Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Consultation Paper on a New Levy Calculation Methodology for Insurers

CP 129

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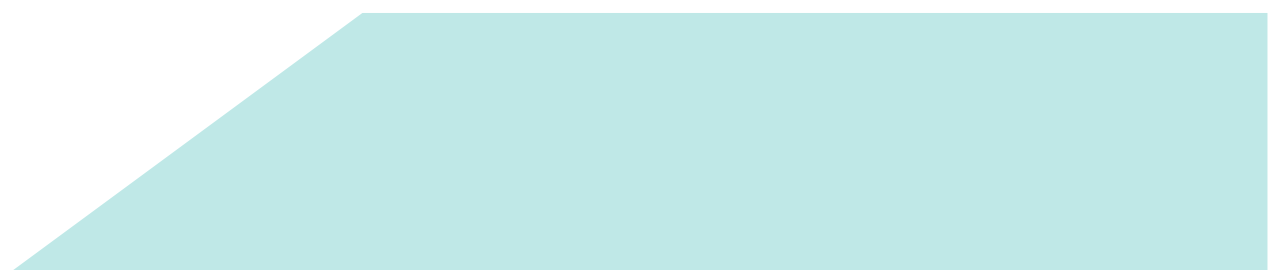

1. Objective

The aim of this consultation is to elicit views on a revised methodology for calculating the industry-funding levy for all insurance entities supervised by the Central Bank of Ireland.

2. Introduction

The Central Bank of Ireland's ("the Central Bank") total funding requirement for financial regulation activity is determined on an annual basis by the resources required to discharge its legal responsibilities under domestic and EU law.

Sections 32D and 32E of the Central Bank Act 1942, as amended, provide that the Central Bank Commission may make regulations relating to the imposition of levies and fees on the financial services sector in respect of the recoupment of the costs of financial regulation.

3. The Case for a New Levying Methodology

In the context of meeting its statutory objectives, the Central Bank's Strategic Plan 2019-2021 anticipates further limited growth in its resources. For instance, these resources will be targeted primarily to address the increasing complexity of the financial landscape arising from Brexit and the expansion of financial conduct regulation. Notwithstanding these requirements, a central theme of the strategic plan is for greater emphasis on stabilisation of the CBI's budget and staffing levels with a heavy emphasis on redeployment and reprioritisation to address new tasks and emerging priorities. The Central Bank is committed to stabilisation both to ensure its long-term financial independence and to limit the rate of increases in levies on regulated firms. In relation to levies, the Central Bank's funding strategy for financial regulation seeks to:

1. Increase the proportion of financial regulation costs chargeable to industry, thereby reducing taxpayer subvention, with the ultimate aim of recovering the full cost of financial regulation activity from regulated firms. This is consistent with the feedback statement on CP95 'Funding the Cost of Financial Regulation', in which the Central Bank and the Department of Finance jointly set out a strategic intention to move towards full industry funding on a phased basis;
2. Adopt, where appropriate, principles which support a predictable, transparent and proportionate pricing approach; and
3. Reduce complexity and risk associated with the current funding approach.

In relation to pricing of (re)insurance levies specifically, the Central Bank currently uses a banded approach to determine 100% of the levy. The relevant band or category is determined by the regulated entity's impact rating under PRISM. In order to determine a firm's impact category, the weighted average of selected metrics, taken from its most up-to-date supervisory returns, is calibrated to compute an impact score. The impact score is recalculated automatically every time new data is submitted to the Central Bank via the online reporting system. Scores for each financial sector or subsector are calibrated in order to align to the impact categories (Ultra High, High, Medium High, Medium Low, or Low) which reflect the potential harm that could arise from the failure of the firm.

Applying this approach, levy rates in 2018 are tabulated below:

Table 1 | 2018 Levy Rates by Prism Category

Impact Category	Ultra High	High	Medium High	Medium Low	Low
Levy	€3,329,855	€1,510,922	€345,472	€68,678	€20,192

The data in Table 1 illustrate the significant threshold effects in monetary terms that currently occur if a firm moves between bands.

In order to eliminate the threshold effect inherent in this banded approach, and to increase the transparency of the methodology behind the levies payable, while maintaining the principle that larger or riskier firms should pay higher levies than smaller or less risky firms, the Central Bank proposes a new levy methodology. The new methodology proposes to place greater emphasis on the individual, or firm-specific characteristics and impact scores, rather than on the rating category assigned under the current approach. The objective is to ensure that levies are more proportionate and to eliminate the "cliff" effects apparent in Table 1 above.

