Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Feedback Statement on Consultation Paper 150

Guidance for (Re)insurance Undertakings on Intragroup Transactions and Exposures

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Introduction

On 4 July 2022, the Central Bank of Ireland (the Central Bank) published Consultation Paper 150 (CP150) on Guidance for (Re)Insurance Undertakings on Intragroup Transactions and Exposures.

The consultation period for CP150 closed on 23 September 2022 and 5 responses were received. The responses received can be categorised as follows:

- Industry bodies 4
- Insurance undertakings 1

This paper summarises the responses received to CP150 and sets out the Central Bank's comments and the approach taken to reflect those responses in the finalised Guidance.

This feedback paper should be read in conjunction with CP150 as it refers to terms and numbering used in the consultation paper, which can be found on the Central Bank's website. All responses are available on our website at this link. A copy of CP150 is available for download at this link.

The Central Bank wishes to thank all parties who responded to CP150 for their contributions.

Financial Risks and Governance Policy Division,

Central Bank of Ireland

Issued 30 January 2023.

Feedback on issues raised in CP150

The respondents commented across a range of areas in CP150, which are addressed thematically below.

The Central Bank's expectations outlined in the Guidance are generally in relation to material intragroup transactions of exposures.

General Comments

Submission:

A number of respondents sought clarification on whether all intragroup arrangements were expected to be captured by the Guidance. Respondents also requested that certain terminology used throughout the Guidance in relation to intragroup arrangements, intragroup assets, intragroup loans, intragroup reinsurance and group cash pooling arrangements should be clarified and the same term consistently used.

Central Bank Response:

The Central Bank's expectations outlined in the Guidance are generally in relation to material intragroup transactions or exposures (IGTs). References to IGTs have been amended throughout the Guidance document to clarify this.

Terminology has been clarified throughout the Guidance document. Section 1 of the Guidance sets out expectations of the Central Bank in relation to the governance and risk management of IGTs in general. Section 2 focuses on the three most significant exposures observed by the Central Bank, namely Intragroup Assets (of which intragroup loans are an example); Intragroup Reinsurance and Cash Pooling/Group Treasury Arrangements.

Submission:

One respondent questioned whether it was appropriate for the Guidance to be applied to captives and undertakings in run off.

Central Bank Response:

Captives are subject to Solvency II requirements. The Central Bank's Guidance outlines a number of expectations in relation to the management of the risks posed by material IGTs. As such, captives are expected to consider this Guidance in terms of material IGTs.

This Guidance does not introduce new requirements on (re)insurers, rather it clarifies the Central Bank's expectations in relation to a (re)insurer's compliance with existing legislation and domestic requirements.

We note the comment in relation to (re)insurers in run-off. In this regard, it should be noted that such (re)insurers are still required to adhere to relevant Solvency II and other requirements that apply to them, and the Central Bank is required to continue to supervise these (re)insurers while they are in run-off. However, it does so and will continue to do so in a proportionate manner.

The Central Bank's Approach

Paragraph 1 of CP150 outlined the Central Bank's rationale for introducing this Guidance. As stated, many (re)insurers established in Ireland are part of large international (re)insurance groups and benefit from synergies and cost efficiencies that arise from being part of a group. However material IGTs may expose a (re)insurer to high levels of concentration and other risks. Therefore, the Central Bank believes that the management and supervision of material IGTs merits special attention.

Submission

A number of respondents welcomed the Central Bank's intention to give greater clarity on its expectations relating to Solvency II compliance but questioned whether the expectations amount to further requirements on (re)insurers in relation to IGTs. Most respondents welcomed the Central Bank's recognition of the benefits arising from being part of a larger group, including the financial support a group can provide and the cost efficiencies and synergies that can be achieved. However, respondents requested that the Central Bank be mindful that placing increased expectations on (re)insurers in relation to IGTs can undermine group diversification and financial strength, which in turn can also undermine the financial robustness of the local subsidiaries supervised by the Central Bank. One respondent commented that the current requirements under Solvency II already cover both external and intragroup transactions, and questioned why additional requirements are now being introduced on intragroup l transactions.

Central Bank Response:

These comments are noted. This Guidance does not represent additional requirements for (re)insurers in relation to IGTs. Rather, it sets out the Central Bank's expectations on how (re)insurers might comply with Solvency II requirements.

