Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Feedback Statement – Consultation on New Levy Calculation Methodology for Insurers (CP129)

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1. Executive Summary

To address shortcomings in the current PRISM[1] based levy calculation methodology, CP129 (published in January 2019) proposed an alternative levy calculation methodology for (re)insurance undertakings. The Central Bank sought views on the proposed methodology and on suggested alternatives. Two responses were received.

Taking into account ongoing progress in relation to the Central Bank's internal review of the PRISM impact framework, a strategic aim to align levy methodologies with the PRISM impact framework where appropriate and responses received, the Central Bank has concluded that (re)insurance entities will remain on PRISM impact-derived pricing in the next levy cycle (i.e. no change) and will move to new methodologies as alternatives are developed.

2. Introduction

The Central Bank's ("the Central Bank") mission is to serve the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy. Our aspiration is for a trustworthy and resilient financial services system that sustainably serves the needs of the wider economy and its customers.

The Central Bank of Ireland's 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 the Central Bank Commission with the power to make regulations relating to the imposition of levies and fees on the financial services sector to recover of the cost of financial regulation.

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[1] PRISM (Probability Risk and Impact SysteM) is the name given to the framework the Central Bank has developed to apply risk based supervision.

CP129 was published on 23 January 2019 with a view to gathering stakeholder views on a potential alternative methodology for calculating the industry funding levy for insurance entities supervised by the Central Bank. Stakeholders were invited to provide observations and comments on the changes proposed by 29 March 2019. Two responses were received and this document sets out the Central Bank feedback to those responses.

3. Background to CP129 Proposal

The Central Bank's Strategic Plan 2019-2021 anticipates further limited growth in its resources to address matters such as 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 Central Bank'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 the pricing of (re)insurance levies specifically, the Central Bank currently applies a banded approach which mirrors PRISM impact categories to determine levies. The relevant band is derived from 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 used to derive an impact score. 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.

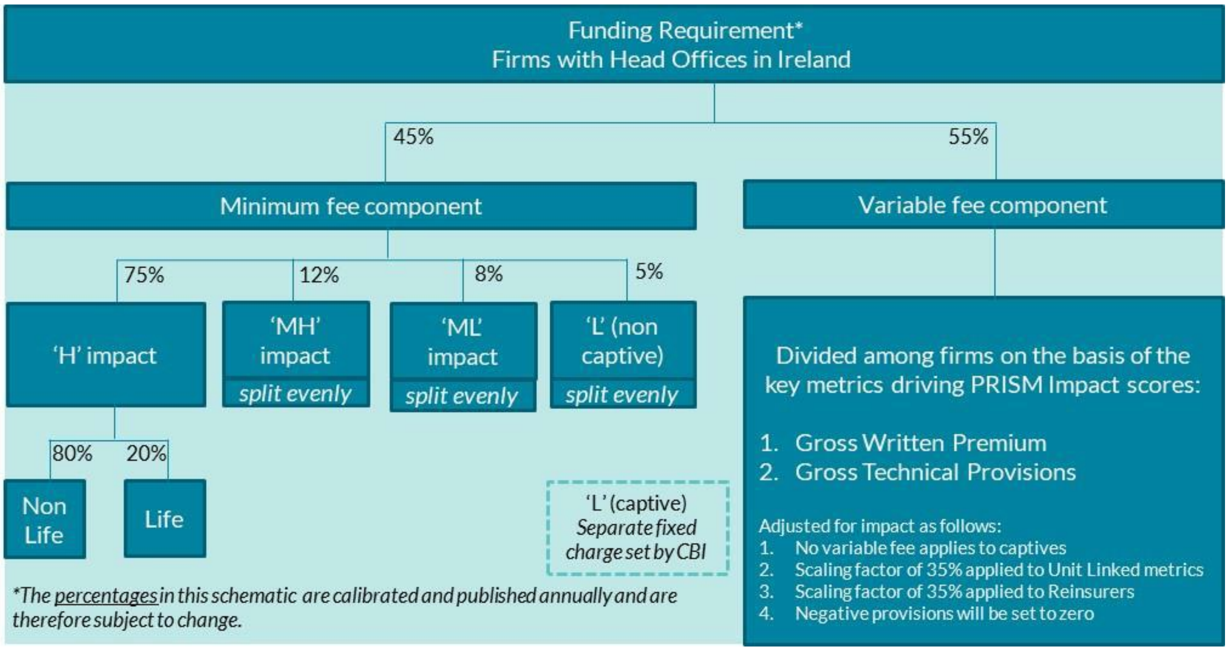
In order to eliminate the threshold effect inherent in this banded approach whereby firms that move impact categories experience a significant change in the amount of the levy to be paid, and to increase the transparency of the methodology behind the levies payable, while maintaining the principle that firms with higher potential impact should pay higher levies than firms with less potential impact, the Central Bank proposed, in CP129, a new levy calculation methodology. CP129 also referred to the fact that the Central Bank is currently carrying out a review of the PRISM impact framework with a view to updating the impact calculation methodology.

