



Consultation Paper 73

Insurance Ireland Response to Consultation on Requirements for Reserving and Pricing for Non-Life Insurers and Reinsurers (CP73)

Overview

Our members are supportive of the principles underlying the requirements in the Consultation Paper. These principles involve the strengthening of the reserving process in companies so as to provide assurance that companies are maintaining appropriate reserves.

However, we believe that Consultation Paper 73, if implemented, will cause uncertainty for insurance companies in general, including those who are assessing whether to establish in Ireland or whether to remain in Ireland. The prime source of uncertainty will relate to the interaction of the final requirements with the Solvency II rules for which companies have already been preparing and in relation to which they have incurred considerable expense. This Consultation Paper was drafted at a time when there was uncertainty around the final implementation date of the Solvency II regulations. Since the publication of this Consultation Paper the implementation date for Solvency II has become more certain at 1st January 2016. We believe that it is now appropriate that the final requirements be altered to be consistent with the requirements of Solvency II.

The Consultation Paper covers the following main requirements:

- Governance requirements
- Data requirements
- Requirements for the Signing Actuary in completing their Statement of Actuarial Opinion and Signing Actuary Report
- Requirements for Internal Audit
- Requirements for regular Peer Review of reserves

We believe that the governance requirements relating to a company Board's responsibility as set out in the Consultation Paper are already addressed appropriately in the Central Bank of Ireland Guidelines on Preparing for Solvency II and the Central Bank of Ireland Corporate Governance Code. The Guidelines on Preparing for Solvency II are consistent with the European approach to governance requirements. As a result we believe that the governance requirements relating to the involvement of the Board should be removed from the final requirements.

We believe that the pricing requirements should be removed entirely from the final requirements. The above mentioned Guidelines on Preparing for Solvency II have more detail on pricing governance.

We agree that companies should be required to have in place appropriate procedures to ensure that the data used in the calculation of claims reserves is complete, accurate and appropriate. We agree that the Board has responsibility for ensuring that these procedures are in place. We believe that the Board should be able to delegate the reviewing of data submitted to the Signing Actuary to the appropriate Pre-Approval Controlled Function(PCF) role holders within the company.

We agree with a lot of the detail in the Consultation Paper relating to actuarial requirements when conducting reserve reviews. However, we disagree with some aspects that are in conflict with Solvency II requirements and request that the final requirements are changed to be consistent with Solvency II. In the event that these changes are not made we would like clarity on the transition from this Consultation Paper to the Solvency II Pillar 1 requirements due to come into force on 1st January 2016.

We would be happy to meet with the Bank to discuss our submission in more detail.

Summary of the more significant proposed developments

i. Governance Requirements

There are a number of areas within the Consultation Paper which would, if implemented, require the Board to take an active role in the work performed by the first line of defence. We believe that this governance approach is not consistent with the Solvency II approach of the Board being responsible for the three lines of defence within the organisation and the Board itself in effect acting as a fourth line of defence.

The following proposals in particular, if implemented, would place either the entire Board or particular Board members into the first line of defence:

- Paragraph 23 of the Consultation Paper suggests that the Board (or Reserving Committee for High Impact companies) review the data submitted to the Signing Actuary. We believe that the Board has responsibility to have processes in place within the company to review the data submitted to the Signing Actuary. However we do not believe that the Board itself should be actively reviewing data as part of its role.
- We agree with the proposal in Paragraph 47 requiring that High Impact companies establish a Reserving Committee. However we do not agree with the requirement that this Committee include at least one Independent Non-Executive Director. This would firmly place that Director in the first line of defence and would compromise that Director's ability to perform their independent duties at Board level.

We believe that the governance requirements set out in the Consultation Paper are already addressed within the Central Bank of Ireland Guidelines on Preparing for Solvency II. The Guidelines on Preparing for Solvency II are consistent with the European approach to governance requirements.

ii. Signing Actuary

We welcome the requirement for companies to have a Signing Actuary. However we disagree with the requirement for the Signing Actuary of High Impact companies to be an employee of the company. A Signing Actuary external to the company brings a high level of external independence. In addition, in many cases an external Signing Actuary brings a high level of knowledge about developments within the claims environment.

The Consultation Paper implies that the roles of the Signing Actuary and the Chief Actuary can be performed by the same individual. We ask that this be confirmed in the final Requirements.

The Consultation Paper defines the Chief Actuary as the individual who is seen as having the prime source of expertise in actuarial matters and is very likely to be relied upon by senior management and the Board of Directors. In addition the Chief Actuary is a PCF. It is not clear from the Consultation Paper how the role of the Signing Actuary is proposed to relate to the role of the Chief Actuary.

We believe that the proposal to designate the Signing Actuary role as a PCF will not add any additional safeguard to the current Signing Actuary regime. This current regime provides valuable oversight and control for the level of reserves being held. The Signing Actuary currently must hold a practising certificate from the Society of Actuaries. The Chief Actuary role is already designated as a PCF role. As a result both the Society of Actuaries and Central Bank currently approve a Board's choice of individuals to provide actuarial input on the level of reserves.

iii. Harmonisation

The Solvency II EU Directive 2009 was written as an instrument for the achievement of an internal insurance market within the EU. This directive specifically refers to harmonisation of regulation within the EU. In particular the directive states that "Harmonisation should be increased by providing specific rules for the valuation of assets and liabilities, including technical provisions". We believe that the Consultation Paper is not consistent with harmonisation of regulation across the EU. As an example, the explicit provision of a Risk Margin within the technical provisions will effectively lead to a more stringent capital environment in Ireland than in other European countries.

iv. Risk Margin

The Consultation Paper introduces the concept of the Risk Margin. This section includes text that is covered by other requirements. For example the following text could be removed:

- Point 27 outlines that the Board should consider the Reserving Policy and Risk Appetite statement when considering the Risk Margin to hold. These policies and statements are established by the Board and are central to decision-making within organisations. It is not necessary to re-make this point in this Consultation Paper.
- Point 27 states that accounting requirements must be satisfied for the financial statements to present a true and fair view. Again this is a necessary condition of producing and signing off financial statements and not necessary in this Consultation Paper.

