

Central Bank of Ireland
Dame St.
Dublin 2

28 July 2016

Dear Sir/Madam

Re: Consultation Paper CP 104, External Audit of Solvency II Regulatory Returns / Public Disclosures

Chartered Accountants Ireland (“the Institute”) is pleased to respond to the above consultation (CP104). We welcome the degree of clarity which CP104 provides in relation to how the Central Bank intends to apply Regulation 37 of S.I. 485 of 2015, European Union (Insurance and Reinsurance) Regulations 2015, (“the Solvency II Regulations”) with regard to auditor’s reports on elements of the Solvency and Financial Condition Report (“SFCR”) of insurers and reinsurers in Ireland.

While acknowledging that the consultation is a welcome contribution to clarity in this regard, we remain concerned that the Central Bank’s final requirements are not due to be published until later in the year putting pressure on insurance and reinsurance undertakings and their auditors to complete the necessary work to comply with the requirements in respect of years ending 31 December 2016. We emphasise the need for the Central Bank to adhere to the timetable for publication of final requirements which is set out in CP104 and encourage the Central Bank to communicate any changes in the intentions set out in CP104 without any delay.

We make the following comments in relation to the proposals set out in CP104:

1. The reasonable assurance opinion

CP104 refers to the Central Bank's requirement for a reasonable assurance opinion on the relevant elements of the SFCR. However, the consultation paper does not explicitly state what reasonable assurance opinion is expected. We anticipate that the likely intention is that auditors will be asked to provide a reasonable assurance opinion that the specified quantitative reporting templates ("QRTs") of the SFCR have been properly prepared, in all material respects, in accordance with the Solvency II Regulations. It will be necessary for the final requirements to be clear in this regard.

The Institute will be pleased to engage directly with the Central Bank in relation to developing an illustrative auditor's report for these assurance engagements.

2. Addressee of the auditor's report

We note that CP104 is not clear on the addressee of the auditor's report under Regulation 37 of the Solvency II Regulations. It is our view that the appropriate addressee of the auditor's report is the insurance or reinsurance undertaking whose SFCR is the subject of the engagement. We also note that this concurs with the approach proposed by the UK's Prudential Regulatory Authority ("the PRA"), as set out in paragraph 3.1 of its recently published CP23/16 "Solvency II: external audit of the public disclosure requirement" (CP 23/16) at paragraph 3.1, where it is acknowledged that the PRA will not be an addressee of the report.

3. Auditor's opinion on consistency of qualitative information

We consider there is a lack of clarity in CP104 in relation to the scope of the auditor's reporting in relation to qualitative information which accompanies the QRTs which are being reported upon. It will be important for the Central Bank's final requirements in this regard to be unambiguous and we propose that the language used should be closely aligned with that in auditing standards.

As such, we recommend that the auditor's work in relation to qualitative information will be limited to that required to enable the auditor to identify whether any elements of the specified qualitative information are materially inconsistent with information made available to the auditor in the course of the reasonable assurance engagement on the SFCR or in the course of the audit of the financial statements of the entity, rather than with any other information that the auditor may have access to.

Appendices 2 & 3 of CP104 set out the relevant qualitative information which it is anticipated that the auditor will consider in the context noted above. We consider the elements of qualitative information included at Appendices 2 & 3 to be appropriate in the context of an audit of the SFCR of an entity applying the standard formula to the calculation of its Solvency Capital Requirement (SCR). We encourage the Central Bank to clarify the qualitative information which will be within the scope of the engagement where a full or partial internal model is used for the SCR calculation. We will be pleased to engage further with the Central Bank in this regard.

4. Audit of group QRTs

CP104 proposes that the SCR and own funds QRTs for Solvency II groups for which the Central Bank is Group Supervisor are within the scope of the auditor's reporting. We note that there will be challenges for the auditor in relation to these QRTs, particularly the SCR, where the individual SCRs of some subsidiaries have not been subject to audit or indeed may not be prepared in a jurisdiction where local compliance with Solvency II is not required. We would welcome further engagement with the Central Bank to explore the possible approaches in these situations.

5. Standard formula element of SCR calculation for undertakings using partial internal models

The requirements as drafted propose to include elements of the SCR template which are calculated using the standard formula within the scope of the reasonable assurance opinion. The other elements of the SCR template calculated using an approved partial internal model would be excluded.

