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Insurance Newsletter

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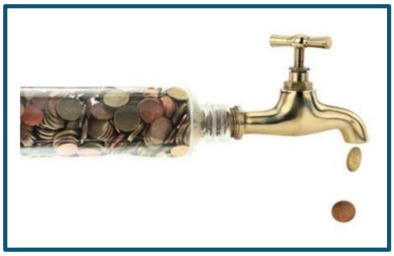

The Importance of Reliable Data

Without question, ensuring the accuracy and reliability of data is one of the most important and challenging aspects that insurance undertakings face. Reliable data is crucial for ensuring compliance with Solvency II regulatory reporting requirements. Reliable data is equally vital to the business decision-making process. Without accurate and complete data any capital or solvency numbers generated will, in effect, be meaningless.

Lisa O'Mahony, Head of Function Advisory & Inspections at the Central Bank of Ireland, reflects on some of the observations and common themes identified during recent thematic inspections of the calculation of the Solvency Capital Requirement (SCR) in a number of (re)insurance undertakings.[1]

During 2019, the Central Bank undertook a thematic inspection of the governance, oversight arrangements and internal controls in place to monitor the generation and reporting of the SCR calculation in a number of (re)insurance undertakings.[2] This inspection followed on from a 'Dear CEO' letter issued in April 2018 relating to the Solvency II QRT reporting process.

Overarching Observations

The challenges in ensuring the accuracy, timeliness and reliability of data used in the SCR calculations emerged as the most significant issue. In each of the inspected undertakings, the SCR calculation is a complex process, with varying levels of automation. The complexity of the process creates potential for miscalculation, through both interpretation and administrative errors. This is due to the technical nature of the calculations and the varied inputs from multiple internal/group functions as well as external data providers.

Key Areas for Improvement[3]

The inspection team noted a lack of robust controls to ensure the accuracy of the input data supplied by information providers. SCR errors had occurred in many of the undertakings inspected. These issues were typically due to errors within the source data provided by internal and external parties, as opposed to issues with the calculation process. The identified errors highlight the importance of internal controls such as peer review and sign-off of data provided by the business for the purposes of the SCR calculation.

In many of the entities inspected, intra-group service providers were responsible for conducting the SCR calculation. The calculation was reliant on resources, systems or inputs from a number of different teams across various geographical locations. Many of the undertakings in scope had not considered the various steps and providers in the process of the calculation to be outsourcing, in particular where the data is modified and/or an intra-group party is performing the calculations. The Central Bank considers arrangements that provide for the conduct of these activities or services, on behalf of a (re)insurance undertaking by an intra-group counterparty to be outsourced activities. It is our expectation that undertakings comply with all relevant guidelines pertaining to outsourcing in respect of these arrangements.

A second key observation from the inspection was that the responsibilities of the Board of Directors were not documented clearly. The Board should clearly set out how the SCR calculations, relevant analysis, use of simplifications and changes to SCR calculation methodology/processes are to be communicated to them. In addition, the Board should clarify how SCR related issues and errors should be recorded, handled and escalated.

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1. The on-site inspections were conducted by Lenka O'Sullivan, Éamon Fitzgerald, Jane Duffy and Eoin McCormack.
2. All inspected undertakings use the Standard Formula to calculate their SCR.
3. Please note that the matters raised in this article should not be considered as an exhaustive list of good and poor practices relating to the SCR calculation. It is however intended to provide beneficial insights, which can be used by undertakings to strengthen governance and controls and to reduce the risk of miscalculation.

The Importance of Reliable Data

A number of other common deficiencies observed included insufficient controls put in place in relation to spreadsheets that form part of the SCR calculation, and weaknesses in the documentation of the SCR calculation process. These findings are similar to weaknesses previously identified in the thematic review of regulatory reporting in 2018. The Central Bank expects that undertakings take appropriate steps to mitigate such issues.

Encouraging Good Practice

We observed some good practices during the inspections, including:

- Reconciliations to prior period results and movements in the SCR – quantitative monitoring of the individual and cumulative impact on the SCR, of changes to calculation methodologies or interpretations.