The Central Bank is currently carrying out a review of the PRISM impact framework with a view to updating the impact calculation methodology. It is the intention that levies will continue to reflect a firm's impact. Accordingly, the methodology and/or the variables for calculation of the variable element of the levy will be updated as necessary to reflect changes in the impact methodology. The approach outlined in this consultation paper is based on the latest updates with respect to the evolution of the PRISM impact review.

4. New Levy Methodology Proposal

4.1 Continuous Levying Methodology for Annual Supervisory Fees for Firms with Head Offices in Ireland

To determine a (re)insurance undertaking's annual fee, the methodology provides for a minimum fee component and a variable fee component, to be calculated as follows[1]:

The minimum fee component is equal to 45%[2] of the total amount of the CBI's aggregate annual levy requirement from the Insurance sector.

[1] There are percentages specified at various stages in the new methodology. These percentages are illustrative of what might have applied in a 2018 context. These percentages will be calibrated and determined annually, and are therefore subject to change in future years.

[2] The proportion of 45% of the total levy to be met by way of a fixed fee has been informed by the requirement for the CBI to recover a fixed cost base of the insurance supervisory function within the Bank. The supervision infrastructure (e.g., permanent staff, IT systems, premises) has to be maintained regardless of the size of the individual firms under supervision.

This sum is apportioned by PRISM impact category as follows[3]:

- High impact firms will pay 75% of this minimum fee component, split 80:20 between non-life and life firms[4];
- Medium high impact firms will pay 12% of this minimum fee component, split equally among them;
- Medium low impact firms will pay 8% of this minimum fee component, split equally among them;
- Low impact (non-captive) firms will pay 5% of this minimum fee component, split equally among them, and
- Low impact (captives) will pay a separately determined fixed charge set by the Central Bank.

The minimum fee by PRISM impact category will be calibrated and published annually by the Central Bank.

The variable fee component is equal to the remaining 55% total amount of the CBI's aggregate annual levy requirement from the Insurance sector. The proposal centres on the distribution of this aggregate sum among firms on the basis of the key metrics driving PRISM Impact scores, Gross Written Premium (GWP) and Gross Technical Provisions (TPs)[5].

Firms will be charged a variable fee (on top of the minimum fee) calculated on the basis of their own metrics, subject to the adjustments that may apply and as described below:

- A firm will pay a fee in proportion to the aggregate sum of GWP and gross TPs; this aggregate sum will be expressed in €millions.
- The rate per million of this aggregate metric will be calibrated and published annually by the Central Bank.
- The aggregate variable levy due is estimated as follows:

Variable € Fee Payable = Firm (GWP€m + TP€m) * Rate per €m

Adjustments:

- To reflect the relatively smaller impact ascribed to captive insurance within our supervisory approach, captive insurers will not be liable to pay a variable fee component on top of their fixed charge.

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[3] Our starting point in distributing the fixed fee across PRISM categories was to consider the distribution of levies paid in 2017 by PRISM category. This distribution was approximately 65% high impact, and 35% by other categories. The calibration of the distribution of the fixed fee across impact categories is based on a consideration of the following factors: (i) the intensive supervision of high-impact firms which reflects staff numbers directly involved in their supervision along with support such as analytics, actuarial and inspections, (ii) among the high-impact firms, non-life firms are, by their nature, more risk-sensitive compared with life firms which predominantly write unit-linked business, and (iii) high impact non-life firms are generally smaller than life and will benefit from a lower variable fee.

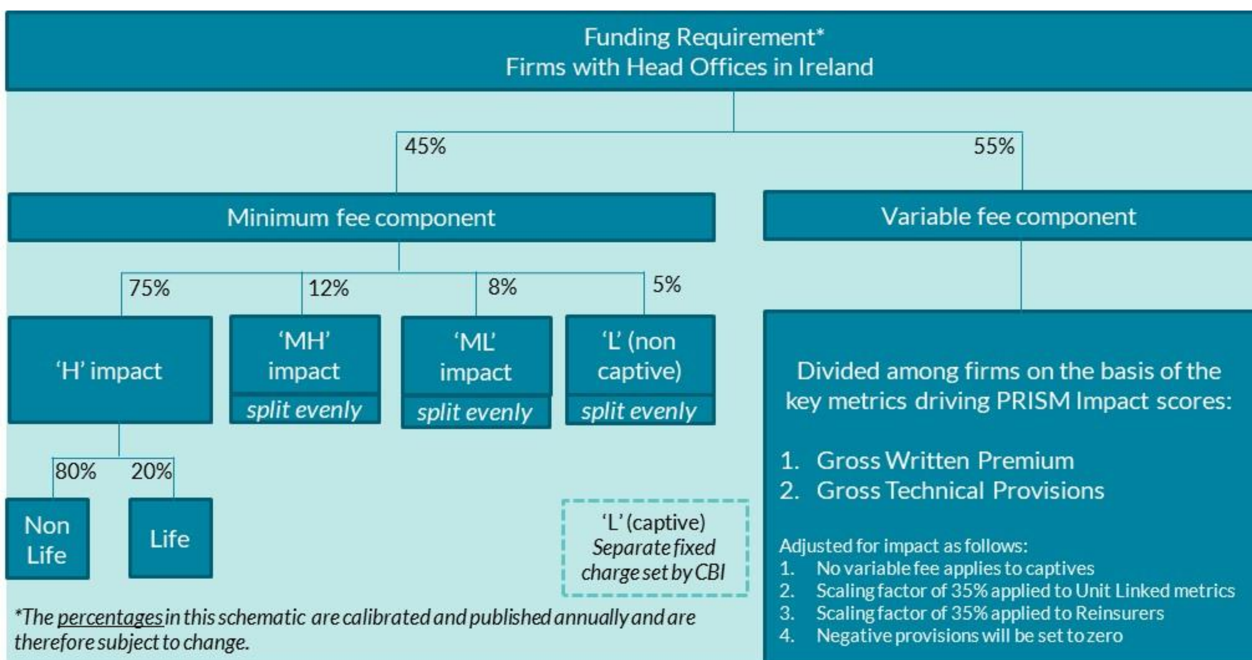
[4] If there are additional categories of firms authorised in the high-impact category (e.g. reinsurance), we will amend the split to include that additional category.

