

Society of Actuaries in Ireland

Consultation on Regulations for pre-emptive recovery planning for (re)insurers (CP131)

Response to Central Bank of Ireland

October 2020

Preface

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland.

The Society welcomes the opportunity to submit this response to the Consultation Paper on Regulations for pre-emptive recovery planning for (re)insurers (CP131).

We fully support the rationale behind these proposals as described in the Objectives set out by the Central Bank in Section 3 of CP131. In particular, we agree that having a well-functioning insurance sector that safeguards consumers and thereby contributes to economic growth and financial stability requires tools to prevent or reverse deteriorating financial positions. This is clearly in the best interests of the sector, its stakeholders and the wider economy.

We also agree that pre-emptive recovery planning is critical for informed and effective decision making in a crisis.

We do, however, have a number of observations in relation to the proposed regulations and guidance that focus on the means by which we achieve the desired objectives. These observations are set out below and cover general comments and responses on the questions posed on areas to be covered and proportionality. Further to these primary observations, some specific suggested drafting changes are included in the Appendix to this submission - please note that these do not represent the entirety of our feedback/observations.

In preparing this response, our focus has been on the public interest and the responses do not purport to reflect the views of the insurance industry.

We would be happy to respond to any questions on this response. Please contact Philip Shier, Head of Actuarial Practice, at philip.shier@actuaries.ie.

Executive Summary

As noted in the preface, the Society is fully supportive of the rationale behind these proposals, namely the role played by pre-emptive recovery planning in informing effective decision making in a crisis, thereby ensuring the safeguarding of consumers and supporting economic growth and financial stability.

We have set out a number of observations in relation to the proposed regulations and guidance that focus on the means by which the desired objectives can be achieved. These observations are set out below and include general comments as well as responses on the questions posed under Section 6 of the consultation paper regarding

- areas to be covered, and
- proportionality.

Key points are summarised under these headings in this summary and explored in more detail in the main body of this response.

Key General Comments

Linkages with ORSA and Solvency II

We agree that, in order to be effective, recovery plans need to be embedded in insurers' overall risk management frameworks and, in particular, there should be strong interlinkages between the recovery plan and the ORSA. We disagree, however, with the distinction outlined in the consultation paper that:

- The objective of the ORSA is to prevent an insurer from breaching its SCR and coming under severe stress and focuses on solvency, informing capital risk appetite by identifying the impact of plausible but severe stresses; whereas
- A recovery plan envisions the insurer being confronted with severe stress, considers a wider range of causes that might ultimately lead to failure if not properly addressed (including solvency, liquidity and operational events) and contemplates the actions needed to mitigate the stress and restore financial strength and viability.

We believe the focus and remit of the ORSA is wider than that articulated here. It is our understanding that the ORSA should, and does, consider more severe stresses through reverse stress testing and that it does consider a wider range of risks through consideration of 'all material risks whether quantifiable or not'. In addition, the ORSA report would also normally consider other risks such as liquidity or operational risks. Furthermore the ORSA, in its stress testing, is expected to address the following: 'Future possible management actions are realistically considered. The severity of the assumptions applied and variety and reliability of the scenarios are appropriate for the undertakings risk profile'.

In short we feel that the articulation of the linkages (and distinction) between the ORSA and Recovery Plans could be further acknowledged in section 2.3 of the Draft Guidelines and that this is a fundamental consideration in informing the consultation more generally i.e. to what degree does the ORSA materially meet the objectives underlying recovery plan requirements, what additional

¹ EIOPA Guidelines on Own Risk and Solvency Assessment

² EIOPA's Supervisory Assessment of the Own Risk and Solvency Assessment – First Experiences (2017)

requirements need to be articulated to ensure a useful recovery plan is put in place and what is the best means of achieving this.

Complexity and length of the formal reporting

The quantitative analyses required in relation to Parts G & H of the Schedule to the draft Regulations are considerable and it appears difficult, as the regulations are currently drafted, for any undertaking (with the possible exceptions of captives and third-country branches) not to complete all of the prescribed calculations and assessments, irrespective of relevance or any consideration of proportionality. It would be important to include text on proportionality explicitly in these Parts (i.e. G & H). Furthermore, we are of the view that the following will enhance the proposals:

- Clarification around the role and purpose of the 'closed to new business scenario';
- Wording changes to allow more discretion around materiality and relevance of the particular recovery options to be explored in a given scenario; and
- Wording changes to allow more qualitative analysis in relation to recovery options within scenarios.

