Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Insurance Newsletter

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Reflections on Reserving

The re-awakening of inflation following a 20-year hibernation. War in Ukraine and the associated economic turmoil. The emergence of litigation funding and increasing social justice movements in the US. The implementation of the Personal Injuries Guidelines in Ireland. The consequences of climate change...

With such change and uncertainty, it is an interesting time to be a reserving actuary. Setting reserves and technical provisions (TPs) these days can be a challenging exercise, requiring a large degree of expert judgement. In such circumstances, robust and well-governed processes and practices are the key foundation for reserving exercises. In response to the elevated uncertainty, the Central Bank's recent supervisory activities have had a heightened focus on reserving practices. Our supervisory work has identified a number of areas which could be further improved.

Expert judgements framework

Expert judgement can form a large part of a reserving exercise and must be appropriately governed.[1] We have recently observed good emerging practices in this area, in particular, the adoption of *expert judgement logs*. Whilst such logs may have their origin in the domain of internal models, they are becoming an increasingly important part of the reserving process. Reserving expert judgement logs provide a concise list of the expert judgements made in the reserving process. For each expert judgement, the log can capture several details, including:

- Description of the expert judgement;
- Owner/approver of the expert judgement;
- Rationale for the expert judgement;
- Validation of the expert judgement;
- Materiality/sensitivity of the expert judgement;
- Subjectivity/uncertainty of the expert judgement.

Such a log could be included as part of the Actuarial Report on Technical Provisions (ARTP) or may form a separate document. Reserving expert judgement logs

are particularly useful for firms' senior management and boards, providing them with visibility of the key expert judgements that underpin the reserves and TPs. The logs also allow for an easy assessment of the consistency and stability of expert judgements over time, and facilitate challenge and discussion. Firms are recommended to reflect on their own expert judgement framework and consider whether it could be strengthened by the adoption of an expert judgements log.

Validation of technical provisions

A number of insurance firms have recently notified the Central Bank of operational errors within reserving. The errors occurred in manual processes, such as spreadsheets, that were used for reserving calculations outside of the main reserving model. There be can weaker controls and understanding of manual calculations, compared to the main reserving model. This can lead to errors, for instance, where cells are linking to the wrong data, there is double counting or incorrect formulae is used.

Firms generally detected the errors in carrying out ad-hoc reconciliations or model development work, outside of the annual validation process. High-level checks such as analysis of change were not sufficient to surface the errors, and only more in-depth validation led to identification of the issues. In a few cases, firms did not apply such controls as part of the regular validation as resources were re-allocated to other projects such as IFRS17 implementation.

The size of the manual adjustments can be material in comparison to the excess own funds, and this is what we consider most relevant for the assessment of materiality in this instance. Solvency II defines information as material if that information could

1. See the relevant EIOPA guidelines for more information: https://www.eiopa.europa.eu/system/files/2023-03/Consolidated_GLs_valuation_TPs_ET_EN.pdf

influence the decision-making or judgement of the intended users of that information.

For Life firms, own funds are on average around 5% of the TPs, whereas this ratio is much higher for non-life and reinsurance sectors. Having a lower ratio than other sectors, means that life firms have potentially less capacity to absorb unanticipated reserve risk. Consequently, a small change in TPs can have a material effect on the solvency coverage ratio of life firms, highlighting the importance of robust validation of life TPs.

It is important that firms have effective systems, controls, and documentation for the purpose of valuation of assets and liabilities, as per Article 267 of the Solvency II Delegated Acts. This article also states that firms must provide sufficient resources to develop, calibrate, approve and review valuation approaches used for solvency purposes. We have observed better practice in some cases where firms have reduced the extent of manual processes in reserving, by introducing automation to minimise the operational risk. Where there is material reliance on manual approaches to reserving, it may warrant further attention as part of the annual validation of TPs.

"It is important that firms have effective systems, controls, and documentation for the purpose of valuation of assets and liabilities."

Where there is significant use of manual processes within reserving, the capital risk charge for operational risk in the Standard Formula may not fully reflect this risk. Hence, firms may need to consider the buffer that is required for uncertainty due to such operational risks, within its own solvency needs assessment. Where an internal model is used, operational errors could be considered in the firms' on-going appropriateness of the internal model, and updates made to the model where required.

2022 Year-End AOTP Review

The 2022 year-end Actuarial Opinion on Technical Provisions (AOTP) review showed broadly consistent findings with the previous year-end. We provide below some summary statistics from this year's review.