The Central Bank carried out a number of Thematic Reviews in 2020 and 2021, the findings of which were published in the June 2021 edition of the Insurance Quarterly Newsletter. It was found that that the majority of (re)insurers, even those with otherwise good risk management frameworks, do not consider the risk of transactions with related group entities to a sufficient degree. Having regard to the output and the findings of these thematic reviews, the Central Bank has published this Guidance in order to be fully transparent on what the expectations of the Central Bank are in relation to (re)insurers' management of material IGTs.

As set out in the Guidance, many (re)insurers established in Ireland are part of large international (re)insurance groups. Notwithstanding the many benefits from financial resources, diversification and pooling of risk, and other supports a group can provide, material IGTs may expose a (re)insurer to high levels of concentration and other risks.

As can be seen in the figures below, a high proportion of the reinsurance that is visible on the balance sheets of Irish (re)insurers is classified as intragroup.

Wording of paragraph 1 has been amended to clarify the Central Bank's rationale.

Figure 1: Reinsurance Recoverables from 2021 Annual QRT returns (S.31.01) for solo Irish regulated companies split by Intragroup & External reinsurer.

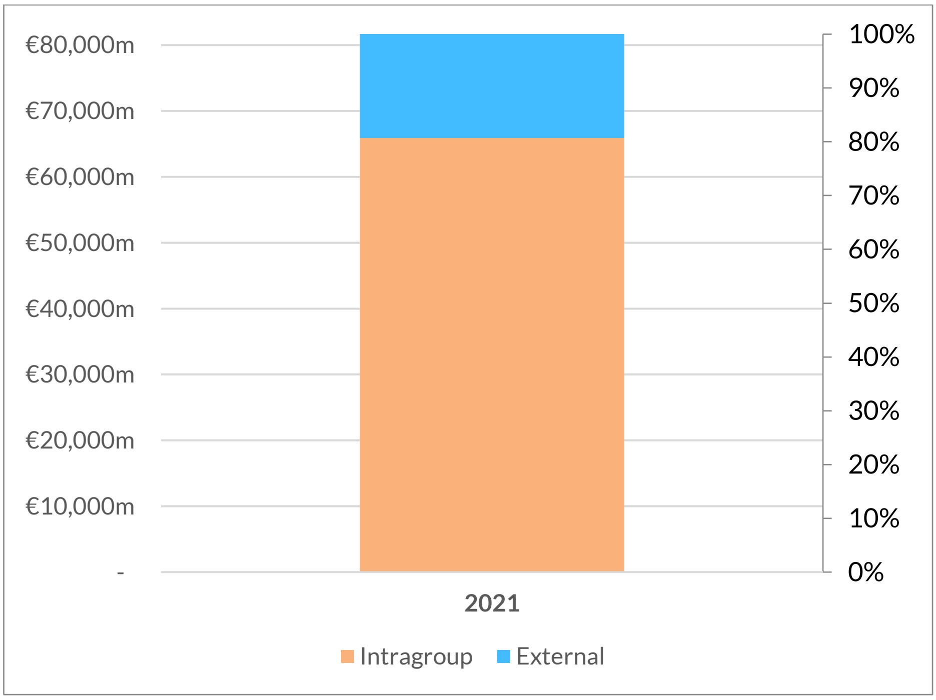


Figure 2: Aggregated Balance Sheet (S.02.01.02) from 2021 SFCR Repository for solo Irish regulated companies.