In terms of the overall exercise, we also have concerns around the extent to which the proposed requirements are modelled on those applicable to the Banking industry. Banking Recovery Plans can be particularly long and require simplified 'playbooks' to drive clarity around formal reports. We believe that there is a risk that a lengthy and involved recovery plan could be less effective in achieving the stated objectives than one that focuses very tightly on the following principles:

- What recovery options are available to the undertaking?
- What is the undertaking's capability to deploy those options, considering different circumstances?
- To what extent do those recovery options rely on third parties? (e.g. parent or group to provide capital or other support, third parties to accept portfolio transfers or other arrangements, regulators to approve proposed actions where relevant, etc.)

We have a concern that the level of prescription and apparent volume of content suggested by CP131 could defeat the essential purpose and lose sight of the overall objectives, resulting in inappropriate focus on the recovery plan as a 'compliance' exercise.

Financial Support from other undertakings

Paragraph 3(2) of the proposed regulations sets out that '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'.

We have a concern that the wording here could create difficulties. Depending on the exact form of a written confirmation and the jurisdiction of the "other undertaking", this requirement could create contingent liabilities that would need to be recognised on the other undertaking's balance sheet and create constraints in objectives around fungibility of capital. If the objective is to get comfort on the willingness and ability of the other undertaking to provide support in the relevant circumstances, we believe this could be achieved by requiring the insurer to carry out a realistic assessment, with the active involvement of the other undertaking. Our suggested rewording for this paragraph is as follows:

'the insurer shall include in the recovery plan confirmation from its Board that it has carried out, in consultation with the other undertaking, a realistic assessment of the other undertaking's willingness and ability to provide such financial support in the scenario contemplated'.

Alignment with European developments

We note that a report on the outcome of an EIOPA consultation on additional Recovery and Resolution measures arising from the Review of Solvency II is expected by year-end. We believe that the adoption of a Recovery framework as part of the Solvency II Review is extremely likely and could reasonably be expected to achieve the desired objectives set out in CP131. If this results in inconsistencies between an Irish regime and European requirements, that would be unlikely to be in the best interests of stakeholders. We note in particular that EIOPA proposes explicitly addressing Resolution measures, while CP131 is confined only to pre-emptive Recovery planning.

Specific Questions posed by the Central Bank

1. What, if any, other areas should be covered in the Guidelines or in future guidance.

We would like to see the following:

- More reference to Risk Appetite Statements in Sections 2.3 and 5.7 of the Draft Guidelines
 to drive a greater coherence in how Recovery Indicators fit into the overall risk management
 framework of an undertaking.
- Further clarification of the Central Bank's expectations around the review process. We agree
 that approval of (each iteration of) the recovery plan by the Board is appropriate, but we
 would appreciate clarification of the "formal assessment" expected of the Board does this
 imply any level of external review? It would also be helpful to understand if the Central Bank
 has explicit expectations of the Risk (or other Board) Committee, External Audit, Internal
 Audit or other control functions in the review process.
- Guidance on the expected time horizon for the scenario analysis.

Concerns have also been raised around the treatment of the Italian Tax Asset for undertakings to whom it is relevant within this exercise. Whilst the issues may be too specific to address in detail in this response, it should be noted that there appears to be an appetite for further clarity in this area.

2. Are there any areas where the application of proportionality can be improved or clarified?

Further specific allowance is needed on proportionality; otherwise it is not going to be possible for companies to apply it, particularly given the level of detail contained in the regulations and in the guidelines.

We believe, in section 3.6 of the Guidelines, that the timing of introduction and reporting on these requirements should be clarified for all levels of PRISM rating.

A simple way to apply proportionality on an ongoing basis could be to reduce the frequency of review of the plan in line with PRISM rating. For example: High/Medium High annually, Medium Low every 2 years, etc., while retaining the obligation to review after a material change.

The regulations and guidelines could also explicitly mandate that not all scenarios have to be completed in full quantitative detail, at least for lower impact undertakings. For example, if a certain

scenario is extremely unlikely to lead to difficulties, this could be addressed purely qualitatively in the recovery plan.

The regulations and guidelines, rather than requiring quantification of every combination of scenario and recovery option, could allow the undertaking to carry out the quantification only for the most appropriate recovery option(s) within a given scenario, helping the recovery plan to be more focused and appropriate.