For Non-Life AOTPs:

- 51% of non-life AOTPs included limitations, up from 43% in 2021. Of these, 55% were specific to the firm in question, slightly up on 48% in 2021;
- Approximately 88% of non-life AOTPs included reliances, which relate almost entirely to data used in the TP calculation or elements of the calculation performed by other functions;
- In terms of uncertainties, inflation is called out in 38% of AOTPs in 2023, compared to 25% in 2021, with the Head of Actuarial Function (HoAF) most often recognising increased economic and claims uncertainty arising from the higher inflationary environment. 25% of AOTPs call out general macroeconomic uncertainty;
- 39% of AOTPs included recommendations for improvements, which is positive to see. The majority related to data and process improvements

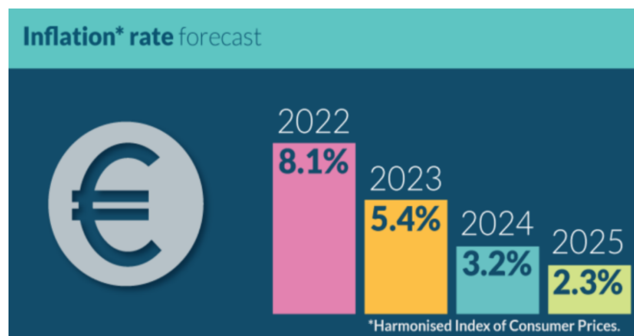
For Life AOTPs:

- 17% of Life AOTPs at YE 22 include limitations, which is a reduction from 31% last year;
- All Life firms note reliances in the AOTP, mainly in relation to data, calculation of the best estimate and policy administration. In better examples, the AOTP (or ARTP) gives assurance that the opinion is not impacted by the reliances due to the controls that are in place;
- Uncertainties are called out in approx. 30% of the Life AOTPs, mainly in relation to Covid-19 developments and post balance sheet events. Less than 5% of Life AOTPs mentioned uncertainty around inflation;
- 45% of Life AOTPs included recommendations for improvements, which is similar to last year.

We encourage HoAFs to continue to use the limitations, reliances and recommendations sections in the AOTP to provide good visibility to Boards on key issues in reserving. We provide some further reflections arising from non-life reserving work only.

Inflation risk for Non-Life firms

By 2022 year-end, many firms had enhanced their reserving approach to calculate an explicit allowance for higher-than-expected inflation. Often, firms calculated this explicit inflation allowance by first projecting the claims cashflows expected in each future calendar year, and then applying an explicit inflation index to these cashflows. This calculation was generally performed at line of business to reflect differences in both the duration of future cashflows and the degree of inflation sensitivity between different lines. In general, the explicit inflation allowance did not lead to a material increase in the level of firms' reserves. Whilst it is encouraging to see reserving practices enhanced in response to rising inflation, firms are reminded to continue to adopt a sound and prudent approach and we have identified a number of areas to consider.



Source: Central Bank of Ireland, Quarterly Bulletin Q3 2023

Uncertainty in the future trajectory of inflation

Most firms assume that inflation will revert to its long run historical average level within the next 2-3 years. Should inflation remain *higher-for-longer*, there is a risk that reserves may be inadequate. Firms are recommended to quantify the impact and materiality of such a higher-for-longer inflation scenario and clearly communicate this to senior management and the board.

Appropriateness of non-life reserving methods in the long-run

While inflation continues to be a concern, there will continue to be a need to re-assess whether current methods are appropriate. For example, as inflation becomes further embedded in claims triangles over time, impacting more and more calendar year diagonals, the basic chain ladder method may be prone to mis-estimating the ultimate. Alternative methods, such as the inflation adjusted chain ladder, may become necessary.

Visibility and oversight of expert judgements

Assumptions made around inflation and its future trajectory is a good example of the expert judgements referenced above. Explicitly modelling inflation may require several expert judgements, including selecting relevant inflation indices, projecting future inflation, assessing the degree of sensitivity for each line of business etc. These expert judgements are recommended to be clearly documented and, as noted in the EIOPA guidelines[2], material expert judgements are recommended to be communicated to senior management and the board, allowing for appropriate oversight and understanding.

Firms would benefit from reflecting on these observations and continuing to monitor the impact of inflation, taking action where necessary.

Use of external data in non-life reserving

We have observed examples of external data being used effectively to support a reserving exercise. This may occur for example in the context of growing books of business where sufficient historical information is not available internally. In such cases, the firm may rely on external data (such as development patterns and loss ratios) sourced from market benchmarks or other entities within its group.

