KPMG response to Consultation Paper CP89

Consultation on National Specific Templates for Insurers and Reinsurers under Solvency II

23 January 2015

KPMG

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1. Introduction

KPMG is a leading provider of professional services in Ireland. We work with clients in all sectors of Irish business, including many of the leading insurers and reinsurers, providing a range of Audit, Tax and Advisory services. Our insurance practice is involved in both professional and industry bodies and takes an active role in pursuing regulatory, accounting and tax issues affecting the industry.

Our response is structured as:

- Executive Summary
- Key Observations
- Observations Relating to Specific Templates

We welcome this Consultation by the Central Bank of Ireland ('CBI') and the additional time provided to facilitate responses, and would be delighted to discuss our response further with the CBI.

2. Executive Summary

The key points arising from our review of Consultation Paper No. 89 ('CP89') are as follows:

- We are of the view that the additional information required in the templates principally relates to major domestic non-life insurers and to Variable Annuity ('VA') writers. Therefore, we believe that the scope of the requirements should follow those two classifications.
- Recognising the local specificities of the market and the complexity of VA business, we understand the need for formalisation of information currently collected through the "VA Monitor" into a National Specific Template ('NST') format.
- We are generally of the view that other than the specific templates relating to VA business, the formalisation and extent of the information requested into NSTs is unnecessary and that a better result for all stakeholders could be achieved by taking a more focussed and tailored approach.
- We are unconvinced that the analysis of non-life claims and technical provisions as required by the NSTs will provide the claims and reserving trends envisaged by CP89. The market analysis and trends will be most useful for domestic and homogenous lines of business and less so for others. The requirement for all high and medium high impact firms to comply with this report is not proportionate to the supervisory benefit.
- We consider that the (quarterly) frequency of the information requested from Non-Life Insurers is unduly onerous, and is inconsistent with the main objectives of Solvency II reporting as described in the 2nd Implementing Technical Standards from EIOPA, including CP-14/052.

3. Key Observations

Scope of the proposed requirements and Relevance to PRISM

We note that CP89 proposes to apply the NSTs to high impact and medium-high impact firms. Given that a key focus of the PRISM model is on the impact of a (re)insurance failure domestically, it is natural that the classification of firms reflects this feature of PRISM, with large domestic non-life writers falling into the high impact bracket. It is our view that, for supervision purposes, the analysis of non-life claims information sought within the proposed NSTs, is much more relevant to the domestic non-life insurers than to those writing international business or reinsurance business.

We suggest that the scope of the CP should also reflect the fact that the CBI is better resourced to deal with the supervision of high-impact firms and extra reporting. We note that in the CBI's "PRISM Explained" guidance, less than one Supervisor is allocated to each firm rated "medium-high" impact. Within Solvency II, there are many examples of the expanding scope of the supervisor's role. Examples include understanding the more complex calculation of the Solvency Capital Requirement, the range of supervisory approvals including ancillary own funds and Undertaking Specific Parameters, and the review of the ORSA. Therefore we would question the capacity of the CBI to fully utilise the additional information being sought, particularly in the supervision of medium-high impact firms.

We note that the above view is consistent with a point made in the UK Prudential Regulatory Authority's (PRA) consultation paper, CP16/14, which covers NSTs, advising that templates are *"intended to be proportionate, taking into account the burden on firms and the effective use of the PRA's own resources"*.

Therefore, we suggest that the scope of the NSTs be limited to high impact domestic non life insurers and to VA writers.

VA reporting requirements

We recognise that VA business is only written in certain Member States and that accordingly, the harmonised templates may not adequately cover the necessary reporting requirements. We also agree that VA business meets the definition of "*specificities of local markets*" as described in the Consultation Paper on the proposal on Quantitative Reporting Templates (EIOPA-CP-11/009b).

We note that the proposal for NSTs relating to VA business aligns closely with the recent development of a "VA Risk Monitor". We support the harmonisation of the information that is required to allow for the examination of key risks, including hedge efficiency, convexity and profit and loss attribution.

(In contrast, with VA templates, we would question the introduction of the proposed non-life templates on the basis set out in the CP which is to "address *requirements specific to the local market and or the nature of insurance undertakings.... which are not catered for in the Solvency*

II templates"). Arguably, the Irish non-life market is not sufficiently different from other jurisdictions to justify NSTs.

How Best to Support Supervisory Activity

As outlined above, we believe that the focus of the (non-VA) NSTs is directed towards domestic non-life insurers. As the number of firms involved is quite limited and as each has its own context and history, we would contend that the current ad-hoc approach to requesting additional analysis of information is more appropriate and flexible than a more formalised approach. We suggest that the CBI should obtain the information by applying its powers as provided under Article 35 of the Framework Directive, on an ad-hoc basis, rather than on the formalised basis proposed.

In that regard, we would also question the usefulness of some of the information being requested in the templates. Whether the analysis being sought will provide supervisors with claims and reserving trends envisaged within the CP is doubtful. Please see our comments on the specific non-life NSTs.