Additionally, the proposed regulations appear more suitable for larger / higher impact entities than smaller single-line writers. There are certain 'optional' requirements for Captives and Branches, particularly in relation to the prescribed scenarios, which might be considered for extension to Medium Low and Low PRISM rated entities.

In terms of interlinkages with other areas of the risk management framework, it would be quite demanding on Boards, particularly of smaller entities, having to review two independent sets of indicators and scenarios, at least annually. Aligning fully with the ORSA process, by expanding (if necessary) the scenarios and aligning the Recovery Indicators with a sub-set of the quantitative measures of the Risk Appetite Statement would also improve efficiencies and reduce duplications.

Analysis of Regulations and Guidelines by Section

Draft Regulations 1-4

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We have a concern that the wording here could create difficulties. Depending on the exact form of a written confirmation and the jurisdiction of the "other undertaking", this requirement could create contingent liabilities that would need to be recognised on the other undertaking's balance sheet and create constraints in objectives around fungibility of capital. If the objective is to get comfort on the willingness and ability of the other undertaking to provide support in the relevant circumstances, we believe this could be achieved by requiring the insurer to carry out a realistic assessment, with the active involvement of the other undertaking. Our suggested rewording for this paragraph is as follows:

'the insurer shall include in the recovery plan confirmation from its Board that it has carried out, in consultation with the other undertaking, a realistic assessment of the other undertaking's willingness and ability to provide such financial support in the scenario contemplated'.

In paragraph 4 (2) (a), we suggest that, in accordance with the principle of proportionality, the frequency of review for lower PRISM-rated entities should be reconsidered e.g. every two years for low and medium-low entities. (This comment applies also to Guideline 3.1).

In paragraph 4 (2) (c), we believe that further clarification on what 'formal assessment' by the Board is intended to mean, in particular, it could usefully be clarified that the Board is not expected to commission an external view on the recovery plan. It would also seem appropriate that an insurer's risk committee (where one is in place) be assigned a particular responsibility to review the recovery plan.

Paragraph 4 (2) (d) could also be made clearer to confirm that a mandatory role in reviewing the recovery plan is not being prescribed for either internal audit or the external auditor.

Paragraph 2A (2) refers to 13A and 13B of the Solvency II Regulations. 13A and 13B are draft regulations contained within 'Withdrawal of the United Kingdom from the European Union Act 2019'. Article 73 of this amends regulation 13 of SI.No.485 of 2015 and splits it into 13A and 13B. It should be noted that this amendment has not yet been enacted.

Parts A – D: Summary, Changes, Approval and Governance

We have no specific comments on these Parts.

Part E: Strategic Analysis

Similar to other sections, much of what is required here will appear in other documents. It would be useful, where applicable, for companies to be able to reference other documents to avoid duplication e.g.

- Regular Supervisory Reporting; and
- Annual review of Strategy and Operating/Business Plans.

Part F: Recovery Indicators

We expect some overlap to arise between the Recovery Indicators and the Risk Appetite Statement ("RAS"). We also believe that alignment between the Recovery Indicators and the quantitative measures or risk indicators of the RAS would bring improvements to undertakings' risk management frameworks.

In the guidelines, the description of the Recovery Indicators is very similar to the requirements on the RAS. For example: "The RAS needs to express risk appetite in quantitative measures as well as qualitative terms. Risk appetite should be measurable and quantifiable. A Risk Appetite Statement written solely in the context of current solvency capital requirements is not acceptable ... There must be clear trigger levels for each material risk. As well as material breach limits, statements need to include interim limits which when breached will require remedial action." 3

Undertakings are likely to consider in their RAS metrics the same indicators that are listed in the CP131 guidelines under 5.7 (also described in the Appendix).

To reduce duplications and ensure consistency, regulations could state that the undertaking should identify recovery options for each of the material risks and measures that are listed in the RAS, and to ensure that the RAS metrics capture all the relevant categories.

Part G: Recovery Options

Our interpretation is that the proposed regulations imply working through all possible options where greater focus could be achieved through analysis of material and relevant actions. In line with proportionality, each undertaking is then free to set its own view on relevance, appropriateness and materiality of potential recovery options.