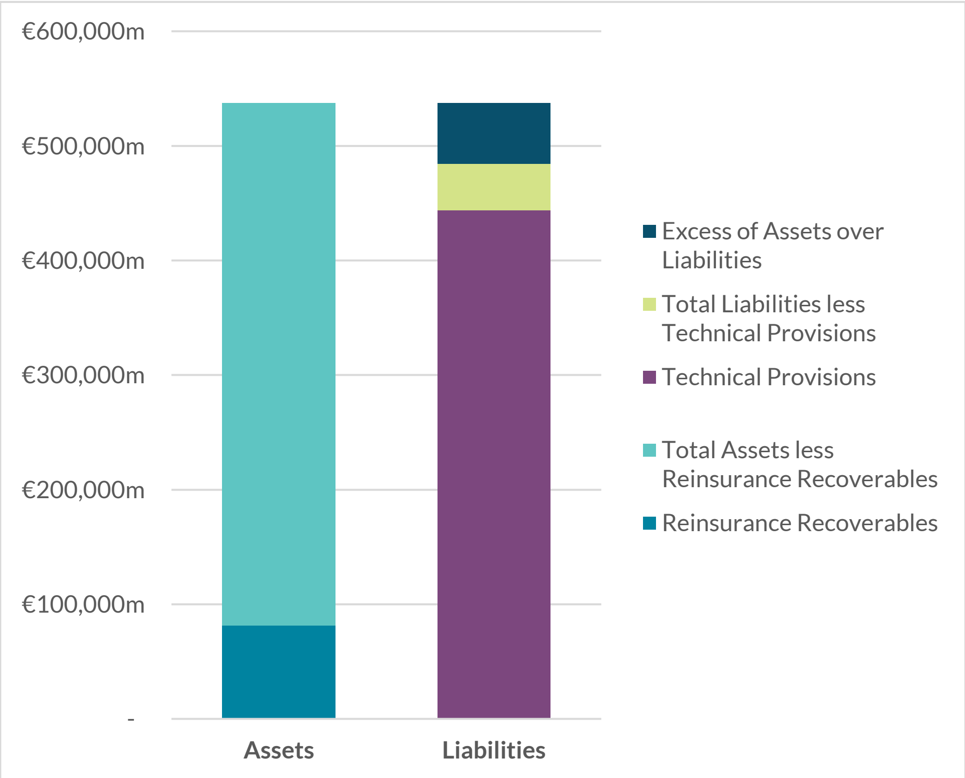
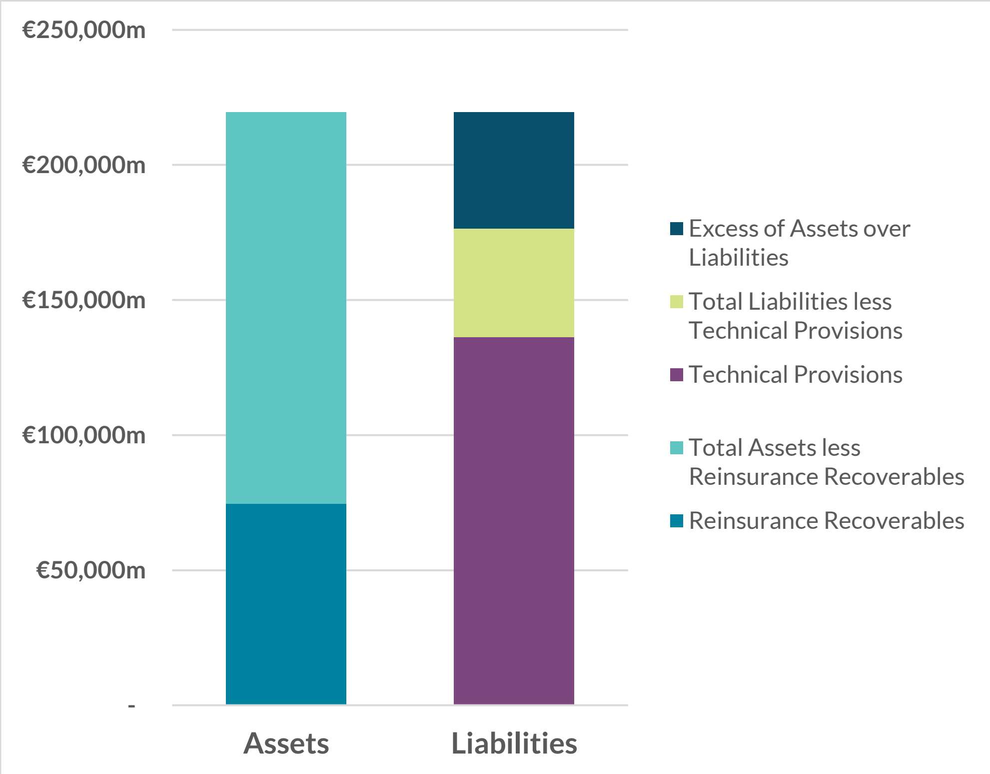


Figure 3: Aggregated Balance Sheet (S.02.01.02) from 2021 SFCR Repository for solo Irish regulated companies, excluding assets and liabilities for index and unit-linked contracts.



