Submission to the Central Bank of Ireland

Consultation Paper 115

This submission is made on behalf of William Fry.

William Fry welcomes the publication of Consultation Paper 115 ("CP115"). CP115 brings clarity to the Central Bank's proposed position and approach to the authorisation and supervision of branches of 'third-country' insurance undertakings ("third-country branches"), and offers an important opportunity to comment thereupon.

Our comments on specific sections of CP115 are set out below.

Appendix 1: Policy Notice on branches of third-country insurance undertakings authorised by the Central Bank

Section 1.1 provides "This Policy Notice is addressed to third-country insurance undertakings intending to establish a branch in Ireland pursuant to Regulation 176 of the European Union (Insurance and Reinsurance) Regulations, 2015 (the 2015 Regulations)."

Currently, there are no third-country branches established in Ireland. However it is important that the Central Bank's policy includes considerations of likely future scenarios for certain existing insurance operations. We refer to the specific circumstances where a branch of an EEA insurance undertaking is operating in Ireland, but at a certain future date, through no fault of its own, that operation will become a third-country branch (as a result of being the branch of a UK-authorised undertaking, after the UK's departure from the EU). The Central Bank will need to make specific provision for such branches if they are to continue operating in a seamless way after the effective date of Brexit. (Please note that the present submission is being drafted in February 2018 at a time of considerable uncertainty as to the outcome of negotiations between the EU and the UK, and indeed the timing of the UK's exit from the EU. Views articulated in this submission may evolve depending on the course and conclusion of those negotiations.)

William Fry suggests two practical approaches:

1. Introduce a preparatory regime in advance of the Brexit date to facilitate early application by such branches to be authorised as third-country branches. In that regard, the preparatory regime that was implemented in respect of various aspects of Solvency II offers a template. Such a preparatory regime would allow the Central Bank to confirm that it is minded to approve an authorisation application for such branches before they become in effect third-country branches. In this context, it should be borne in mind that practically facilitating ongoing business for such operations will require arrangements to be in place a year ahead of the Brexit date, to facilitate renewals where part of the cover period would run beyond the Brexit date (e.g. if Brexit ultimately takes place in March 2019, an annual renewal with an effective date of 1 May 2018 will see part of the annual policy term fall into the post-Brexit period.)
2. Introduce transitional provisions automatically authorising such branches as third-country branches with effect from the Brexit date and with the obligation to satisfy the Central Bank's third-country branch requirements postponed for a reasonable period, e.g. 2 years after the Brexit date. Such branches would of course not be permitted to operate in other EEA member states (i.e. apart from Ireland) with effect from the Brexit date. This approach would allow such branches to continue their Irish and non-EEA business (see further comment below) without disruption. The approach would similarly serve to spread the Central Bank's burden in assessing authorisation applications over a longer period of time.

Furthermore, it would be helpful if the Central Bank could clarify that existing business written during the time that the establishment was an EEA branch can continue to be managed and serviced in a seamless way by the successor third-country branch following its authorisation.

On a related matter, we would request that the Central Bank make a clear policy statement in relation to legacy books of business that have been written by UK undertakings in Ireland (whether under Freedom of Establishment or Freedom of Services), where the undertaking does not intend to write future new business in Ireland post-Brexit. Such undertakings require a clear authorisation status to meet their contractual obligations and service policyholders for the duration of the run-off. In the event of a "hard Brexit[1]", it would in most instances be disproportionate to require the undertaking to establish a third-country branch or authorised Irish subsidiary to service the business, or incur the effort and expense of a portfolio transfer of the legacy business to a newly-established entity. It will be important to establish a regime that will allow this run-off business to be supervised in a proportionate fashion. We acknowledge that it is not within the remit of the Central Bank to ensure specific regulations are implemented with regard to such a regime. Notwithstanding, we suggest that the Central Bank should engage with this issue at an early stage and make public its policy in this regard to inform the actions of other key stakeholders. Without suggesting that Solvency I rules should be used as a model for such a regime per se, we would highlight as a relevant example the provisions made at the onset of Solvency II whereby the new regulatory regime did not apply to run-off undertakings, which continued to be supervised under Solvency I regulations for a number of years, subject to demonstrating progress towards completing their run-off.