It is our view that the proposed regulations create overly onerous requirements in relation to impact assessment from a quantitative perspective and that more qualitative analysis should be permitted - wording that might achieve a more proportional approach could be:

'The elements to be considered in the impact assessment are listed above but should be proportional to the nature, scale and risk rating of the insurer. The impact assessment shall include qualitative analysis and such quantitative analysis as is necessary to make the impacts clear. It is not expected that all actions will require quantitative analysis or that all quantitative analysis will require a full projection into the future. The nature and risk of the business should be considered (e.g. PRISM rating, level of Solvency coverage, etc.) such that the same action may require quantitative analysis for some insurers but not for others.'

A qualitative feasibility assessment should also be permitted.

Part H: Scenario Analysis

We have struggled with the interpretation of the 'closed to new business' scenario, and whether it might be considered a scenario or instead a recovery option (as indicated in the guidelines, which state "scenario where insurer would close to new business as a recovery option"), and hence switched into Part G.

In its current form, the text suggests that this is scenario where nothing adverse has happened i.e. no stress, but rather it is an 'elective' closure to new business. It should be clear from the text that

³ Central Bank Letter to CEOs on RAS dated 22 Dec 2011

the intention of this exercise is for undertakings to contemplate stresses that could lead to closure to new business. The text should therefore specify that this requires an assessment of a stress scenario which would lead to closure to new business and then this being implemented as the recovery option. This is not clear to us from the existing text. We have provided suggested wording in the appendix.

However, we think it would be more appropriate for this scenario to be considered as a separate exercise from the other scenarios. This would remove any confusion around a scenario being treated as a severe impact that causes deterioration of the financial position (currently required as per Part H, Item (d)), as a scenario where a company closes to new business may not result in the financial position deteriorating.

We suggest that if the undertaking concludes that the scenarios required to threaten solvency are not plausible in the context of the insurers risk profile, the scenario may be excluded if appropriately justified in the report. At a minimum, a combined scenario and closed to new business "scenario" should be included.

In considering the analysis around scenarios, we note the following could also be considered:

- 1. The time horizon over which the scenario develops;
- 2. That risk profile and Solvency II SCR should be considered as separate analyses.

Similar to Part G and as discussed under our response to the proportionality question we believe proportionality might be introduced:

- By allowing discretion to identify and primarily focus on the recovery option(s) that would be most appropriate for that particular situation; and
- In the level of quantitative detail required under each recovery option for each scenario.

While Part H (e) (iii), suggests some level of differentiation in the level of assessment required for the appropriate recovery option, it remains unclear from the current text in Part H (e) the extent of "assessment" required for every recovery option under every scenario. We suggest the regulations and guidelines be amended in line with suggestions in Part G and under our response to the proportionality question. Additionally, there is a strong emphasis on scenario testing and cause of financial difficulty. It has been noted that the recovery options are the most important aspect and options that can be deployed independently of the 'cause' should not be seen as less valid.

Part I: Communications

We have provided some additional points below to consider for inclusion in guidance on Communication Plans:

- Timing of actions;
- Frequency of communications;
- Contact details required for communications;
- Roles and responsibilities of specific people for communications; and
- Consideration of legal responsibilities in relation to disclosure and confidentiality.

We would like clarification if the point regarding effective proposals for managing any potential negative market reactions is a requirement or guidance only.

Part J: Information on preparatory measures

We have no specific comments in relation to the preparatory measures section of the consultation paper.