We note that in the UK, the PRA's CP23/16 scopes out templates relating to the SCR for undertakings/ groups using both the full or partial internal model from the reasonable assurance opinion.

We understand that the PRA is of the view that the external audit of the SCR calculated using an internal model or partial internal model would not provide the same degree of confidence that the SCR has been properly prepared in all material respects with Solvency II requirements, as the audit of the SCR calculated using the standard formula. The PRA also notes that any audit work on the SCR calculation using a full or partial internal model would need to be against an insurer's basis of preparation rather than Solvency II. This is due to the fact that models are based on an undertaking's specific risks as approved by the regulator and not on a basis contained within Solvency II. The full and partial internal models are also subject to ongoing regulatory supervision and the undertaking's independent internal validation process.

For undertakings using approved partial internal models, we are of the view that there is limited additional value to be obtained from scoping in the standard formula elements of the SCR templates. The standard formula elements are likely to be routine calculations and many of the important elements of the SCR calculation for these undertakings will be out of scope.

6. Scope of the reasonable assurance engagement for full and partial internal models

We note the dependency between the SCR and the calculation of the risk margin in technical provisions. In scoping out the SCR calculated using a full internal model or elements of the SCR calculated using a partial internal model, the SCR element for calculating the risk margin would also be outside the scope of external audit. We understand that this may lead to a potentially material element of the valuation of technical provisions in the Solvency II balance sheet not being subject to external audit.

We would welcome further engagement as to how the auditor clarifies the scope of the reasonable assurance engagement for undertakings using full or partial internal models and the impact on the auditor's opinion in respect of the elements which are out of scope.

7. Head of Actuarial Function (“HoAF”) sign-off on the SCR calculation

We note that under the Irish actuarial regime and related governance requirements under Solvency II, there is no requirement for the actuarial function to provide an opinion or report on the SCR. The main focus of the HoAF responsibilities under the Irish actuarial regime, in addition to those areas contained within Article 48 of the Solvency II Directive on the actuarial function, is the requirement to provide an actuarial opinion on technical provisions and an actuarial report supporting the actuarial opinion. We also note that the peer review requirement for high, medium high and medium low impact undertakings includes a peer review of the actuarial opinion and related actuarial report.

Based on the proposed requirements in CP104, the external auditor would be the sole provider of an opinion on the SCR calculation, where calculated using the standard formula or in the case of those undertakings using an approved partial internal model, those elements of the SCR which are calculated using the standard formula.

We believe this is a gap in the overall requirements and would recommend that the actuarial opinion and related actuarial report of the HoAF should be extended to cover the SCR calculation. This extension would bridge this gap so that the external auditor is not the only responsible individual providing an opinion on the SCR, where applicable.

8. Independence of actuary

We note that paragraph 6.10 of CP 104 requires auditors, as part of audit, to “determine whether they should use the work of an auditor's expert, for example an actuarial expert”. We consider that this is appropriate.

Auditing standards require the auditor to consider the competence, capability and objectivity of a management's expert if they plan to place reliance on the work of a management's expert. The level of reliance that the auditor can place on the work of management's experts will impact the level of additional work required by the auditor's own expert. Clearly, there is a cost implication here for the audit.

The current domestic actuarial regime and the proposals under CP 103 "Consultation on Guidance for Re(Insurance) Undertakings on the Head of Actuarial Function Role" envisage two main actuarial functions, the HoAF (a PCF role) and Peer Review Actuary (Peer review is not required every year and not at all in some cases). It is possible for either or both these roles to be outsourced to actuarial consultants. This arises particularly for captives and cross border operations in Ireland.

We believe that there should be further guidance as to the extent to which the auditor could rely on the work of the HoAF and/or Peer Review, particularly where this has been outsourced to actuarial consultants. We will be pleased to engage further with the Central Bank in this regard.

9. Clarification regarding long term guarantees

We note that at paragraph 6.16 of CP104 reference is made to the inclusion of the QRT relating to long-term guarantees within the engagement scope. However, that QRT is not included in Appendix 2. We therefore ask for clarification as to whether or not it is intended to bring this QRT within scope of the engagement.

