DIMA

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Funding the Cost of Financial Regulation – Financial Consultation
Financial Services Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

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Dear Sir/Madam

DIMA is the industry representative body for the international re/insurance industry operating on a cross-border basis from Ireland. The majority of our members are engaged in non-life insurance, life reinsurance and non-life reinsurance, including captive insurance and reinsurance subsidiaries of international non-insurance corporates. Our 57 members transact re/insurance with counterparties across the world, and Ireland is recognised as a leading global centre for this type of business, representing the broadest range of re/insurance activity in any jurisdiction. The majority of the more than 150 companies which fall into the DIMA constituency represent a low or medium-low systemic risk to Ireland, as defined by the Central Bank of Ireland through its PRISM rating system of regulation.

The paper "Reinsurance in Ireland: Development and Issues", published by the Central Bank of Ireland in 2014 identified that reinsurers based in Ireland identified that the gross value add (GVA) to the Irish economy by the re/insurance sector in 2011 amounted to €2.5bn, with a higher GVA per employee from reinsurers than other sectors measured.[1]

Ireland's success in attracting international re/insurance business has been built on a number of factors, not least the competitiveness of the jurisdiction. Over recent years, that competitiveness has been eroded as costs have increased at a higher rate than in other centres, reflecting, *inter alia*, the increased complexity of the Irish regulatory system. All European Union countries are currently in the process of implementing Solvency II, a maximum harmonisation directive which starts on 1st January 2016 and brings a new degree of sophistication into the regulation of the re/insurance industry by implementing a regime which will consider all risks within a regulated entity to define the solvency levels required.

Ireland has been at the forefront of developing aspects of this regime through local initiatives such as the corporate governance code, fitness and probity regime, reporting requirements, and actuarial regime. Some of these local requirements are over and above the requirements of Solvency II, which is designed as a maximum harmonisation directive. This has been a progressive implementation over several years, requiring continuous changes in resources and structures, a feature which is unlikely to change for several years. Analysis undertaken by DIMA

[1] http://www.centralbank.ie/publications/Documents/Reinsurance%20in%20Ireland%20Development%20and%20Issues.pdf

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member companies indicate that the minimum spend for the smallest companies in the membership relating to implementing the new regulatory regime is €50,000. Estimates from the UK regulator put the cost of Solvency II implementation at £3 billion. These are not discretionary spends, and any increase above and beyond them will impact policyholders detrimentally.

Although Solvency II starts officially at the beginning of 2016, its implementation will continue beyond its commencement into forthcoming years, and as such the development of the new regulatory regime will be ongoing, requiring regulated entities to persistently implement change far beyond the formal start date. As supervisors and industry alike better comprehend the practical implications of the new regime, consequent impacts requiring adapting and changing of systems, processes and structures will become clear. Thus the industry in Ireland, across Europe and ultimately at a global level, is in a state of regulatory flux at this point in time, and it is in this context that the following answers are given to the questions raised in the consultation paper.

The following comments represent the views of the DIMA membership, and therefore are representative of international re/insurers in Ireland, which are predominantly engaged in business-to-business activities. They do not pertain to the perspective of Ireland's domestic insurance industry, and have little involvement with the Irish consumer market.

Question 1: Any change from the current funding arrangement would have to have due regard for the competitiveness of the industry. Do you consider that there are any particular competitiveness issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues, their quantification and suggestions on how they may be addressed.

The progressive changes highlighted previously, both at the local level through new regulatory requirements implemented locally by the Central Bank of Ireland in recent years (such as the corporate governance code, actuarial functions and reserving requirements) and across the European industry with the introduction of Solvency II have already placed a heavy burden on the re/insurance industry in Ireland, somewhat in excess of that imposed in other European Member States. This has presented substantial challenges and demands on the international re/insurance community in Ireland, and these factors have been highlighted by other jurisdictions to their competitive advantage.

As a result of the progressive changes, Ireland's cost base has become disproportionately higher than in other jurisdictions. By way of comparison, the annual supervisory fee for a reinsurance entity in Luxembourg ranges from €5,000 to €17,500; in Ireland, the lowest fee level last year was €7,485, with the top of the range much higher than in Luxembourg. Furthermore this is expected to increase substantially for 2015 fees, seriously widening the gap in competitiveness. This has obvious and highly significant detrimental impacts on Ireland's competitiveness, which has also been impacted on the other side of the regulatory relationship as companies have been required to increase their regulation and compliance functions, systems and personnel, resulting in increased internal costs to comply with the requirements. As highlighted earlier in this document, some of these requirements are in excess of those demanded in other European Member States.

