on the cause and extent of the deterioration in the financial strength or liquidity position of the Firm, i.e. the output of Part H – Scenario Analysis. We are of the view that the impact and feasibility assessments should be cognisant of these circumstances which should help the recovery plan to be more focussed and help outline to the insurer's Board and management the most appropriate measures to be adopted depending on the nature of the crisis.

— Consideration should be made to extending the modifications applicable to captives and branches to small subsidiaries of larger groups, on the basis that smaller entities are likely to place a significant reliance on group support and seek alternative options in the event of group failure. Consideration should also be made to implementing the requirements of Part G on a proportionate basis, with reduced requirements for Firms with a low or medium-low PRISM rating. We note that modifications are included for captives and branches which note that the recovery plan may include all of the Specific Actions but is not required to do so. This could be extended to low or medium-low PRISM rating entities subject to the inclusion of actions that are relevant to those entities.

Part H – Scenario analysis:

— Clarification should be given as to the extent of scenarios required for the purposes of Part H and whether the requirements set out in paragraphs (b) to (h) can be captured as part of the analysis required for part (a). Additionally, it is unclear whether the scenarios required for part (a) can be taken from the ORSA (plausible but severe stresses) or whether additional scenarios (exceptional but plausible or reverse stress testing) would need to be considered.

— We are of the view that the wide number of scenarios envisaged by the draft Regulations could lead to a significant modelling burden on a number of insurers. This could potentially lead to focus and effort being placed more on number production rather than on an assessment of new and emerging risks. We are also of the view that consideration should be given to allowing for qualitative analysis to be performed where the results of the scenario are unlikely to have changed materially since the last assessment.

Observations on the Guidelines

1. Section 5.7, paragraph 8: Additional guidance should be provided to clarify the level and extent of continuous monitoring and the expectations on monitoring in the event of a deterioration in circumstances. Is the expectation that under normal circumstances monitoring of indicators would follow the requirements of paragraph 7 (e.g. in line with regular MI monitoring by a finance function) with more frequent monitoring following a significant deterioration?

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