Submission

A number of respondents questioned the distinction made by the Central Bank between intragroup and external arrangements and questioned whether it was the intention of the Central Bank to discourage (re)insurers from entering into these types of intragroup arrangements.

Central Bank Response:

The Central Bank's main concern in preparing the Guidance is to ensure that IGTs are not subject to a lower standard of risk management and oversight than equivalent arrangements with non-group third parties. The board and management of Irish (re)insurers should not simply follow group expectations / instructions without full and appropriate consideration of their duties and obligations to the Irish-authorised undertaking.

The Guidance is not intended to discourage the practise of IGTs, rather where an IGT poses a material risk to a (re)insurer, the Central Bank has made clear its expectations in that regard. We have the same expectations in relation to transactions with external counterparts.

In line with the sentiment expressed re outsourcing requirements/guidance in the Central Bank's Cross-Industry Guidance on Outsourcing (which should be read in conjunction with this Guidance) IGTs, while potentially different to external arrangements, should not be treated as being less risky than external arrangements. While IGTs may allow for a more flexible selection or implementation process, they should not be viewed as requiring less care and oversight than external arrangements.

Submission

One respondent proposed a wording change to the last sentence of paragraph 1 to clarify the aim of the Guidance.

Central Bank Response:

This comment is noted and accepted. Wording amended in last sentence of paragraph 1.

As outlined in Paragraph 2, notwithstanding the Central Bank's participation in and contribution to group supervision, at the level of the group, the Central Bank believes that strong and robust oversight and monitoring of IGTs at the solo (re)insurer level is paramount in promoting good risk management, protecting policyholders and ensuring a sound financial position of the Irish (re)insurer.

Submission:

Most respondents sought clarity on how the Central Bank's Guidance will operate in relation to the overall group supervision requirements.

Central Bank Response:

The Guidance will apply to all (re)insurers authorised by the Central Bank. It is about a (re)insurer's understanding of the risks posed to it by the activities it engages in. Where an IGT poses a material risk to the (re)insurer, the Central Bank expects that the (re)insurer is aware of the risk and takes appropriate measures to mitigate against it. The Guidance sets out how the Central Bank expects (re)insurers to demonstrate this.

The Central Bank recognises that Solvency II establishes a rich and comprehensive framework for the regulation of (re)insurance groups, in addition to solo (re)insurers. As stated in the Guidance, the Central Bank participates in various Colleges of group supervisors and this Guidance does not seek to interfere with that process. Rather it seeks to clearly set out the Central Bank's expectations in relation to the risks posed by material IGTs and how the local undertaking is reacting to and managing these risks, which will in turn contribute to the Central Bank's overall effectiveness in Colleges.

Paragraphs 12 and 13 outlined that the Central Bank expects (re)insurers to consider the Guidance and adopt appropriate measures in a proportionate way. Where (re)insurers adopt practices different to those outlined in the Guidance, the Central Bank expects that (re)insurers will be able to demonstrate why this is appropriate.

Submission

A number of respondents welcomed the Central Bank's consideration of proportionality in developing the Guidance and sought clarification on how supervision of adherence to the Guidance will be carried out by the Central Bank.

Central Bank Response:

These comments are noted. (Re)insurers will be supervised in line with the PRISM engagement model.

Recovery and Resolution

Paragraph 3 outlined how IGTs can also affect the solvency and liquidity position of individual (re)insurers within a group, in addition to the group itself, and set out the Central Bank's expectations in relation to recovery and resolution.

Submission:

All respondents commented that the Central Bank's Guidance should be consistent with the upcoming Insurance Recovery and Resolution Directive (IRRD) and questioned the suggestion that a (re)insurer should be able to withstand a group failure. A number of respondents suggested that the Central Bank was introducing new requirements by expecting (re)insurers to establish a recovery plan at local level.