The consultation paper on funding the cost of financial regulation has referred to three jurisdictions for comparing the mechanisms used to pay for regulatory costs – Luxembourg, UK and Australia. It has not, however, provided any benchmark on the level of fees in those jurisdictions, nor any commentary on what is deemed to be financial regulatory activity for funding purposes. The previous paragraph illustrates the discrepancy between the fee levels in Luxembourg (which is a fully funded model) and those currently in place in Ireland (which operates a subvention model). This is a particularly important aspect for Ireland, where the Central Bank of Ireland provides both central bank and financial regulatory functions. Any change to the regulatory fee model will need to properly ring fence central bank and regulatory functions, to ensure that the regulated financial services industry is in no way subsidising the central bank activities.[2]

Equally important is that the regulated entities will not in future be required to subsidise public service decisions, existing commitment or political agreements which are beyond their control. Examples of these include but are not limited to:

- arrangements made under the Haddington Road agreement, "Public Service Stability Agreement 2013 – 2016" which expires next year with the likely impact of increasing costs;
- amendments to the regulatory demands on parts of the re/insurance sector and the structure of the Central Bank of Ireland's insurance directorate in response to the International Monetary Fund's "Report on Observance of Standards and Codes (ROSC)" of May 2015, including pay scales and levels of staffing;
- aspects of the Central Bank of Ireland's operations such as the Defined Benefit pension scheme, responsibility for which should not be placed wholly on the financial services industry (the regulatory fees for the majority of DIMA members are likely to increase by more than 50% for 2015 compared to 2014 because of Financial Reporting Standards, which require recognition of the pension funding requirements, requiring a significant increased contribution to this scheme);
- activities such as data gathering required by external agencies such as the ECB;
- the cost of the Central Bank of Ireland's development of and move to its new headquarters;
- the Central Bank of Ireland's provision of economic advice and financial statistics;
- the Central Bank of Ireland's activities with respect to payment and settlement systems, and currency services; and
- the Central Bank of Ireland's new strategic plan, currently being concluded.

In order for a fully funded model to operate effectively from a competitiveness perspective, it needs to ensure that only activities directly relevant to financial services regulation are charged to industry. The cost of these activities should be benchmarked against those in other

[2] As a side note, the Irish non-financial regulatory authorities cited in the consultation paper have very different legislative and regulatory responsibilities, and therefore are not suitable for comparison with the Central Bank of Ireland's financial regulatory activities for the purposes of this consultation.

jurisdictions which are similar in terms of the types of entities they regulate. It is also important that a range of jurisdictions, both European and further afield, are used for benchmarking purposes. From the DIMA membership's perspective, such jurisdictions include Luxembourg, Bermuda, Malta, and the UK, and the benchmarking should specifically identify the type of operation as well as general fee levels for insurance entities, reflecting the structure and systemic impact of the regulated entities.

With the ongoing changes in financial regulation currently being faced by the re/insurance sector, at a time when the IFS2020 initiative is aiming to increase activity and employment in this area over the next five years, it is of paramount importance that certainty in the fee basis and reasonable fee levels are at the heart of any decisions pertaining to this consultation.

Ireland's regulatory reputation internationally has been restored following the impact of the domestic banking crisis, not least through the efforts of Irish-located re/insurers which are parts of international groups. A sudden and extreme increase in the fees imposed on Irish-based re/insurers would compromise the work which has been done to re-establish this reputation, particularly for low impact companies which in recent years have been subject to higher regulatory requirements than in other jurisdictions, such as the compliance and actuarial requirements. The parent companies of Irish domiciled re/insurers will be less likely to invest capital in Ireland given these cost challenges.

A question arising in the context of this consultation is that of the accountability of the Central Bank of Ireland – in effect, who regulates the regulator. The recent International Monetary Fund's Report on Observance of Standards and Codes notes that the Central Bank of Ireland is accountable to the Minister of Finance in discharging its statutory functions, and that the Minister is the sole subscriber to and holder of its capital. The structure of this relationship will need to be clearly prescribed should a fully funded model be applied to financial regulation. In addition, the changed relationship between the regulator and industry in the case that industry fully funds the supervisor's activities will need to be redefined in detail.

Question 2: Any change from the current funding arrangement would have to have due regard to consumers and tax payers. Do you consider that there are any particular consumer or tax payer issues to be taken into consideration in revising the funding approach? Please state clearly you reasons for any such issues and suggestions on how they may be addressed.

