Consultation Paper 95

Joint Public Consultation Paper

Department of Finance and the Central Bank of Ireland

Funding the Cost of Financial Regulation

Our Mission

To build a **world class** business that puts **you at the centre** of our organisation and **society at the heart** of our goals

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1. Introduction

a) Purpose

This submission is in response to the joint Consultation Paper 95 (CP 95) issued by the Department of Finance and the Central Bank: Funding the Costs of Financial Regulation. IPB Insurance ('the firm') welcomes the opportunity to engage in the consultation process as an institution who may be impacted by the potential revisions to the model of financial regulation funding.

b) Scope of the Consultation Paper CP95

The Central Bank of Ireland has invited interested parties to comment on the proposed move from the current approach of partial industry funding of financial regulation to a full industry funding model. In order to ensure that the outcome of this review of funding arrangements is based on the widest possible range of views and opinions, the Central Bank are seeking the respondents' views on the following matters:

1. Particular competitiveness issues to be taken into consideration in revising the funding approach
2. Particular consumer or tax payer issues to be taken into consideration in revising the funding approach
3. Whether it is considered appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity
4. Whether it is considered appropriate that industry will be required to fully fund the cost of financial regulation activity
5. Whether it is considered appropriate that a move to full funding should commence in 2016
6. Whether it is considered appropriate that a move to full funding should take place in a single step in 2016
7. Whether it is considered appropriate that any revision in the proportion of funding provided by the industry should continue to apply uniformly across all industry funding categories
8. Whether there are any particular industry funding categories which warrant a derogation or alternative funding approach
9. Any other considerations which should be taken into account in seeking to come to a decision on a move to full industry funding.

IPB Insurance has responded to the particular matters outlined above on a question by question basis which includes the consideration of the Board of IPB Insurance and also IPB Insurance Management.

2. Executive Summary

CP95 outlines the Central Bank's proposal to commence the move to a 100% industry funded model of financial regulation activity. The consultation paper indicates that this proposed revision to the current financial regulation funding model is a result of the challenges faced by the Irish financial services industry as well as the Central Bank during a period of unprecedented regulatory challenge and change since the economic crisis of 2008.

The firm is cognisant that this period resulted in the requirement to increase the level of resources devoted to the regulatory and compliance matters which further translated into significant increase in the costs of financial regulation incurred by the Central Bank. IPB Insurance is committed to the continuous support and engagement with the Central Bank on all matters required to fulfil its mission of safeguarding stability of the Irish financial services sector and protecting consumers as set out in its *Strategic Plan 2013-2015.*

We remain mindful of the continuing financial stability concerns, challenges to government finances, difficult economic conditions for consumers, businesses and regulated firms, as well as the challenges posed by the increase in regulatory requirements. We have considered the matters outlined by the Central Bank within the consultation process on an individual and overall basis in the context of the general insurance industry. Our comments contained herein are provided from that perspective.

In summary, however, the firm would ask that the Central Bank consider a balanced approach to any proposed change of the current financial regulation funding model by evaluating the potential for other incomes streams which would include continued funding from the Government and the Irish financial services industry. We would also highlight the need to implement any funding increases within the Irish financial services industry in a measured and phased manner to ensure that all businesses can effectively adapt to any new levy requirements within a specified period. Governance processes should also be considered as part of the outcomes with respect to any changes in the current funding model to ensure transparency, oversight and mechanisms to evaluate value or changing contributions made by individual stakeholders.

3. Appendix 1 – Detailed Responses

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 qualification and suggestions on how they may be addressed.

IPB Insurance Response:

Whilst IPB Insurance fully appreciates the resources and costs incurred by the Central Bank to fulfil their mandate of financial regulation, it notes the significant investment borne by the insurance industry to ensure its effective implementation of Solvency II. This core piece of legislation has resulted in an increase across the market in financial, governance and procedural requirements aiming to increase consumer protection within the financial services sector, EU market integration, and market competitiveness. Market competitiveness is understood as the ability of a firm to offer products or services meeting the quality standards at prices providing returns adequate to the resources employed by the firm.

IPB Insurance therefore notes the Department of Finance International Financial Services 2015-2020 Strategy[1] which outlines the drive for continued growth and job creation within the Irish financial services sector and the Department's vision for Ireland to be recognised as the global location of choice for specialist international financial services resulting in the estimated target to expand the employment in the sector by 30% by the end of the year 2020.

The firm would also draw the Central Bank's attention to the ongoing, significant challenges faced by the insurance industry as noted in the Central Bank Macro-Financial Review (the Review) Quarter One 2015, Section 3.3 which details the industry's concerns resulting from underwriting losses reported amongst insurers in 2014, including a number of high impact firms, and forcing the insurers' profitability to become increasingly reliant on investment returns. This report further notes that such reliance has proved insufficient to cover underwriting losses.