Central Bank Response:

The Central Bank acknowledges comments received on paragraph 3. The intention of this element of the Guidance was to outline that the Central Bank expects (re)insurers to have at least the operational and governance capacities in BAU to assist a Liquidator or Administrator who may be appointed by the High Court in carrying out their duties. In the absence of an existing resolution framework for (re)insurers in Ireland, the Central Bank has decided to remove this wording.

S.I.184 of 2021 (Recovery Plan Requirements for Insurers Regulations)[1] requires (re)insurers authorised by the Central Bank to establish a recovery plan. These Regulations are supported by the Recovery Planning Guidelines published by the Central Bank in 2021. The Central Bank expects (re)insurers to comply with the existing legislation and Guidelines. It is expected that domestic legislation will be updated as appropriate and necessary in line with IRRD, once implemented.

The Central Bank has amended the wording of this paragraph accordingly.

Governance and Risk Management

Submission

A number of respondents sought clarity on the Central Bank's expectation regarding the role of key functions in relation to the management of risk introduced by IGTs and the expectation that (re)insurers conduct regular audits of IGT risk management.

Central Bank Response:

These concerns are noted. It is the intention of the Central Bank that the Guidance is considered where an IGT poses a material risk to the (re)insurer and it is for undertakings to establish when that is the case. In those circumstances, the Central Bank expects (re)insurers to have clear roles and responsibilities for all key functions with regard to the identification and management of these risks. In relation to the internal audit function, it is not the intention of the Central Bank to prescribe audits of every IGT, rather that material IGTs are included in the universe of auditable topics.

The wording of paragraph 14 has been amended accordingly.

[1] Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Recovery Plan Requirements for Insurers) Regulations 2021

Submission

One respondent commented that risk registers are not explicitly mentioned or defined in the Corporate Governance Requirements for Insurance Undertakings 2015 and suggested this reference be removed in the final Guidance to avoid potential for misunderstanding or ambiguity.

Central Bank Response:

The comment is noted and accepted. 'Risk register' is not specifically referred to in the Corporate Governance Requirements. This reference has therefore been amended.

Paragraph 17 outlined the Central Bank's expectation that risk management policies should be established at the level of the (re)insurer, clearly setting out internal limits in line with the (re)insurer's risk appetite.

Submission

One respondent sought clarification on whether the management of liquidity and counterparty risks could be integrated with a (re)insurer's broader risk management policies.

Central Bank Response:

The comment is noted and accepted. Solvency II foresees the integration of policies, where appropriate. The wording has been clarified.

Intragroup Assets

Paragraph 21 outlined the Central Bank's expectation that (re)insurers formally document all intragroup loans and that a Board approval process should be in place with respect to the renewal of, or increase in, these types of arrangements and that all material intragroup loans are reviewed annually.

Submission

One respondent commented that the terms of (re)insurers' existing loans cannot, in most cases, be altered unilaterally after issue and requested that the Guidance recognise this.

Central Bank Response:

This comment is noted. It is important for the Board to be aware of situations where intragroup loans may not be compliant with a (re)insurer's own policies and procedures. An annual assessment is appropriate in these circumstances. The wording has been amended.

Paragraph 23 outlined the Central Bank's expectation in relation to the application of the Prudent Person Principle (PPP) to intragroup assets.

Submission

One respondent commented that the PPP should be applied proportionately.

Central Bank Response:

It is important to note that Requirement 141(2)(d), requiring that investments are made in the best interests of policyholders and beneficiaries, speaks to individual conflicts of interest, rather than referring to the portfolio as a whole. Proportionality is not viewed as being particularly relevant to the application of this requirement as every conflict of interest should be resolved in the best interest of policyholders.

Paragraph 26 outlined that (re)insurers should be in a position to demonstrate how they have classified own funds, in accordance with the criteria set out under Solvency II and consider whether the item is free from encumbrances (after taking intragroup assets into account).

Submission

One respondent requested more clarity on what is meant by 'the required criteria or features for classification of existing own funds into certain tiers are no longer met' when the intragroup assets are taken into account.

Central Bank Response:

The Central Bank notes the request for further clarity. We recommend that this Guidance is read in conjunction with EIOPA's Guidelines on the Classification of Own Funds, - including Guideline 13 thereof.

Intragroup Reinsurance

Paragraph 27 outlined the Central Bank's expectation for (re)insurers to consider reinsurance assets under the arm's length criteria and Prudent Person Principle (PPP).