DIMA has not identified any particular consumer issues to be taken into consideration due to the nature of its membership, the majority of whom are not engaged in consumer-facing activities. From a tax payer's perspective, the move from the current model could have an impact on the level of activity taking place in Ireland, thus the overall tax contribution from the international re/insurance sector has the potential to be negatively impacted and therefore more than offset any benefit to the tax payer. The introduction to this response outlines the economic contribution made to Ireland by the re/insurance industry as identified by the Central Bank of Ireland, with the sector contributing €2.5bn GVA, as well as high value primary and secondary employment. These factors are directly beneficial to the Irish tax payer.

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Separately, currently any regulatory penalties imposed by the Central Bank of Ireland are paid across to the Exchequer. The removal of the subvention from the Department of Finance would make this arrangement unequitable, since industry would in theory be bearing the cost of regulatory investigations and enforcement while the Exchequer would be benefitting from any fines imposed. These funds should be applied solely to the costs of financial regulation in the future should the subvention be removed, at the same time ensuring that a sufficiently robust system is in place to prevent overly zealous application of enforcement actions by the Central Bank of Ireland, as a form of income generation. Nevertheless, fines and penalties should be used in the future to offset the cost of financial regulation.

Question 3: Do you consider it appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity? If you disagree, what would you propose instead?

The DIMA membership contributes a substantial level of tax to the Irish authorities in the form of corporation tax, VAT, PRSI, PAYE, etc. Those employed in DIMA member companies are also substantial tax payers. Figures produced by the Central Bank of Ireland in its analysis of the reinsurance sector in Ireland show that the tax paid by reinsurers far outweighs the cost of the current subvention.

Question 4: Do you consider it appropriate that industry be required to fully fund the cost of financial regulation activity? If you disagree, what would you propose instead?

While we have no opposition in principle to fully funding the cost of financial regulation activity, we reiterate our previously stated position that it must only be the costs directly related to financial regulation activity. Other activities should be funded from alternative sources, and operational decisions such as restructures due to external demands or requirements should not be funded by regulated entities. A robust analysis of the appropriate operations, future exposures to costs and expenses beyond the reach of industry, such as the expiration of the Haddington Road Agreement, and similar items should be undertaken before the new regime is implemented.

Question 5: Do you consider it appropriate that a move to full funding should commence in 2016? If you disagree, what would you propose instead?

DIMA does not consider it appropriate to move to a fully funded model in 2016. As explained earlier in this response, there is considerable change taking place both in industry and the financial regulator as Solvency II is implemented. This is proving very demanding for both the supervisory and regulated communities, and it will take a period of time before the system is embedded and settles into a more predictable and constant structure.

DIMA proposes that the currently regulatory funding model is maintained for five years, by which time the implementation "hump" of Solvency II will have been surmounted and better clarity for the future activity and cost base for both industry and supervisor will have been established.

Question 6: Do you consider it appropriate that a move to full funding should take place in a single step in 2016? If you disagree, what would you propose instead?

DIMA does not consider it appropriate to move to full funding in 2016, nor indeed to change the current model until the cessation of the IFS2020 project. At this point, the model should move towards full funding on a stepwise basis, with incremental increases year on year. Precedent has been set through Ireland's adoption of a single corporation tax regime for both domestic and international companies on a stepwise basis some years ago. The size of each of the steps is open to discussion; DIMA suggests splitting the steps over a five year period, thus taking 20% of the Department of Finance's subvention on to the industry fee levy each year of the transition in model.

Question 7: Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories? If you disagree, what would you propose instead?

DIMA believes that the funding should be specifically applied on a detailed basis reflecting the regulatory intervention required for each category of regulated entity. This may require a more granular approach to the current PRISM model, perhaps subdividing each of the categories in the model to better reflect the regulatory relationship between regulator and regulated.

Question 8: Do you consider that there are any particular industry funding categories which warrant a derogation or alternative funding approach? Please state clearly your reasons for such a view?

This response relates solely to the views of the international re/insurance market as represented by DIMA, and therefore we have no comment to make in respect of this question.

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Question 9: Are there any other considerations that you think should be taken into account in seeking to come to a decision on a move to full industry funding? If so, what are they?

We believe we have identified the main considerations which should be taken into account with respect to this consultation.

Should you require any further detail on the points raised in this document, or wish to discuss further any aspects, we will be happy to furnish you with more information or meet with you directly.

Yours faithfully

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