[5] These data are sourced from regulatory returns. GWP as reported in annual return S.05.01 rows R0110 R0120 R0130 R1410 columns C0200 and C0300. Gross TPs as reported in annual return SE.02.01.16 rows R0510 R0600 R0690 column C0010

- To reflect the relatively smaller impact ascribed to unit-linked business, the calculation of an aggregate GWP or TP figure will be on the basis of 35%[6] of any unit-linked GWP and unit-linked TPs, plus 100% of all non-unit-linked business.[7]
- To reflect the relatively smaller impact ascribed to reinsurers' business, the calculation of the variable component for reinsurers will be on the basis of 35% of aggregate GWP and TP figures.
- Where a firm reports a negative figure for technical provisions, this figure will be set to zero for the purposes of calculating the aggregate metric.

A summary of the overall approach is provided in Figure 1.

Figure 1 | Overview of the Approach



[6] Reinsurance firms and unit-linked life firms can appear to be disproportionately "large" in terms of their balance sheets or premium income, relative to the size of other types of insurers. Our approach aims to have the same levy methodology for all firms. The application of a generic methodology across heterogeneous groups of firms requires us to make some adjustments to ensure consistency. For this reason it is proposed that the variable fee applied to those types of firms will be discounted to 35%, and this discount aims to put these firms' GWP and unit-linked TPs metric on a par with the non-life and the non-unit-linked life firms. The choice of 35% has been informed by scenario analyses on the data.

[7] These data are sourced from regulatory returns. GWP as reported in annual return S.05.01 rows R1410 columns C0230 and Gross TPs as reported in annual return SE.02.01.16 rows R0690 column C0010.

Four examples of how this new methodology will work in practice are set out below[8].

In the illustrative examples, the minimum fee per impact category is as follows:

Table 2 | Sample Minimum Fees by Impact Category for Illustrative Examples

Impact Category	High/Ultra High Impact	Medium High Impact	Medium Low Impact	Low Impact (Non-Captive)	Low Impact Captive only
Minimum Fees	€1,289,044 (Non-Life) €375,971 (Life)	€78,464	€29,344	€18,799	€15,000

For the purposes of the following illustrative examples, the rate to be levied per €million of the aggregate metric of GWP + TP has been set by the Central Bank at €103.36 (per €million).

Figure 2 | Illustrative Examples

Example 1: High Impact Life Firm with Unit Linked Business

Example 1 High Impact Life Firm with Unit Linked business

	Online Returns			Scaling for Variable Levy			Rate per €m	Levy payable
	Total	*Components*		*35%*	*100%*	Leviable		
		U.L	*Other*	*U.L*	*Other*			
GWP €m	3,233	*2,795*	*438*	*978*	*438*	1,416		
TP €m	20,050	*17,373*	*2,677*	*6,081*	*2,677*	8,758		
Variable Levy Component:						**10,174**	x **€103.36** =	**€1,051,564**
Fixed Levy Component:								**€375,971**
Total Levy								**€1,427,535**

[8] Examples have been chosen to reflect the approximate average fee for this impact category of firms with a total levy to be raised of €35m.