Submission

We received feedback querying the application of the PPP to reinsurance assets.

Central Bank Response:

The Central Bank acknowledges the feedback received on the application of the PPP to reinsurance assets.

We note the different ways in which exposures to reinsurance counterparties can accrue and we acknowledge the comments submitted to that effect. The Central Bank notes that (re)insurers are required to invest their assets in the interest of policy holders and beneficiaries. In our view, it is a question of how reinsurance assets should be considered in the context of the PPP as opposed to whether the PPP should apply to reinsurance assets more generally.

We consider it appropriate that the PPP should be applied at the outset of making an investment decision (including creating or increasing asset exposure to a particular counterparty through a reinsurance arrangement).

When considering the PPP in relation to an investment decision, all other asset exposures (including any reinsurance counterparty exposures, however they may arise) should be taken into account. This is consistent with the wording of Solvency II which refers to the application of the PPP to the whole portfolio.

Paragraph 28 outlined the Central Bank's expectation for (re)insurers to be aware of the potential impact of adverse outcomes in relation to reinsurance exposures, and highlighted aspects which are not fully captured by the Standard Formula.

Submission

One respondent commented that there should not be a starting assumption that the Standard Formula is inappropriate.

Central Bank Response:

The Central Bank agrees that the Standard Formula has been calibrated on an overall basis, with the aim of offsetting limitations within certain modules and submodules. The Central Bank's expectation, as outlined in this section of the Guidance, is not in relation to the SCR, but in relation to the risk management system of the (re)insurer, which we would expect to include a detailed analysis of risks such as the potential downgrade of a material counterparty.

Paragraph 29 outlined the Central Bank's expectation that (re)insurers will include robust Group Counterparty Risk stress tests and reverse stress tests in their ORSA and pre-emptive recovery plans.

Submission

Respondents noted that a blanket expectation to test group failure in the ORSA is not proportionate and could undermine a (re)insurer's own assessment of key risks. One respondent requested that the expectation should take into account the reinsurer's/intragroup strength. Respondents requested that the Central Bank clarify that the purpose of such analysis is not to undermine group capital management.

Central Bank Response:

The Central Bank agrees that the expectation should be limited to material exposures to an intragroup counterparty. In line with the response to the general comments on proportionality, references have been amended to clarify that the expectations outlined are generally in relation to material IGTs.

The Central Bank does not agree that the performance of stresses should be conditional on intragroup strength. It is important for the Board to be aware of the potential outcome of a counterparty failure in order to make decisions on the appetite for such outcomes.

The Central Bank does not see an inconsistency between group capital management and a solo (re)insurer being aware of the extent of any exposure to Group Counterparty Risk.

Paragraph 30 outlined the Central Bank's expectation that (re)insurers robustly monitor and measure material risks arising from intragroup reinsurance arrangements, in order to offset any limitations of the Standard Formula when compared to the actual risk profile.

Submission

Respondents highlighted a conflict between the use of "and" in paragraph 29 and "or" in paragraph 30.

Central Bank Response:

This comment is noted. Wording clarified by deleting first sentence of paragraph 30.

Paragraph 31 outlined the Central Bank's expectation that risk appetite statements in relation to intragroup assets and the board's consideration of same in the overall appropriateness of a (re)insurer's reinsurance strategy, and the level of cover provided by the (re)insurer, are adequate.

Submission

One respondent commented that the Central Bank's expectation to have quantitative metrics is not proportionate. A number of respondents questioned the Central Bank's reference to EIOPA's Opinion on the use of risk mitigation techniques by insurance undertakings.

Central Bank Response:

This comment is noted and accepted. The wording has been amended to reflect a more proportionate approach and to clarify the reference to the EIOPA Opinion.

Paragraph 32 outlined the Central Bank's expectation that intragroup reinsurance arrangements are reviewed and approved by the board prior to the arrangement coming into force.

Submission

A number of respondents requested that the Central Bank apply proportionality with respect to approving intragroup reinsurance arrangements.

Central Bank Response:

This comment is noted and accepted. The Central Bank has clarified its expectation that all material intragroup reinsurance arrangements should be approved by the board prior to the arrangement coming into force.

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