Section 2.8 provides "The Central Bank's Domestic Actuarial Regime and Related Governance Requirements under Solvency II will apply to third-country branches"

We acknowledge that this policy would place third-country branches in the same position as Irish head office undertakings. However, it should be noted that the various requirements established under the Domestic Actuarial Regime and Related Governance Requirements are unique to Ireland and not specifically required under Solvency II. Accordingly, an Irish third-country branch is at a relative disadvantage to one established anywhere else in the EEA, not least due to the costs involved in meeting these additional requirements. This would have the effect of reducing the attractiveness of Ireland as a location for branch operations with a global (non-EEA) focus.

We note **Section 2.10 provides** that "A third-country branch authorised by the Central Bank may only pursue insurance business within the State" and further that **Section 3.2 of the Policy Notice**, provides: " … the Central Bank considers that the primary purpose of establishing such branches should be the provision of insurance to policyholders within the State."

We consider it important to ensure that the said sections cannot be interpreted to discourage or prohibit third-country branches from doing business with policyholders outside the State. A number of existing branches of UK undertakings already operate sound business models that involve transacting business with policyholders not resident in the State. To the extent that such business models relate to non-EEA business, we contend that, post-Brexit, this will continue to be an entirely valid business model. Such business models do not result in increased financial stability risks, Irish policyholders risks or risks otherwise adversely affecting the mandate of the Central Bank. Furthermore, the continued availability of this business model will help to maintain the reputation of Ireland as an important centre of excellence for insurance, contributing to employment opportunities and the generation of tax revenues.

We propose that above highlighted sentences at Section 2.10 and Section 3.2 be omitted from the final Policy Notice to be adopted by the Central Bank.

[1] Where there is no agreement between the EU and the UK that would provide a framework to facilitate the management of such business

Section 3.3 provides "The Central Bank does not consider that the establishment of a third-country branch will be appropriate for all business models, as such; it may deem certain operations unsuitable for establishment as a third-country branch due to the nature, scale and complexity of the proposed business model, and/or with the proposed customer base."

It will be crucial for potential new applicants, and indeed the existing operations referred to above, to have full clarity around the Central Bank's criteria as to the "*nature, scale & complexity"* that would render certain operations unsuitable to be structured as a third country branch.

While we appreciate that specific quantitative criteria may not always be an appropriate way to address this issue, we refer to the December 2017 consultation paper (CP30/17) issued by the UK Prudential Regulatory Authority (PRA): "International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision" (Link here: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2017/cp3017.pdf?la=en&hash=FA4613AF416B1E6EDB48329EC67FC61C2E13AF55). This paper offers helpful guidance on the PRA's view of the scale of operations at which a subsidiary approach would be preferred to the establishment of a third-country branch (albeit that the paper notes that the figure of Stg 200 million of liabilities mentioned therein is "not a hard threshold").

Corresponding benchmarks from the Central Bank would be welcomed to enable potential applicants judge the best structural approach to apply. More generally, we would encourage the Central Bank to expand further on the intended meaning of "*nature, scale and complexity"*, and perhaps give examples of the types of operation / risks / scale that it would deem unsuitable.

We would similarly welcome an elaboration from the Central Bank on its concerns around the "*proposed customer base*", and how that would impact on its decision-making process for a proposed third country branch. This is unclear from the present text.

Section 3.7 provides "The Central Bank must be satisfied that relevant regulatory and supervisory requirements and arrangements in the third country correspond, such that they deliver equivalent outcomes, to requirements and arrangements in the State. The Central Bank will require the third-country insurance undertaking to provide it with an independent assessment of the third-country regime."

