by email: risk@centralbank.ie

Ref: MK/CW 24th February 2011

Ms Helen Guinane,
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Dear Helen,

Impact Metrics Consultation Paper – Views of Irish Insurance Federation

Thank you for inviting us to comment on the Consultation Paper on Impact Metrics for the Risk-Based Supervision of Financial Firms by the Central Bank and on Impact Based Levies, and for the meeting we had on 20th January which helped us to identify and consider the issues.

As an initial general comment, we would say that we support the objective of the approach set out in the Consultation Paper. It seems clear that impact measurement and categorisation will help the Bank to improve the allocation of supervisory resources, and in the longer term to facilitate alignment of regulatory levies with resources expended.

We do feel that the task of developing an accurate measurement system which has relevance across all of the subcategories of firm regulated by the firm should not be underestimated. In particular, it seems that it will be difficult to:

a) distinguish the measurement of impact as defined in Section 2.2 of the Paper from risk factors, which obviously also need to be measured, monitored and controlled in a parallel process;

b) find a basis for comparison of firms in different sub-sectors, given the likelihood that different metrics will be adopted in the various sub-categories and the difficulty of comparison across such a wide range of activities, and the differing sizes and prudential importance of the regulated firms concerned; and

c) cater, within the metrics adopted for insurance companies, for the position of companies which may be relatively small in overall terms but have an important position in a particular class or sub-class of business with potential consequences out of proportion to the overall size of the enterprise in the event of failure. (Similar considerations arise in the case of a small to medium-sized undertaking with a dominant or market leading position in the provision of insurance covers across a range of classes to a particular sector of sub-sector of the economy).

Specific Comments

2.3 The example quoted in relation to a firm authorised to hold client money seems to us to go more to the assessment of risk than impact rating.

2.3.1 We would suggest that prudential and systemic impacts are treated separately. With particular regard to insurance companies, we are firmly of the view that every insurer, whatever its size, presents no or a very limited systemic impact risk. The insurance sector is an absorber rather than a creator or source of systemic risk. However the question of prudential impact needs to be assessed differently. Clearly the failure of a major insurer can have significant systemic damage.

As an aside, "failure" is used throughout the document as an absolute term. Regard must be had to the overwhelming likelihood that an insurance "failure" will not be a total failure of the entity. Thus the metrics used need to take account of the likelihood of varying **degrees** of failure, as this will impact on:

a) the level of recourse to any relevant compensation fund or guarantee scheme;
b) the chances of rescue and the firm's ability to "trade out" of short-term difficulties;
c) the value of the firm if a trade sale is viable after a partial failure; and
d) the ability or inability of the firm to continue to trade (presumably under administration) pending a sale or winding-up, and therefore the impact on the ability of the remainder of the market to absorb any "orphan" business.

In the definition of probability in figure 2.2, therefore, further elaboration of what constitutes "material" compliance or business failure may be required.
And in figure 2.3 the impact will vary in proportion to the scale of the failure.

3.1 Whilst appreciating that the use of divisors has been pioneered elsewhere and that such experience, while developing, may be of assistance in implementing a system in Ireland, the choice of the (very large) divisors envisaged in the examples will be crucial in the ranking of firms from different sub-sectors. It will therefore be important to set a firm basis for the calculation of the divisors and, it is suggested, to commit to early and regular review of the divisors, as well as of the actual metrics used in each sub-category, as the system evolves. It is difficult to comment on the various options for calculating the overall impact score in the absence of further data and experience. Clearly a simple or weighted average would be relatively easy to apply, but the adequacy of the final result will depend on the metrics themselves, the weighting (if a weighted average is used), and the basis for the divisors used. However, use of a weighted average would appear to be the most appropriate initial approach to the problem.

In relation to question 2, we suggest that it is only possible in applying mathematical processes to calibrate impact scores to work from previous experience in relation to actual failures, in the Irish market and elsewhere, and to apply any useful lessons learnt from the experience of other jurisdictions who have applied this approach in the past. Again, it is impossible to comment on whether the categorisation of impact scores outlined in figure 3.3 is appropriate in the absence of further experience.