Appendix – Suggested wording changes to the proposed regulations

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Reference	Regulations	Suggested amendments
Part H - Scenario Analysis	(a) include at least one scenario in respect of each of the following: (i) a 'system-wide scenario', which means an event that risks having serious negative consequences for the financial system or the real economy; (ii) an 'insurer-specific scenario', which means an event that risks having serious negative consequences specific to the insurer; (iii) a scenario that involves a system-wide scenario and an insurer specific scenario occurring simultaneously; (iv) a scenario where the insurer is closed to new business but continues to honour, in full or in part, agreements made prior to that date,	(a) include at least one scenario in respect of each of the following: (i) a 'system-wide scenario', which means an event that risks having serious negative consequences for the financial system or the real economy; (ii) an 'insurer-specific scenario', which means an event that risks having serious negative consequences specific to the insurer; (iii) a scenario that involves a system-wide scenario and an insurer specific scenario occurring simultaneously; (iv) if not already covered in (i) to (iii), a scenario where the ongoing viability of the insurer is threatened, such that, closure to new business is selected as the recovery option (but the undertaking continues to honour, in full or in part, agreements made prior to that date). This stress will not be applicable for a company already in run-off.
	(c) reflect, in respect of each scenario, a scenario that is relevant to the insurer having regard to the following: (i) the insurer's business, investment strategy and reinsurance strategy; (ii) the insurer's operating model, including outsourcing and distribution arrangements, and the insurer's corporate structure; (iii) the insurer's asset size; (iv) any arrangement referred to in the recovery plan for the purposes of paragraphs (e) and (f) of Part E of the Schedule; (v) any identified vulnerabilities of the insurer relating to the information referred to in Part E of the Schedule,	(c) reflect, in respect of each scenario, a scenario that is relevant to the insurer having regard to the following: (i) the insurer's business, investment strategy and reinsurance strategy; (ii) the insurer's operating model, including outsourcing and distribution arrangements, and the insurer's corporate structure; (iii) the insurer's asset size; (iv) any arrangement referred to in the recovery plan for the purposes of paragraphs (e) and (f) of Part E of the Schedule; (v) any identified vulnerabilities of the insurer relating to the information referred to in Part E of the Schedule, (vi) the likely time horizon over which a plausible scenario could occur which would threaten the solvency of the company.
	(e) include in respect of each scenario - (i) an assessment of the impact of the scenario on the insurer in terms of the following: (i) the insurer's own funds; (ii) the insurer's available liquidity; (iii) the insurer's risk profile and Solvency Capital Requirement applicable pursuant to the Solvency II Regulations; (IV) the insurer's operations, including the impact on continuity of the insurer's key services and critical functions as referred to in Part E of the Schedule, (iii) an assessment of the effectiveness of each recovery option in that scenario, in terms of the potential contribution of the recovery option to restoring the financial position of the insurer or maintaining the insurer's ongoing viability, (iii) an assessment of the adequacy of the framework of recovery indicators in that scenario, in terms of identifying in a timely manner that a recovery option should be implemented by the insurer, and (iv) identification of the recovery option that the insurer considers could be appropriate in that scenario including an analysis in that scenario in accordance with Part G of the Schedule, in terms of impact assessment, feasibility assessment and timeframe required for implementation,	of the company. (e) include in respect of each scenario - (i) an assessment of the impact of the scenario on the insurer in terms of the following: (ii) the insurer's own funds; (iii) the insurer's available liquidity; (iiii) the insurer's six profile; (iv) the insurer's Solvency Capital Requirement applicable pursuant to the Solvency II Regulations; (v) the insurer's operations, including the impact on continuity of the insurer's key services and critical functions as referred to in Part E of the Schedule, (vi) an assessment of the effectiveness of each recovery option in that scenario, in terms of the potential contribution of the recovery option to restoring the financial position of the insurer or maintaining the insurer's ongoing viability, (vii) an assessment of the adequacy of the framework of recovery indicators in that scenario, in terms of identifying in a timely manner that a recovery option should be implemented by the insurer, and (viii) identification of the recovery option that the insurer considers most appropriate given the scenario including an analysis in that scenario in accordance with Part G of the Schedule, in terms of impact assessment, feasibility assessment and timeframe required for implementation,
Part I - Communication s	The recovery plan shall include a communication plan that provides for the following: (a) an internal communication plan for the insurer's communication of the implementation of recovery options to staff, trade unions or other staff representatives, including an analysis of how the internal communication plan would be implemented when a recovery option is implemented; (b) an external communication plan for the insurer's communication of the implementation of recovery options to shareholders and other investors, the Bank, counterparties, financial markets, reinsurers, policyholders and the public, as appropriate, including an analysis of how the external communication plan would be implemented when a recovery option is implemented.	The recovery plan shall include a communication plan that provides for the following: (a) an internal communication plan for the insurer's communication of the implementation of recovery options to staff, trade unions or other staff representatives, including an analysis of how the internal communication plan would be implemented when a recovery option is implemented; (b) an external communication plan for the insurer's communication of the implementation of recovery options to shareholders and other investors, the Bank, counterparties, financial markets, reinsurers, policyholders and the public, as appropriate, including an analysis of how the external communication plan would be implemented when a recovery option is implemented. (c) effective proposals for managing any potential negative market reactions.

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