- Recalculation thresholds – adoption of specific recalculation triggers based on the level of movement of individual components of the SCR. We recommend that such triggers should be tailored to the individual components of the SCR and be based on the materiality and volatility of the outputs, and that undertakings should formally document these triggers.

- Board Training – in the sample of companies selected, Board members were generally provided with appropriate training/information sessions in order to ensure their understanding of the SCR calculation process.

- Independent Review – many of the undertakings had completed, or planned to complete, an internal audit or external review of the SCR calculation.

Conclusion

Under Solvency II and the Corporate Governance Requirements for Insurance Undertakings 2015, the Board of an undertaking has ultimate responsibility for putting in place an effective system of governance, oversight and internal controls. One reason for this is to ensure that information provided to the Central Bank, as part of regulatory reporting, is reliable and complete.

Executives and Boards should carefully consider how they can discharge their responsibilities in relation to, the integrity of the data and oversight of the regulatory reporting process, in particular the calculation of the SCR, and provide evidence of same.

By **Lisa O'Mahony**
Head of Function -
Advisory & Inspections

Liquidity Risk Management

Liquidity risk is the risk that a firm is unable to realise its investments and other assets in order to settle its financial obligations when they fall due. All insurers are expected to take responsibility for ensuring that it can meet its liabilities as they fall due, and have appropriate risk management strategies and systems in place for managing its liquidity risk.

Why is liquidity risk management important for your firm?

An insurer, though solvent, may nevertheless find itself short of cash or funding options to meet its liabilities as they fall due. Liquidity risk is an important aspect of risk management that lays foundations for pre-emptive recovery planning.

Although this review focused on the life sector, the observations are relevant for other sectors. Any changes in investment strategy, being made in response to the continuing low interest rate environment, or the increased use of derivatives must have regard to the impact on the liquidity profile of the assets held and any increased scope for delays in asset liquidation, increased trading costs or haircuts under stressed market conditions.

What were the common observations from our review?

1. Clearly define the approved risk tolerance limits for liquidity risk and take into account the nature, scope and time periods of the business leading to liquidity risk exposure.

In some cases, the approved liquidity risk tolerance levels in the risk appetite statement were outlined without demonstrating how the actual liquidity needs of the firm were considered when defining the limits. Article 259(1) of the Commission Delegated Regulation (EU) 2015/35 sets out the requirement for approved risk management policies and controls that take into account the nature, scope and time periods of the business and the associated risks.

Some examples where the tolerance limits were ill defined and not well justified include levels defined as an arbitrary value of liquid assets to be held on the balance sheet; or as a percentage of liquid assets of the overall balance sheet; or as a percentage of the Solvency Capital Requirement.

'An insurer, though solvent, may nevertheless find itself short of cash or funding options to meet its liabilities as they fall due.'

When firms define a liquidity risk tolerance levels, we expect firms to:

- Tailor tolerance levels to the needs of its business and the liquidity risks that it faces;
- Clearly define the types of assets which is deemed to be a liquid asset and available to cover liquidity needs.

2. Liquidity risk should be measured in both benign circumstances and under stress.

An insurer is expected to conduct liquidity stress tests to identify sources of liquidity strain, and ensure its current liquidity profile continues to conform to its liquidity risk appetite, as approved by the Board. (as per Article 259(3) of the Commission Delegated Regulation (EU) 2015/35)

Some good practice that we observed in this area included:

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Liquidity Risk Management

- Analysis of the liquidity position of the firm in both separate and combined stresses;
- The stress tests capture all the relevant, material risk drivers such as the impact of a significant increase of new business; an increase in the amount of payments driven by changes to the Italian withholding tax regime; and liquidity strains caused by significant lapses or sales varying from expectations;
- The stress tests capture potential group-specific risks, particularly the use of intragroup transactions and their impact on an insurer's liquidity position; and
- Consideration of both the availability of liquid assets for the long - term liquidity needs and the timing of the cash flows for the short and medium term liquidity needs.

3. Firms are expected to consider the potential costs or financial losses arising from an enforced realisation of assets and the costs of alternative financing tools.