We query whether such an assessment is always necessary. For example, if the third country is at the time of the authorisation application formally deemed equivalent (or temporarily equivalent) by the European Commission, then it would seem redundant to place any requirements of this sort on the applicant. Furthermore, if the Central Bank is processing multiple applications of branches of undertakings authorised in the same third country, is it necessary for each of them to deliver a separate assessment?

We would welcome the Central Bank's guidance on what constitutes an independent assessment for the purpose of this requirement. For example, would an assessment carried out by a consultancy firm engaged by the insurance undertaking be sufficiently independent? What credentials would such a firm have to present to demonstrate their competency to carry out such an assessment? How detailed should such an assessment be?

Section 3.10 provides "The Central Bank must be satisfied that the home jurisdiction bankruptcy regime provides at least the same level of protection of third-country branch policyholders in winding up proceedings as that provided under the 2015 Regulations. The Central Bank will require an analysis from the third-country insurance undertaking of the applicable winding up regime analysing the priority given to policyholders of the third-country branch and how the assets of the third-country insurance undertaking would be distributed to those policyholders."

We make similar observations to our commentary under Section 3.7 above to which we refer. Albeit, we acknowledge that the instant requirement at Section 3.10 is less onerous where the analysis requested is not required to be independent.

Section 3.11 provides "The Central Bank must be satisfied that the proposed business model of the third-country branch … [has] been verified by the relevant third-country supervisory authority."

It would be helpful for the Central Bank to clarify what form this "verification" would take. Would the requirement be satisfied by the third-country supervisory authority confirming that it is receiving the same information from the undertaking about the proposed business model? Or are further requirements envisaged e.g. an approval of the proposed business model?

Section 3.12 provides: "The Central Bank expects a Memorandum of Understanding (MoU) to be concluded with the third-country supervisory authority before a formal decision is made to grant an authorisation to a third-country branch."

We understand that the conclusion of such a MoU is outside the control and influence of the undertaking seeking to set up a third country branch in Ireland. It will be important for the Central Bank and the third country supervisory authority to engage positively and in a timely way if this requirement is to be workable. In particular, it will be crucial for the Central Bank to engage with the UK PRA to conclude a MoU, anticipating the post-Brexit environment. The timing of the conclusion of such a MoU would be an important consideration to take into account in deciding on the measures to adopt in relation to the points raised in our comments above under Section 1.1 of the Policy Notice.

Section 3.14: "All authorised third-country branches will be subject to a standard condition of authorisation that their authorisation will be subject to the Central Bank's prerogative to periodically review whether the relevant corresponding regulatory and supervisory requirements in the third country continue to be deemed equivalent to the requirements in the State."

It is understood that the Central Bank's third-country branch requirements will be built on the expectation of equivalence of the third-country supervisory regime, and that it will not be sufficient for that equivalence to be considered only at the time of initial authorisation of such a branch. However, it is important that the timing of reviews and particularly the timing of requiring a status change[2] is dealt with in such a way that continuity of business operations is not compromised. Third country branches will need sufficient notice to prepare a subsidiary authorisation application, and have it assessed by the Central Bank, while still being allowed to continue operating as a branch in the interim. We suggest that for practical purposes the minimum notice period involved should be set as one year.

[2] The requirement that a subsidiary be established and authorised in place of a third-country branch, as a result of the third-country regime no longer being deemed equivalent by the Central Bank.

Section 3.15: "The third-country branches should have sufficient and appropriately skilled resources including senior management within the State."

Notwithstanding the content of Section 2.1 of Appendix 2 to the Consultation Paper[3], further clarity and guidance is welcomed on the Central Bank's interpretation of "*sufficient and appropriately skilled*". ,. Such guidance should include commentary on expectations in relation to experience and qualification of holders of key functions at the branch and the degree to which reliance on functions or resources that are not located within the State are acceptable to the Central Bank.