10. Clarification regarding QRT S19.01.21

We welcome the Central Bank's stated intention to limit the "look back" period subject to audit in respect of QRT S19.01.21 to 2 years in the first year of the application of the new reporting requirements. We seek clarification, however, as to whether this is a year one derogation only. It is our understanding that the limitation shall extend beyond the initial year of reporting, such that the period ended 31 December 2014 will continue to be the first period audited for the purposes

of the claims paid triangle in subsequent years of audit. We would welcome confirmation of that understanding.

11. A private opinion on a public report – practical considerations

While we are strongly supportive of the privacy of the reasonable assurance report on the SFCR we note that there are communication challenges arising as a consequence of the unusual situation of having a private assurance report in relation to a publicly disclosed SFCR. CP104 notes that the Central Bank's proposals in relation to Regulation 37 of the Solvency II Regulations are *"intended to give users of the SFCR, including investors, policyholders and the Central Bank, greater confidence in the quality of information disclosed in the SFCR."* To that end we expect it is likely that the existence of the private assurance report will be referred to in the public SFCR. However since the auditors' report will not be publicly available and public users of the SFCR will not be privy to the content of that opinion, including any possible qualifications, it will be important the language used in any reference in the SFCR to the private auditors report does not serve to create false confidence amongst public users of the SFCR. We consider it will be helpful to agree a consistent form of wording for this reference to the private auditors' report. We will be pleased to engage with the Central Bank to determine an appropriate reference.

12. Possible inclusion of a Directors' Responsibility Statement on the SFCR

We believe there is merit in having a requirement for a Directors' Responsibility Statement included in the SFCR. It is important for readers of the SFCR to understand that the directors of the company have ownership of the SFCR and are responsible for its proper preparation and publication. We note that the PRA has stated in its CP23/16 at paragraph 3.5 that it will ask the governing body of a reporting entity to acknowledge their responsibility for the preparation of the SFCR in writing and attach a statement to that effect to the published SFCR.

13. Impact on scope of approvals, waivers or supervisory determinations of the Central Bank

We note that in the UK the PRA's CP23/16 at paragraph 3.7 provides some useful clarity in relation to regulatory approvals, waivers and supervisory determinations. The PRA has clarified

that the auditor is not expected to express an opinion on the validity of an approval, waiver or other supervisory determination. Instead such provisions made by the competent authority should be considered as part of the framework against which the audit opinion is given. We consider that a similar clarification would be useful in the Irish context.

14. Inclusion of captive insurance and reinsurance undertakings within the scope of the requirements

We have concerns regarding the inclusion of captive insurance and reinsurance companies within the scope of the reporting requirements as proposed in CP104. We anticipate that the application of the proposed reporting regime to such companies will be costly for those entities. Most captives have a low supervisory risk rating demonstrating that they are not a significant threat to economic stability, and they are subject therefore to a lower level of supervision. It may be appropriate to take a more proportionate approach to captive insurance and reinsurance companies for example by including only those which have a higher supervisory risk rating.

Conclusion

We are pleased to respond to the proposals in CP104 and hope to continue dialogue with the Central Bank as you move towards preparing your final requirements in respect of the application of Regulation 37 of the Solvency II Regulations. As our above comments indicate, there are a number of areas where we consider it will be important to have some specific further engagement with the Central Bank, particularly with regard to:

- the wording of the reasonable assurance opinion;
 - clarifying the qualitative information which will be within the scope of the engagement where a partial internal model is used for the SCR calculation;
 - the level of audit work required in relation to subsidiary QRTs in the audit of group QRTs;
 - the scope of the engagement for undertakings using partial or full internal models;
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- the extent to which the auditor could rely on the work of the HoAF and/or Peer Review, particularly where this has been outsourced to actuarial consultants;
- the wording of any reference in the publicly disclosed SFCR to the private auditors' report.

We look forward to having an opportunity to discuss these matters further with you.

If you have any queries on our comments above or wish to discuss these or any other issues with regard to CP104, please contact Karen Flannery of Chartered Accountants Ireland at 01-637 7389 or by email to karen.flannery@charteredaccountants.ie.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'KF' followed by a long horizontal stroke that loops back under the 'F'.

Karen Flannery

Secretary, Audit and Assurance Committee, Chartered Accountants Ireland