Frequency

We note that EIOPA make the point within the second set of Implementing Technical Standards from EIOPA, (CP-14/052) that "*the main objectives for the Solvency II reporting requirements are to collect data that are needed for supervisory purposes under the new regime by creating a system that will not be too burdensome for small and less complex insurance undertakings."* When considered in a European context, arguably almost all Irish firms, both high and medium-high impact, are small and less complex than in other territories.

Moreover, we note the PRA's approach to the frequency of reporting where the NSTs will be limited to annual reporting with the PRA stating that *"All templates will be collected annually to minimise the burden on firms"*.

We also note that the requirement to produce IFRS results on a quarterly basis is not a current requirement under Solvency I. Based on the above and considering the onerous nature of the QRT requirements, we suggest that the frequency of the NSTs be limited to annual reporting and that the same submission deadlines as those for the annual reporting templates, as set out in the Directive, be applied.

4. Observations Relating to Specific Templates

Life Income Statement (Template no. NST. 02)

IFRS v Solvency II

We note that template NST .02 is required to be completed using International Financial Reporting Standards (IFRS4 – Insurance Contracts) or Local Irish GAAP (FRS103 – Insurance Contracts) in line with the Company's local accounting basis.

A key feature of Solvency II is the emphasis on financial strength, in the form of capital/own funds as opposed to a focus on performance between balance sheet dates. Accordingly, the Solvency II Balance sheet measures the economic valuation of a company. In contrast, IFRS and Irish GAAP focus on both the balance sheet and performance.

The inconsistency between IFRS and Solvency II is evident in certain aspects of Life Assurance. Solvency II applies a consistent valuation approach to all contracts issued by insurers. Under IFRS 'investment contracts' issued by insurers which do not transfer significant insurance risk (and that do not contain a discretionary participation feature) are accounted for as financial instruments, not insurance contracts. Areas where other differences arise include DAC, deferred tax and in asset valuations.

The differing emphasis in the two approaches, and the focus of prudential oversight on the income statement, is inconsistent with the essence of Solvency II.

Segmentation

We note that the segmentation of the business may not be in a consistent format with what companies currently produce, e.g. premiums being segmented for reporting purposes (i.e. protection business, annuities by type, and group risk). While we note such information would generally be available on the underlying systems and general ledgers additional effort may be required to produce this information to meet the additional requirements. Thus the production of more granular information may place an additional burden on companies from a resource and system perspective although we do not expect the ongoing requirements to be overly burdensome.

Non-Life forms NST. 01, .03, .04, .05, .06.

Identification of Trends

We note the explanation for the information being requested, which includes facilitation of early identification of claims and reserving trends. We would question whether the level of detail that will need to be provided across the insurance industry (and therefore ultimately at a cost to the consumer) justifies moving from the existing ad-hoc approach to imposing formal requirements on all firms within scope.

The reference in the CP to the early identification of trends requires clarification in the sense that trends may (1) highlight an outlier among the industry on a specific measure, or (2) may indicate a change in the pattern of a firm's own performance. We would contend that the information sought could not accurately detect an outlier within the industry as firms take differing approaches to the recording of claims and premium within the headings provided. While the proposed templates may highlight a change in pattern in a firm's individual performance, we suggest that this level of assessment could be achieved on the ad-hoc basis; otherwise much of the information sought will not provide insight for supervisors.

Examples of ad-hoc information that may help with the identification of trends include:

- Frequency, severity, and burning cost of claims;
- Levels i.e. numbers and amounts and movements in large claims; and,
- KPI's supporting consistency of case reserve strength, for example average case estimates which can be considered alongside reserving KPI's such as IBNR to outstanding ratios.

Distribution Channels

We feel that the introduction of analysis across these forms between two overarching distribution channels (Direct and Intermediated) will not achieve the CBI's goal as outlined in Section 4.1 of the C.P. Distribution models across industry vary hugely and regularly as firms' strategies change and due to advances in technology. Indicators of change that would raise regulatory red-flags would be difficult to identify in areas that are continually evolving.

In addition, for reserving purposes, analysis by Direct and Intermediated channels is not currently performed by all market participants. Ad-hoc analysis of mix changes e.g. by main rating factors would be less onerous for participants and, in our view, would better achieve the stated aim of the CP.

Categorisations within Classes of Business

In relation to the categorisation sought, we recognise that analysis of Motor insurance between Commercial and Personal lines is consistent with current practice in the industry. In addition analysis of bodily injury and property damage is different to the SII segmentation but more consistent with current approaches and should not cause a problem as we would expect projections to be performed at that level and aggregated up for SII reporting.

We would note however, that the segmentation requested is on a SII line of business basis, which reflects the principle of substance over form i.e. reflecting the nature of the risks underlying the contract (substance), rather than the legal form of the contract (form). For example, it is envisaged that Motor business would be segmented by Motor Liability (TPPD and

TPI) and Motor Other (OD, F&T, WS). This is different to the segmentation currently used for CBI reporting and also differs from how most companies would present accounting information. Therefore it would create a significant extra burden to segment the income statement on this basis requested, for example, companies may need to generate notional allocations which would create inconsistencies and reduce the value of the information.

ENDS

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