Example 2: Medium High Impact Reinsurance Firm

Example 2
Mediun High Impact Reinsurance Firm

	Online Returns			Scaling for Variable Levy				Rate per €m		Levy payable
	Total	*Components*		*35%*	*100%*	Leviable				
		Reinsce	*Other*	*Reinsce*	*Other*					
GWP €m	2,485	*2,485*	*0*	*870*	*0*	870				
TP €m	5,008	*5,008*	*0*	*1,753*	*0*	1,753				
Variable Levy Component:						**2,623**	x	**€103.36**	=	**€271,067**
Fixed Levy Component:										**€78,464**
Total Levy										**€349,531**

Example 3: Low Impact Non-Life Firm

Example 3
Low Impact Non-Life Firm

	Online Returns			Scaling for Variable Levy				Rate per €m		Levy payable
	Total	*Components*		*35%*	*100%*	Leviable				
		U.L	*Other*	*U.L*	*Other*					
GWP €m	25	*0*	*25*	*0*	*25*	25				
TP €m	13	*0*	*13*	*0*	*13*	13				
Variable Levy Component:						**38**	x	**€103.36**	=	**€3,928**
Fixed Levy Component:										**€18,799**
Total Levy										**€22,727**

Example 4: Low Impact Captive Firm

Example 4
Low Impact Captive Firm

	Online Returns			Scaling for Variable Levy				Rate per €m		Levy payable
	Total	*Components*		*35%*	*100%*	Leviable				
		U.L	*Other*	*U.L*	*Other*					
GWP €m	30	*0*	*30*	*0*	*30*	30				
TP €m	19	*0*	*19*	*0*	*19*	19				
Variable Levy Component:						**49**	x	**€0.00**	=	**€0**
Fixed Levy Component:										**€15,000**
Total Levy										**€15,000**

4.2 Continuous Levying Methodology for Annual Supervisory Fees for EEA Insurers

In 2017, and following consultation (CP108), EEA insurers - writing Irish risks on either a branch or freedom of services basis - were no longer subject to a single low levy, irrespective of size and complexity. This approach was replaced with a differentiated approach reflecting that:

- A few EEA insurers are major participants in the Irish insurance market and require greater supervisory oversight.
- The cumulative losses in motor insurance and the concurrent failures of Setanta (Malta) and Enterprise Insurance (Gibraltar) have required an increase in the Central Bank's supervisory oversight on all insurers writing motor insurance business, including EEA insurers.

The approach implemented in 2017 was to differentiate three categories for levying purposes:

Category 1: Non-life insurers writing motor insurance in Ireland with more than €50m in Irish risk premiums and life insurers having written more than €100m Irish risk premiums, to be levied at one half the rate of medium high insurers.

Category 2: Non-life insurers writing motor insurance in Ireland with less than €50m in Irish risk premiums, to be levied at one-half the rate of medium low insurers.

Category 3: Insurers not belonging to category 1 or 2, to be levied at a minimum flat fee.

In summary, the continuous levying methodology will continue to be applied similarly to EEA insurers as was outlined in CP108. It is proposed to retain the categorisation of EEA insurers into Categories 1, 2 and 3. The levy will be calculated as follows:

- Category 1 branches will pay a levy amount equivalent to the "average" levy paid by all medium-high firms;
- Category 2 branches will pay a levy amount equivalent to the "average" levy paid by all medium-low firms, and
- Category 3 branches will pay a levy amount that will be determined annually and will be lower relative to Category 2.

By way of illustration of this approach, the 2018 levies for Category 1, 2 and 3 firms are €172,736, €34,339, and €15,144 respectively.

In addition, a scale of levies for Third Country Branches will be developed reflecting an amount of supervisory effort that lies between that for an EEA branch and a subsidiary

5. Consultation Questions

The Central Bank would like your views on the proposed methodology and if you do not agree with this approach please propose alternatives.

6. Consultation Process

The public consultation process will run from **23 January 2019 to 29 March 2019**. Any submissions after this date may not be considered.

The Central Bank intends to make submissions available on its website after the deadline for receiving submissions has passed. Therefore, please do not include commercially sensitive material in your submission, unless you consider it essential. If you do include such material, please highlight it clearly, so that reasonable steps may be taken to avoid publishing that material. This may involve publishing submissions with the sensitive material deleted and indicating the deletions.

Notwithstanding the above, the Central Bank makes no guarantee not to publish any information that you deem confidential. So be aware that, unless you identify any commercially sensitive information, you are making a submission on the basis that you consent to it being published in full.

Please clearly mark your submission 'New Levy Methodology for Insurers' and send it to:

Insurance Consultation 2018
Industry Funding
Central Bank of Ireland
PO Box 9708
Dublin 1

Or by e-mail to: levyconsultation@centralbank.ie

Please ensure to include contact details if you are responding by post.

E: levyconsultation@centralbank.ie
www.centralbank.ie

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