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[1] IFS 2020, A strategy for Ireland's International Financial Services Strategy;
http://www.finance.gov.ie/sites/default/files/IFS2020.pdf : 14/09/2015

Since the publication of the Review, the investment returns across all sectors have been further affected by the adverse developments in the financial markets around the world. In addition, the insurance industry was also forced to absorb the impact of the reversal of the low-yield environment which has also been noted by the Central Bank as a potential risk to the insurance sector[2].

Bearing the above factors in mind, IPB Insurance support all efforts to increase employment and financial stability within the sector and notes the continued sensitivity of the insurance market to the increased costs of the financial regulation activity resulting in the following concerns:

- Potentially higher operating costs for financial services firms already within the market.
- Additional operational costs acting as a barrier to market entry for international and EU financial services firms,
- An increased financial burden on smaller firms which could constitute a significant contributory factor to the exit of those firms from the Irish market.
- An increase in operating costs may also impact the level of available capital for firms trading on the Irish market which may potentially translate into a corresponding reduction in the variety of product lines and insurance options available to consumers.

We note that the proposed insurance market funding increase is cited within the consultation paper as €14.7 million and respectfully query whether an expected increase in current product sales across the insurance market will generate this additional revenue to support the funding model, whilst also maintaining effective management of operating costs across the sector. We would ask that any such assertions are considered in the light of the issues noted above and referenced in Section 3.3 of the Central Bank Macro-Financial Review Quarter One 2015 particularly with respect to non-life insurance products and combined ratio results[3].

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 your reasons for any such issues and suggestions on how they may be addressed.

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[2] Central Bank of Ireland Macro-Financial Review Quarter 1 2015, Section 3.3 page 36 – 37; http://www.centralbank.ie/publications/Pages/MacroFinancialReviews.aspx; 15.09.2015

[3] ibid.

IPB Insurance Response:

Figures available from the insurance industry body, Insurance Ireland, note that the current contribution made by the insurance industry to the economy is estimated to generate approximately €25bn in the annual premium income, employing 27,000 people directly,…….as well as, the annual tax returns of more than €1.6bn remitted to the Exchequer each year.[4]

Recognising the importance of regulatory requirements with respect to the Consumer Protection within the insurance industry, IPB Insurance believes that it is important that all firms remain in a positon to offer their clients the most appropriate insurance packages at the most competitive and affordable prices. As such, the firm remains mindful of the fact that higher operating costs may impact premiums offered to consumers by other firms within the insurance sector which may result in reduced product options for consumers particularly with respect to homogenous insurers.

Again the proposal to increase the levies within the insurance sector by a further €14.7 million will need to be considered in terms of product sales and pricing models within the different insurance undertakings which have been heavily impacted by the increase in claims frequency caused by the recent adverse weather conditions and also by continuous high costs of fraudulent and exaggerated claims costing the industry an estimated €200 million annually.[5] The impact of inappropriate pricing and potential increase of claims within the insurance market should also be considered with respect to any potential impact on the State Claims Agency.

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?

IPB Insurance Response:

Whilst IPB Insurance fully acknowledges the impact of the subvention born by the Central Bank on the annual surplus remitted to the Exchequer, the firm would also wish to draw the Central Bank's attention to the fact that the cost of the subvention should be balanced with the understanding of the contribution made by the insurance industry to the strategy announced by the Central Bank in its *Strategic Plan 2013-2015.* The importance of the resilient and well-functioning insurance sector to the economic activity and financial stability highlighted by the

[4] Insurance Ireland, *2014 Annual Report*, page 3.

[5] http://www.insuranceconfidential.ie/

Central Bank in the previously cited Central Bank Macro-Financial Review Quarter One 2015 Section 3.3 insurance sector[6] and the potential impact on same should also be taken into the account during consideration of increasing operating costs for the industry.

It should also be noted that, notwithstanding the constraints mentioned above, the industry fully engages with the Central Bank in the delivery of its mission to safeguard financial stability, support the economic recovery, protect consumers by minimising consumer risks, as well as, the delivery of the Central Bank's eight High Level Goals which would further result in promotion of a better functioning financial sector.

The insurance industry further supports all efforts made by the Central Bank in this regard through the significant tax returns made to the Exchequer on an annual basis, consistent work towards achieving better consumer outcomes and also by being one of the key employment sectors within the Irish financial services sector.

It would be preferable if a balance between a percentage of funding from the Irish financial services industry, the Exchequer and potential revenue streams as undertaken by other Regulators in other jurisdictions, especially those Regulators who are also subject to Solvency II, was explored to address this funding issue more appropriately, ensure consistency and also to avoid a perception of regulatory arbitrage. Income streams such as the offsetting of fines against Central Bank costs, potential separate billing for the approval of internal models within financial institutions and authorisations or approvals may be considered to support any proposed funding changes.

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?

IPB Insurance Response:

Notwithstanding the fact that the firm acknowledges the Central Bank's submission presented in the Consultation Paper CP95 and that it is not uncommon for specific regulators to be fully funded by the organisations whom they supervise, we would welcome further detail and engagement as an industry regarding the proposed strategic changes within the Central Bank of Ireland's potential approach to regulatory supervision that may necessitate this proposal.