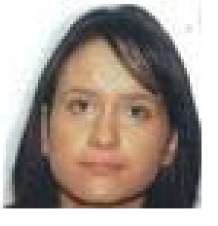
As per the EIOPA Guidelines on system of governance (Guideline 26), insurers should consider a quantification of potential costs or financial losses arising from an enforced realisation of assets.

Some examples of good practice we observed was where firms clearly describe the contingency plans in place to deal with changes in expected cash in-flows and out-flows along with capturing the impact of invoking the liquidity contingency plans.

The liquidity stresses in these instances capture the potential costs or financial losses, the plausibility of the contingency plan under a stressed scenario and the speed these can be executed.

Questions for Undertakings to consider

1. Is there a clear definition of what is considered to be a liquid asset?
2. Are the risk tolerance limits clearly defined and is it relevant for the risk profile of the firm?
3. Do the stress tests adequately capture the range of liquidity risks that the firm is exposed to?
4. Is there a contingency plan in place in the event of liquidity issues and has the potential financial costs and the plausibility of the plan been considered?



By **Marie Bradley**
Life Actuarial Manager

National Claims Information Database – First Report Published

On 16 December 2019 the first report from the National Claims Information Database (NCID) was published here on our website. The report contains analysis of the cost of claims, the cost of premiums, how claims are settled, how settlement costs vary depending on how claims are settled, and an analysis of the various types of cost that make up settlements. Private motor insurance was selected to be the initial class of insurance in scope of the NCID. A private motor report will consequently be published on an annual basis. More information on the NCID is available here on our website.

Insurance Updates

Tim O'Hanrahan appointed Head of Insurance Supervision

On 25 November 2019, Tim O'Hanrahan was appointed to the role of Head of Insurance Supervision. Tim rejoins the Insurance Division following his time as Senior Advisor to Ed Sibley - Deputy Governor (Prudential Regulation). Tim brings his wealth of insurance experience to the role, having worked in a number of senior supervision and policy roles in the Insurance Directorate over the previous decade. Tim will lead the Insurance Supervision Division and oversee the prudential supervision of (re)insurance undertakings across the life, non-life and reinsurance sectors.

Differential pricing in the Motor and Home insurance industries

On 21 November 2019, Derville Rowland, Director General – Financial Conduct, wrote to Chief Executive Officers of undertakings offering motor and home insurance business. The Dear CEO Letter is available to view here on our website.

The letter is concerned with the practice of differential pricing (whereby customers with the same risk and cost to serve are charged different premiums) in the Irish insurance industry. The letter informed affected parties that the Central Bank intends to conduct a review of differential pricing in the motor and home insurance industries, to examine the extent to which the practice of differential pricing is consistent with the Consumer Protection Code. The review will begin in January 2020.

Principles of Best Practice – Website Update

Please note that the document "Principles of Best Practice applicable to the distribution of Life Insurance Products on a Cross-border Basis within the EU or a Third Country" (the Principles) is no longer applicable to life insurance undertakings distributing insurance products on a cross-border basis and it has been removed from the Central Bank website. This document was issued in 2011. On the introduction of Solvency II the Principles document was retained pending a more comprehensive review of its continuing relevance.

We have now completed this review and have concluded that the Principles duplicate the existing requirements[1] and they no longer serve their original purpose. The Principles therefore have been removed from the Solvency II section of the Central Bank website, and are no longer applicable to Solvency II undertakings. The Principles continue to apply to non-Solvency II undertakings and have been retained in that section of the website.

If you have any questions in relation to the "Principles of Best Practice" update please contact insurancepolicy@centralbank.ie

1. The Insurance Distribution Directive transposed into Irish law under the European Union (Insurance Distribution) Regulations 2018 (S.I. No. 229 of 2018); the Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors; the Solvency II Directive transposed into Irish law by the European Union (Insurance and Reinsurance) Regulations 2015; and the EIOPA Guidelines on Complaints-Handling by Insurance Undertakings

EIOPA & NST Taxonomy updates

As both industry and regulators prepare for a fourth round of annual reporting under Solvency II, it is timely to call attention to the impending changes to the reporting requirements. The changes for 31 December 2019 relate to incremental corrections and amendments, with limited material changes to the reporting package.