[3] In particular sub-sections 4 to 8 of Section 2.1 of Appendix 2

Appendix 2: Handbook of Requirements for branches of third-country insurance undertakings authorised by the Central Bank;

Section 1.4(2) provides "Any third-country branch that becomes aware of a material deviation from the requirements contained in the Handbook shall within 5 business days report the deviation to the Central Bank, advising of the background and the proposed remedial action."

In recognising the corporate governance responsibilities of the Branch Management Committee as set out in the Central Bank's proposed Handbook, we suggest that the above requirement be amended in line with the following text to clarify the process required and the responsibilities involved:

"Any third-country branch that becomes aware of a material deviation from the requirements contained in the Handbook shall **escalate them without delay to the Branch Management Committee, and shall,** within 5 business days **of the Branch Management Committee being informed,** report the deviation to the Central Bank, advising of the background and the proposed remedial action.

Section 1.6 (t) defines “qualifying holdings” as "a direct or indirect holding in the third-country branch which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking;"

We suggest that this definition should be amended as follows

“qualifying holdings” means a direct or indirect holding in the third-country **undertaking that has established, or wishes to establish, a** branch which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking;", which we assume was the intention of the Central Bank in this regard.

Section 2.1(9) provides "A third-country branch shall, at times specified by the Central Bank and at least once a year, and once the third-country branch becomes aware of the acquisition or proposed acquisition of any qualifying holding in the third-country branch, notify the Central Bank of the names of shareholders or members who have qualifying holdings in the third country insurance undertaking and the size of each such holding."

In line with our comments at Section 1.6 above, it appears that this section was intended to and should refer to **" … any qualifying holding in the third-country undertaking that has established a branch …".**

Additionally, we would request that the Central Bank clarifies its intention as to the frequency of such notifications (noting the phrase "at times specified by the Central Bank" above). It is our contention that an annual notification as part of annual reporting, together with notification in the event of the branch becoming "*aware of the acquisition or proposed acquisition of any qualifying holdings*" should adequately fulfil the practical requirements in this regard.

Section 2.1(12) provides "Subject to the overall responsibilities of the third-country insurance undertaking’s board, …[the] Branch Management Committee will retain primary responsibility for corporate governance within the third-country branch at all times."

It would be helpful if the Central Bank could clarify its views on the respective responsibilities of the third-country undertaking's board and the Branch Management Committee in relation to corporate governance. It is unclear from the existing text whether "*primary responsibility*" means "first line responsibility" which is subsidiary to the responsibilities of the third-country undertaking's board, or "ultimate, final responsibility".

Section 2.1(12) further provides "The responsibilities and composition of the Branch Management Committee may be specified by the Central Bank on a case-by-case basis and will depend on the nature, scale and complexity of the branch operations."

CP115 provides useful details as to the responsibilities of the Branch Management Committee. However, no detail is provided as to the composition of the Committee, save the requirement that the Branch Manager be a member. Whilst appreciating that universally applicable rules may not be appropriate in relation to the composition of a Branch Management Committee, we would suggest at a minimum, that the Central Bank set out the criteria it will apply in making the case-by-case determination envisaged in this section.

It would also be useful if any absolute minimum guidelines could be provided as a benchmark for simpler branch operations (e.g. a minimum membership of 3 individuals inclusive of the Branch Manager, holders of key functions must be included in the membership etc.)

Section 2.1(20) provides "[The Risk Appetite] shall be subject to annual review by the Branch Management Committee and Board of the third-country insurance undertaking."

We regard the requirement for annual review of the Risk Appetite by the Branch Management Committee as appropriate. However, we question the practicality of the obligation on the Board of the third-country insurance undertaking to carry out its own review. How does the Central Bank intend to monitor and enforce this obligation? Would this be a necessary part of any MoU between the Central Bank and the relevant third-country supervisory authority?