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[6] Central Bank of Ireland Macro-Financial Review Quarter 1 2015, Section 3.3 page 36 – 37; http://www.centralbank.ie/publications/Pages/MacroFinancialReviews.aspx; 15.09.2015

It is important, as noted in CP95, that there is a continued independence with respect to financial regulation across all markets which, would potentially be best supported by a retention of a significant degree of self-funding by the Central Bank.

Furthermore, whilst the firm fully acknowledges a significant commitment to increased levels of regulatory implementation with the Central Bank, it is important to note that this has been positively responded to by financial institutions in terms of increases in resource, improvement to systems and processes required to support the revised regulatory supervision to date. Therefore moving to a fully funded model would require the potential review of costs of operating models for some financial institutions within all sectors. It would be preferable if a balance between a percentage of funding from the Irish financial services industry, the Exchequer and other potential revenue streams as undertaken by other Regulators in other jurisdictions was explored to address this funding issue more appropriately and also to ensure that potential effects on public perception of undue industry influence are minimised.

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?

IPB Insurance Response:

As stated above, IPB Insurance would welcome further detail and engagement as an industry regarding the proposed strategic changes necessitating this proposal. It is also important that we take this opportunity to highlight the scale of the significant investment made collectively by the industry to meet the Solvency II requirements designed to further protect consumers, increase financial stability and strengthen the competitiveness of the markets on the national and EU level which will be implemented as of the 01.01.2016 for the insurance sector. It is important to note that any potential adjustments to the current funding model of financial regulation activity must also include the consideration of the impact to insurance undertaking operating models and should be agreed on a phased basis to provide for mitigation this impact on affected businesses.

Question 6

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

IPB Insurance Response:

In order to fully understand the scope and the impact of the proposal put to the consultation process, IPB Insurance would welcome further information on the nature of the changes to the regulatory structure envisaged by the Central Bank which have resulted in the requirement to introduce adjustments to the existing funding application.

We would however note the significant investment by all insurance undertakings with respect to the effective implementation of Solvency II and the potential impact of further increases in costs for insurance undertakings in 2016. A single step increase would not indicate consideration of the impact to the insurance market objectives as part of the overall IFS 2020 Strategy. As noted previously it is important that any potential amendments to the current financial regulation activities funding model must also include the consideration of the impact to insurance undertakings' operating models. Envisaged adjustments could be agreed on a phased basis to provide for the alleviation of this impact on the industry as a whole. We would also recommend, that in the interest of transparency and fairness, any changes are introduced using the approach modelled on the arrangement adapted by the Central Bank to the revision of the funding contributed to by the credit union sector, which has been agreed to be implemented gradually over a five year period.

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?

IPB Insurance Response:

In order to fully understand the process utilised to revise the proportion of funding provided by individual industry categories, IPB Insurance would welcome further details regarding policies and processes governing any potential change in the imposition of levies required to cover the proposed costs of financial regulation.

However, not drawing any definitive conclusions pending further engagement from the Central Bank, we believe that the PRISM framework focused on a risk posed by the institution in light of the Central Bank's assessment of governance processes and Solvency II ratios within the firm, rather than a potential impact, could effectively assist the Central Bank during the allocation of costs.

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.

IPB Insurance Response:

As stated above, IPB Insurance would welcome further details regarding particular circumstances where such derogation or alternative funding approach could be considered by the Central Bank which would enable the firm to provide the Bank with a fully informed opinion on this matter.

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?

IPB Insurance Response:

IPB Insurance would like to note that any changes to the current model of funding of financial regulation activity should be duly considered with respect to the potential impact on consumer protection, international competitiveness of the Irish financial services sector and potential decrease in employment rates which may result from the impact on the attractiveness of the Irish market to international providers. Furthermore, we also wish to encourage the Central Bank to consider the potential consumer impact which could result in a decrease in the affordability of appropriate level of insurance cover and the impact of such an outcome on the potential increase in claims for the industry and the State Claims Agency.

As noted previously in this submission, it is important that any potential amendments to the current Central Bank activities funding model must also include the consideration of the impact to insurance undertakings' operating models and agreed on a phased basis to provide for this impact to the industry as a whole.

It is also important to stress the importance of the Central Bank's independence from the regulated sectors which serves as a core foundation to impartiality by the Central Bank. Successful implementation of the proposed move to full funding approach could significantly undermine the perception of the impartiality and independence of the Central Bank in the public eye. In order to avoid such an outcome, we would recommend that any revisions to the funding approach are accompanied by strong standards of governance, accountability and management information benchmarked against the highest international standards. Such standards should also be independently evaluated on at least annual basis via means of stakeholder's surveys and audits carried out by the relevant experts.

The firm would also welcome further engagement with the Central Bank on this matter at the industry level, as we believe such engagement would facilitate better understanding of this important proposal and it would also provide IPB Insurance with an opportunity to further advocate the matters raised in this submission paper.