Solvency II Reporting

As undertakings will be aware, the reporting requirements under Solvency II, as originally set out in Commission Implementing Regulation (EU) 2015/2450, have been amended by the European Commission in the 2016 (Commission Implementing Regulation (EU) 2016/1868), 2017 (Commission Implementing Regulation (EU) 2017/2189) and 2018 (Commission Implementing Regulation (EU) 2018/1844).

EIOPA has proposed a number of further amendments to be applied in 2019. The updated taxonomy (2.4.0) was published in July 2019. In November 2019, EIOPA published a hotfix to amend a number of non-working validations. We encourage undertakings to familiarise themselves with the proposed changes and ensure that these are appropriately reflected in submissions from 31 December 2019 onwards. Submission dates for firms with 31 December year ends are provided below. These submission dates, and those for firms with non-standard year-ends, can be found here on our website.

Undertakings with 31 December year-end

	Reference date	Submission period (weeks)		Submission deadline date	
		Solo	Group	Solo	Group
Annual returns	31-Dec-19	14	20	07-Apr-20	19-May-20
Quarterly returns	31-Dec-19	5	11	04-Feb-20	17-Mar-20
	31-Mar-20	5	11	05-May-20	16-Jun-20
	30-Jun-20	5	11	04-Aug-20	15-Sep-20
	30-Sep-20	5	11	04-Nov-20	16-Dec-20

National Specific Templates

Since Q1 2016, the Central Bank has been receiving national specific reporting templates ("NSTs") , which address requirements specific to the local market and/or the nature of insurance undertakings supervised in Ireland and which are not catered for in the set of Solvency II harmonised reporting templates. Based on the experience from reporting to date, the Central Bank is introducing a number of amendments to the NSTs. A summary of the forthcoming changes are set out in the table across. The required changes to the NST taxonomy to facilitate these changes, was published on 12 November 2019, including a revised list of taxonomy validations.

Template	Main changes
NST.01.01.01.01	Fix of validation IEBV371 - See List of Known Issues file for more information
NST.01.01.03.01	Fix of validation IEBV341 – See List of Known Issues file for more information
NST.13	New validations added – IEBV375, IEBV376, IEBV377, IEBV378, IEBV380 – See NST Validations file for more information

General Updates

Publication of Discussion Paper on the Use of Services Companies in the Insurance Sector

On 11 November 2019, the Central Bank published a Discussion Paper (DP9) on the Use of Services Companies in the Insurance Sector. The Central Bank has developed this Discussion Paper in order to seek stakeholder's views on how (re)insurance undertakings, who enter arrangements with separate legal entities for the provision of extensive staffing to the undertaking, adequately identify, assess and mitigate against all material risks that these arrangements introduce. The Discussion Paper focuses in particular on issues such as:

- the appropriateness and adequacy of the initial and ongoing risk identification and management in relation to the arrangement;
- the adequacy of the protections provided for policyholders and other beneficiaries on an ongoing basis and in stress scenarios;
- the substance in the Irish undertaking

and seeks to explore these issues further by posing questions to interested stakeholders on how the Board and senior management of undertakings satisfy themselves, and appropriately demonstrate that the undertaking complies with relevant requirements, standards and supervisory expectations where arrangements of this kind are in place. A copy of the Discussion Paper can be accessed here on our website.

Submissions are invited from interested parties by 31 January 2020. Any queries in relation to this Discussion Paper should be directed to insurancepolicy@centralbank.ie.

Insurance Statistics - Updates

- In order to minimise the reporting burden on the insurance industry, the ECB regulation for compiling the Insurance Corporations Statistics allows National Central Banks (NCBs) to derive the necessary statistical information from data reporting for supervisory purposes under the EU's Solvency II framework. Given this possibility for integrated supervisory and statistical reporting, the ECB and EIOPA have also defined common minimum standards for revisions transmitted by national authorities to both the ECB and EIOPA. These minimum standards are available here on our website.