4.1 Assuming that the impact-based models are appropriately calibrated, it would be appropriate to use them as part of the Central Bank's programme of risk-based supervision. This is however a considerable assumption, and the incremental development and review processes suggested above should be built into any longer term plans for the integration of impact-based models in the approach to risk-based supervision.

Whilst it is agreed that the risk of a serious prudential or consumer-related event is largely uncorrelated with the size of a firm, it is not necessarily the case that the occurrence of such an event at a larger firm would have a more material impact on the broader market or economy, or on consumers. An event of a given size may be easier to absorb at a large firm than at a smaller one. Correlation of impact merely with size could be fallacious. Reference in the Executive Summary to impact as a proxy for "importance" of regulated firms is relevant here. It is suggested that the ***importance of the impact of an event*** rather than purely the scale of the firm affected should be the key consideration.

4.2 Whilst it would seem appropriate, in the context of the impact levels associated with the suggested four categories (low, medium-low, medium-high and high) for there to be about 20 or so firms or groups in the high category, and it is to be expected that there would be a close alignment between that category and the list of firms already designated as "major institutions" for corporate governance purposes, we do not believe that the lists should necessarily be identical. As already pointed out, the systemic risk attaching to a major insurer, if any, is very small in comparison to systemic risk associated with a major bank. Overall, we should be concerned here with the impact on the market and wider economy rather than on the firm itself. As noted in Section 4.5, whilst insurance companies would typically not have systemic characteristics due to the structure of their balance sheet (and their business model), some insurance companies are likely to be in the high impact category. This merely outlines the point that categorisation should not be correlated solely with systemic risk.

5 In response to question 3, we agree that the intention to use impact metrics as a major determinant of levies payable by regulated firms is appropriate, and we consider that it should be phased in (irrespective of impact on current balance of net annual funding requirement between categories). However this answer is dependent on the elaboration of an equitable impact metrics system, using the appropriate factors, divisors etc. for comparison purposes between sub-categories, and will require the regular review and updating already referred to.

6. We agree that the Central Bank should share a firm's impact rating with the firm but should not publish the firm's impact score more widely.

With regard to the potential impact metrics listed for insurance undertakings (category B) at pages 18/19 of the consultation document, we suggest that the following are the most relevant:

Life Assurers (categories B1, B2 and B3):

- capital requirements;
- gross level of reserves;
- premium income by business line;
- share of market;
- total assets;
- total liabilities.

Non-Life Insurers (categories B4, B5 and B6):

- capital requirements;
- gross assets;
- gross liabilities;
- gross/net technical provisions;
- gross/net written premiums;
- share of market (both as a whole and by major class of business).

With regard to insurance intermediaries (category C), turnover and number of customers would appear to be the most appropriate metrics. On the basis that a wide range of agency appointments provides greater flexibility, we would suggest that the number of appointments (other than as an inverse factor) would not be appropriate.

In the case of approved professional bodies (category H), only a single potential measurement is given (number of members conducting financial services business). We would suggest that consideration be given to additional measures of importance, such as:

- the aggregate value of business controlled by members conducting financial services business;
- the nature of the professional body (statutory, voluntary etc.);
- the extent of the body's activities (regulatory, representative etc.); and
- the funding model and overall size of the professional body itself (not-for-profit or profit-making; sources of funds; size of balance sheet; staff numbers…..).

In response in particular to question 10, as it applies to the possible subdivision of insurers within category B, there is certainly a case for consideration of separate metrics for life and non-life insurers, for domestic and international insurers, for captive insurers and reinsurers; and for inclusion of metrics which take account a firm's mix of business across major business lines and/or market shares in each of the major business lines.

I hope these observations are of help to you in developing your proposals. If there is anything else we can do to assist, please contact me.

Yours sincerely,

MICHAEL KEMP
Chief Executive