Section 2.3(10) provides "The third-country branch shall deem any significant changes to the winding-up regime applicable to the third country branch in Ireland as a significant development."

Further clarification of the Central Bank's expectations under this Section would be welcome. We understand that the Irish winding-up regime that will be primarily and/or exclusively applicable to a third-country branch in Ireland. Any changes that may arise in that regime will be fully known to the Central Bank and the potential impact on authorised entities will presumably have been considered prior to the implementation of such changes. We query whether the Central Bank's expectation is limited to considering and quantifying any impacts on third-country branch reports arising from changes to winding-up regimes outside of Ireland (most likely in, but not limited to, the jurisdiction of the third-country undertaking)?

Section 2.4(2) provides "Where any of the advantages set out in Regulation 181 of the 2015 Regulations are granted, and the Central Bank has been appointed group supervisor, a third-country insurance undertaking shall submit a single branch balance sheet in relation to all branch operations pursued within the EEA to the Central Bank."

Taking into account the context of Regulation 181 of the 2015 Regulations[4], should this section be interpreted such that, in this circumstance, all the requirements proposed in this draft Handbook are intended to apply at the level of all of the EEA branches of the third-country insurance undertaking, rather than being applied at the level of the Irish branch? For example, will it be sufficient to submit quantitative templates and ORSA[5] reports to the Central Bank that reflect the aggregate of all EEA branch operations, rather than submitting the equivalent items taking into account exclusively the Irish branch operations? If submissions are expected at the Irish branch and the aggregated EEA branch levels, this should be clarified.

[4] For example, "SCR shall be calculated in relation to the entire business which it pursues within the European Union but with account being taken only of the operations effected by branches established within the European Union"
[5] Own Risk and Solvency Assessment

Appendix 3: Addendum to the Domestic Actuarial Regime and Related Governance Arrangements under Solvency II;

Please see comments under Appendix 1, Section 2.8 above.

Appendix 4: Guidance and Checklist for Completing and Submitting Applications for Authorisation of a Branch of a Third-Country Insurance Undertaking;

Annex 1, Checklist Item 4.1 provides "Confirm the applicant will be registered in Ireland and subject to Irish law."

The Applicant is, by definition, a third-country insurance undertaking and therefore the requested confirmation cannot be provided. We assume that the intention is that the third-country branch should be so registered.

Annex 1, Checklist Item 5.7 provides "Provide an independent analysis concerning the legal and practical operation of the home jurisdiction bankruptcy regime, including the priority given to policyholders of the third-country branch and of other policyholders of the third-country insurance undertaking in winding-up proceedings."

This item is inconsistent with Section 3.10 of Appendix 1, where the required analysis is not specified as needing to be "independent". If an independent analysis is required by the Central Bank, it should clarify what criteria need to be met in order for the analysis to be independent and what qualifications are expected of the provider of the analysis.

Annex 1, Checklist Item 7.5 provides "Set out … the projected staffing requirements over the next 5 years of the third-country branch …"

We note that the Central Bank checklists relating to the authorisation process for new life and non-life insurance undertakings only require projected staffing requirements over 3 years to be provided. We believe that the same 3 year period should be sufficient in the case of a third-country branch application.

Annex 1, Checklist Item 10.7 provides "Provide full details regarding the possible conflicts of interest arising in the conduct of the different types of activity under the applicant's control, demonstrating that adequate arrangements have been made to protect the interest of policyholders."

We believe that there may be an unintended excessive scope to this requirement in its current form. To avoid this, we suggest that the word "*policyholders*" be replaced with "*proposed branch policyholders*".

Annex 2 – Qualifying Holdings provides: "Please complete the relevant section below in relation to all holders of qualifying holdings."

We suggest that it would be helpful to clarify the requirements of this Annex by elaborating on this sentence as follows: "Please complete the relevant section below in relation to all holders of qualifying holdings in the Applicant[6]."

[6] The Applicant being the third-country insurance undertaking