- As detailed in September 2019 Insurance Newsletter, the Insurance Corporations Statistics publication has been expanded to include additional details concerning the issuers of equity holdings, maturity brackets of debt security holdings and the issuers of those debt securities. This information is available here on the Central Bank of Ireland's website. The most recent Insurance Corporation Statistics were published on 6 December 2019 and further information is available here on our website. Any questions on these statistics should be directed to insurance.statistics@centralbank.ie.

EIOPA Updates

2020 Review of Solvency II

On 16 October 2019 the first two consultations on the 2020 review of Solvency II, covering reporting and disclosure and Insurance Guarantee Schemes closed. The CBI would like to take the opportunity to thank all stakeholders who provided feedback. This feedback is very important to the 2020 review process and all comments received will be considered in the development of the final advice.

A third consultation, covering all other aspects of the 2020 review, was launched on 15 October and is scheduled to close on 15 January 2020. While this consultation is wide in scope, the view set out by EIOPA in the consultation document, and one which is echoed by the Central Bank, is that overall the Solvency II framework is working well. While there are certain areas where more material changes are merited, the approach to this review has been, and will continue to be, one of evolution and not revolution. Again, we encourage stakeholders to engage with this consultation, in particular where there are questions to stakeholders, or where EIOPA has set out different options in the consultation paper.

Looking forward to 2020, EIOPA and National Competent Authorities will review the feedback from the consultations, and the data collected in the first impact assessment, in order to to finalise the proposed legislative changes. In March 2020, a holistic impact assessment will be performed where a representative sample of undertakings in each market will be asked to calculate the combined impact of these proposals. EIOPA are due to publish the final advice to Commission at the end of June 2020.

European Insurance Overview

On 19 November 2019, EIOPA published its second annual European Insurance Overview. The European Insurance Overview report is published by EIOPA as an extension of its statistical services in order to provide an easy-to-use and accessible overview of the European insurance sector. The report is based on annually reported Solvency II information. The report is published with all charts data available for download in a separate excel file. The report and data can be found here on the EIOPA website.

Call for Research Proposals

EIOPA has launched a call for research proposals aimed at addressing open questions related to the following topics with a special emphasis on the policy angles.

- Investment allocations of insurers and pension funds;
- Liquidity stress testing in the insurance sector;
- Early warning systems in insurance;
- Systemic relevance of insurance sector and its interlinkages with financial and real sectors;
- Economic valuation of insurers' liabilities; best estimate and risk margin.

Proposals must be submitted to the following e-mail address: research@eiopa.europa.eu by the recently extended deadline of 15 January 2020 at the latest. Further information is available here.

Forward Planner & Communications

Upcoming Dates

15 January -Third Consultation on EIOPA Solvency II 2020 Review Closes

Publication of March 2020 Edition of the Insurance Newsletter

Jan Feb Mar Apr

7 April – Deadline for Submission of Solo Annual Returns

Recently Published Speeches

Date	Topic	Link
4 December 2019	The Macrofinancial Outlook for Ireland: risks, resilience and policy - Governor Gabriel Makhlouf	https://www.centralbank.ie/news/article/speech-governor-fsr20192-mortgage-measures-4-dec-2019
29 November 2019	Innovation in Financial Services: A Regulator's Perspective - Deputy Governor Ed Sibley	https://www.centralbank.ie/news/article/speech-innovation-in-financial-services-ed-sibley-29-november-2019
27 November 2019	Financial regulation and technological innovation: a thematic approach - Gerry Cross, Director of Policy & Risk	https://www.centralbank.ie/news/article/press-release-financial-regulation-technological-innovation-gerry-cross-27-november-2019
20 November 2019	Towards a Consumer-Focused Culture in Financial Services Firms - Gráinne McEvoy, Director of Consumer Protection	https://www.centralbank.ie/news/article/speech-grainne-mcevoy-grant-thornton-consumer-culture-20-november-2019
22 October 2019	The Case for the Senior Executive Accountability Regime - Director General, Financial Conduct Derville Rowland	https://www.centralbank.ie/news/article/speech-senior-executive-accountability-regime-derville-rowland-22-oct-2019

Contact Us

General queries on insurance matters should be sent to:
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Queries on insurance policy matters should be sent to:
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