4. CP129 Proposal

CP129 proposed that a (re)insurance undertaking's annual industry funding levy comprise minimum and variable components. Under this proposal (see Figure 1 below) the amount to be recovered from the minimum fee would be determined based on a percentage of the overall amount to be raised from each impact category which would then be distributed across the rating categories before being split equally between them.

It was also proposed that the additional variable fee component payable by each entity would be determined on the basis of two key metrics for each firm. Specifically, a firm's variable levy would be determined by a measure of gross written premium and gross technical provisions, proxies for size and risk respectively. Adjustments would then be made to levies reflecting particular business models (e.g., captives, unit-linked business, reinsurance business) to reflect the relatively smaller impact ascribed to these categories of business).

Figure 1 | Overview of the Approach proposed in CP129



CP129 proposed that the continuous levying methodology for EEA insurers would continue as outlined in CP108 with EEA insurers being categorised into one of three categories based on whether or not they are engaged in motor insurance business and the level of Irish risk premiums. The amount of the levy payable by EEA insurers in each category would then be determined on the basis of the "average" levy paid by insurers in the relevant rating category.

5. Consultation Question

The Central Bank sought views on the proposed methodology and on suggested alternatives.

6. Summary of Responses Received

The summary below provides insights into two responses received which were in, many respects, similar.

Industry welcomed:

- The Central Bank's objective to achieve cost stabilisation;
- The aim of the proposed methodology to address 'cliff edge' levy structures which can act as a disincentive to growth; and
- The differentiation between unit-linked and other business models within the pricing proposal.

Industry, however, expressed reservations concerning the timing of the change in view of the Central Bank's ongoing review of PRISM impact frameworks and the potential for this work to result in further changes to levy methodologies. The feedback also raised observations about aspects of the methodology including (i) the emphasis on balance sheet size potentially at the expense of a more appropriate size / risk combination of factors and (ii) the basis for the cost apportionments in the decision tree underpinning the methodology.

Industry proposed:

- Retention of the existing methodology pending completion of the PRISM impact framework review so that its outcome can be considered in the context of changes to levy methodologies.
- A continuing focus on transparency and accountability as a means of addressing concerns about growth in regulatory costs including additional external oversight; and
- That budgets be set over 3-5 year horizon to help firms to plan.

7. Central Bank Response

The Central Bank acknowledges the constructive comments provided by Industry and is grateful to industry participants for their engagement in the CP.

Taking into account ongoing progress in relation to the Central Bank's internal review of the PRISM impact framework, a strategic aim to align levy methodologies with the PRISM impact framework where appropriate and views gathered as part of the Consultation Process, the Central Bank has concluded that insurance entities will remain on PRISM impact-derived pricing in the next levy cycle (i.e. no change) and will move to new methodologies as alternatives (likely to be based on the PRISM impact framework) are developed.

This position has been communicated in a Statement issued on 14 June 2019 in which the Central Bank advised that insurance entities, investment firms and fund service providers would remain on PRISM impact-derived pricing in the 2019 levy cycle but would move to new methodologies as alternatives are developed. It noted that the move to levying on an incurred cost basis is an important step in this continuous improvement and will result in invoices for 2019 issuing on an arrears basis in Quarter 3 2020 and referred to the recent publication of the 2018 Annual Performance Statement which provides details on the regulatory agenda and the related costs. The Central Bank will continue to enhance the transparency and predictability of the levy and will update industry bodies on timescales for changes to levy methodology as our work progresses. The message was repeated in letters issued to all regulated entities (including insurance firms) in July.

8. Next Steps

The Central Bank appreciates the engagement with stakeholders in relation to CP129 and, as noted above, will defer further consideration of a new levy calculation methodology for Insurers pending completion of the review of the PRISM framework.

On-going consideration will be given to the additional steps that can be taken to improve the transparency and predictability of the levy calculation process.

10 July 2019