We believe that Boards have a wide range of issues to consider when setting the Risk Margin to hold in excess of Best Estimate. Every company writes different types of business with a different risk profile. We believe the Risk Margin should not be prescriptive in such a way that inhibits Boards from establishing a Risk Margin appropriate to their particular business.

The Risk Margin in the Consultation Paper is a different concept to the Solvency II Risk Margin. Solvency II defines the Risk Margin as part of the Best Estimate reserves. The principle under Solvency II is that the Best Estimate is calculated to reflect the fair value of the technical provisions. This is achieved by assessing the mean of the range of possible outcomes (including discounting reserves) and adding a Risk Margin to that mean to reflect the capital cost of holding the technical provisions.

The Risk Margin proposed in the Consultation Paper is a precautionary margin in excess of the Best Estimate reserves. This concept of holding a precautionary margin in excess of Best Estimate reserves will not exist under the Solvency II Pillar 1 rules. In the Solvency II environment the Risk Margin (as defined in the Consultation Paper) will be replaced by the need for the company to hold sufficient capital to cover a 1:200 year event.

Again, we would request that the final requirements are changed to be consistent with Solvency II. In the event that these changes are not made we would recommend that the terminology for the Risk Margin in the Consultation Paper be changed to avoid confusion with Solvency II and that clarity is provided on how the requirements in the Consultation Paper will transition to the Solvency II requirements.

v. Best Estimate of Claims Liabilities

We agree with the definition of the Best Estimate in the Consultation Paper as the mean of the range of possible outcomes. However we disagree with the prescription that the Best Estimate specifically excludes a number of potential developments as follows:

- Not include new types of claims that are not reflected in historical company or available market data. This would limit newer companies with limited historic data from estimating the true mean of the range of possible outcomes. This is contradictory to Solvency II principles which require that once-off Binary Events be included as part of the Best Estimate.
- Not include an allowance for possible but unpublished legislation. We believe that this could lead to Best Estimate reserves that are lower than the mean of possible outcomes. An example of this is where the Government has flagged its intention to publish legislation that would lead to claims inflation. The likely claims inflation in this example would not, under Consultation Paper requirements, be included in the Best Estimate reserve.
- The requirement to include an allowance for recently enacted legislation and operational changes that are not yet reflected in historical data could in certain circumstances contradict the requirement to not include new types or classes of claims that are not reflected in historical company or available market data.

vi. Peer Review

We believe that there will be capacity issues in finding suitable qualified and experienced Reviewing Actuaries due to the proposed timing and independence restrictions. We suggest that companies be given greater flexibility with regard to the timing of the review, selection of Reviewing Actuary and form of the review.

We believe that there is merit in allowing the Peer Review to be performed on third quarter data to allow the Board and management more time to consider the findings. It may also be beneficial to allow companies perform more frequent partial Peer Reviews while still ensuring that 100% of the business is reviewed over a two year period for High Impact companies or a three year period for Medium Impact companies.

We believe the independence of the Reviewing Actuary is essential. However, rather than specify independence requirements, we believe that the Board should be required to demonstrate the Reviewing Actuary's independence in addition to having demonstrated that they have "the requisite skills, qualifications and experience appropriate to the role". In particular this may allow actuaries from within the same Group to perform Peer Reviews provided they are able to demonstrate independence.

The requirement for Reviewing Actuaries of High and Medium Impact companies to both calculate an independent Best Estimate and perform a Peer Review of the Signing Actuary's work adds little value. We believe that companies and Reviewing Actuaries should be given flexibility in selecting the form of the review (i.e. independent calculation or Peer Review of Signing Actuary's calculation) that is most appropriate to the class of business under review. In some circumstances this may require a blend of the two approaches, with some of the company's reserves reviewed by means of an independent calculation and for others a review of methodologies and assumptions of the Signing Actuary.

The choice of the form of review selected should rest with the Board.

vii. Statement of Actuarial Opinion – Applying for Exemption

We believe that there are circumstances in which a company should be able to request an exemption from the requirement to produce a Statement of Actuarial Opinion. We agree with the Consultation Paper that criteria should be considered, for example, to apply to companies which are in run-off, or which have transferred their liabilities immediately following the financial year-end.

viii. Data

The scope of the data checks and the level of granularity required is not clear from the draft paper. It should be noted that the Signing Actuary can rely on other experts within the Company such as the Head of Claims for accuracy of case estimates and of payment data. Another area where reliance should be placed is on IT checks on system produced data.

In the case of reinsurers we believe that the final requirements should take into account the difference in relationships between a cedant and a reinsurer when compared to a policyholder and a direct insurer. A reinsurer places significant reliance on their cedants for case estimates and exercises claims audits at the reinsurer's discretion. In addition cedants are not bound by specific timeframes when updating reinsurers on case estimates. Also in the case of some types of business there may be little or no information available on case estimates (proportional reinsurance).

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