Whilst use of external data is often necessary and appropriate, we recommend firms understand and assess the *basis risk* arising from the use of such data, in line with EIOPA guidelines.[3] Firms are recommended to validate external data to ensure that it is appropriate for and reflective of their business. Based on our reserving reviews, we believe that this is an area for improvement. A number of shortcomings have been identified and we encourage

2. Guideline 24B, https://www.eiopa.europa.eu/system/files/2023-03/Consolidated_GLs_valuation_TPs_ET_EN.pdf

firms to reflect on these and make improvements as necessary in advance of the 2023 year-end reserving exercise:

- No overview of where and how external data is used in the reserving process;
- Limited or no justification provided for using the selected external data rather than other sources;
- Limited or no validation of whether the external data is appropriate for the firm's own risk profile;
- Limited or no sensitivity testing to show the potential impact of using inappropriate external data;
- Limited or no discussion of the reliance on external data in the AOTP.

Given the material reliance on external data in some cases, we encourage firms to reflect on these observations and make improvements as necessary in advance of the 2023 year-end reserving exercise.

Conclusion

Firms are encouraged to reflect on these observations as we approach year-end 2023. In particular, firms are reminded of the importance of having robust validation and controls around TPs. Some firms would benefit from a more rigorous approach to setting and validating expert judgements, including key expert judgements around inflation, which is likely to remain a material factor at year-end 2023. Some firms would also benefit from a more thorough and much better governed use of external data. We hope the observations and good practice noted within this article, assists firms in developing these fundamentals within their reserving practices.

Chris Gibney &
Marie Bradley
Actuarial Function
Insurance Directorate

ORSA Feedback Part 1 - Supervision of Climate Change Risk

Climate Change Risk is a strategic priority for the Central Bank of Ireland. The Central Bank published its Guidance for (Re)Insurance Undertakings on Climate Change Risk (the Guidance) in March 2023. The Guidance clarifies expectations with regard to how firms consider climate change risk within their business. Consideration of climate change risks is a feature of regular engagements with firms, in addition to deeper analysis to monitor the impact on the sector such as implications for natural catastrophe modelling. Below, we provide feedback on our analysis to support the iterative process of integrating climate change risk into risk management frameworks and to support firms' response to climate change.

The feedback is based on our review of firms' ORSAs (received in 2022 and 2023 to date), materiality assessments, and quantitative analysis, where completed. We have included examples of better practice that have already been observed through our engagement with firms. We encourage firms to reflect on these points as they seek to develop and strengthen their response to climate change.

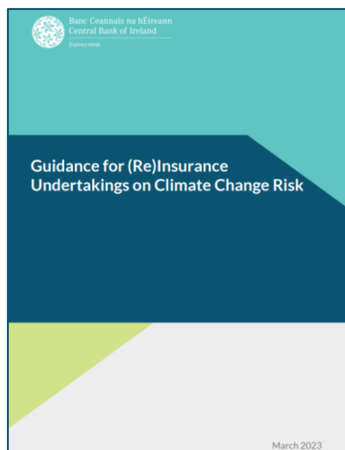
Materiality Assessment is Key

As per the Guidance, the assessment of the materiality of a firm's exposure to climate change risk is key to understanding the potential impact of climate change on the sustainability of their business model. We have already seen some improvements in firms' consideration of climate change risk in ORSAs as their knowledge and understanding of the associated risks is developed. However, few firms

3. Guideline 8, https://www.eiopa.europa.eu/system/files/2023-03/Consolidated_GLs_valuation_TPs_ET_EN.pdf

Published by the Insurance Directorate, Central Bank of Ireland

are undertaking the broad materiality assessment described in the Guidance that considers climate change risk in a holistic manner in the context of their business model.



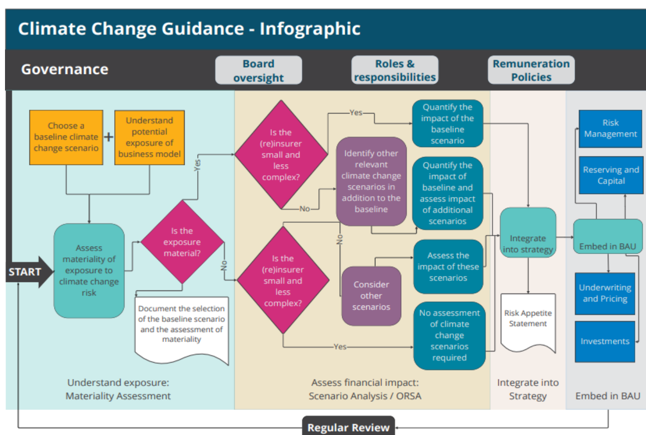
In the ORSAs that we have reviewed, some firms have placed particular focus on the impacts of physical and investment transition/market risk. We have seen little consideration given to secondary and indirect impacts of climate change and interdependencies of risks, which for many firms may be far more material than direct impacts. Such considerations include, for example, what changes may be needed to product offerings and business strategy, changes to policyholder behavior and preferences, geopolitical changes, correlations between physical and transition risks, and the effect on parent capital or reinsurance availability. So far, limited action has been taken by firms on the back of materiality assessments. Better examples of aspects of materiality assessments that we have already seen include:

- Consideration of the potential impact to both assets and liabilities of various climate change risks;
- Consideration of indirect climate change impacts, such as the impact to reinsurance costs and availability in light of higher frequency and severity of physical risks, including how the global nature of reinsurance could lead to changes domestically. Many firms have only considered this question for external placements, even when the group in question has material exposures to climate risk. Further improvements could be made by considering indirect impacts in the context of intergroup reinsurance and how this could potentially be impacted by climate change risk;
- Firms considering their strategic business model decisions in light of exposures identified, including how current product offerings need to be adapted in light of climate change policy, changing customer preferences, or increased exposure, e.g. transitioning to more green product offerings, or reducing exposure to certain risks;
- Exposure to climate litigation risk through both the firm's own business operations and through the lines of business that it writes;
- Assessing materiality of potential impacts to investment transition risks by using a publicly available classification of investments exposed to climate transition risk, such as Climate Policy Relevant Sectors (CPRS) classification;
- Consideration of how the materiality of risks might change over the short, medium, and long term; and
- Consideration of how a firm's own operations and activities are affecting climate change, including how these are being changed or adapted ("inside out" materiality), e.g. cutting their own emissions, updating investment policies, and setting carbon reduction targets and actively working towards them.

In line with the Guidance, firms are encouraged to establish and define a baseline climate change scenario as part of their materiality assessment. The rationale for the selection of the baseline climate change scenario should be documented. We encourage firms to consider publicly available climate change scenarios when defining their baseline. For example, aligning the baseline scenario to a particular climate pathway. However, we encourage firms to ensure that they understand the limitations of the pathway they choose.

We encourage firms to continue to develop their materiality assessments and to use the exercise to consider the "what ifs" that could occur in light of climate change, and how the firm could respond. For example, given that global climate mitigation efforts are not currently on track, this potentially poses much higher "second order" risks, e.g. changes to migration patterns, crop failure, geopolitical risks, and disruptions to supply chains. These risks could have wide ranging and far reaching consequences.

The results of the materiality assessment should be used by firms within strategy and business planning, leading to action being taken where needed. As part of the iterative approach discussed in the Guidance, we will expect to see more action taken in future. The Central Bank will continue to engage with firms to understand what changes or actions that are planned as a result of the materiality assessment.



Developing Quantitative Climate Analysis

As set out in the Guidance, where firms have identified a material exposure to climate change risk, they are expected to quantify the potential financial impact. By carrying out an initial materiality assessment, firms can assess the quantitative impact with a broader understanding of how the risks could change and directly or indirectly impact each other. Where quantitative analysis is already being used, we have seen some better examples within recent ORSAs, which include:

- Defining and designing quantitative assessments in line with climate science, and more specifically linking it to a climate change scenario, including outlining the assumptions underpinning the analysis;
- Considering the financial impacts of secondary or indirect risks such as cost and availability of reinsurance, changes to product offerings, and risks around not complying with climate policy or public sentiment (e.g. regulatory fines or litigation risk);
- Assessing the impact of combinations of risks rather than standalone events, e.g. physical and transition events combined, and assessing the impact to both assets and liabilities.

This is of particular concern where the results of these scenarios lead to strategic decisions being made or equally, a decision taken to continue with the status quo strategy.

Where quantitative analysis of climate change is used, it should be plausible and in line with climate science. Recent publications[4] have shown that climate scenario models used in financial services significantly underestimate the impact of climate change risk.

Within recent ORSAs, we have seen evidence of this issue in quantitative analysis for some firms. We show below a table of results from firms we supervise, showing their estimate of the impact to own funds arising from climate change risk on investments under various scenarios with roughly 1.5°C - 4°C of warming. Typically in these scenarios, no additional policy action is taken and/or late policy

Firm	Assumed Scenario	Impact to Own Funds
Firm 1	1.5°C Warming/4°C Warming	(1-2%)
Firm 2	Late/no additional policy action	(13%)
Firm 3	Late/early/no policy action	(6-10%)
Firm 4	1.5°C-2°C Warming/4°C	(10%)
Firm 5	Disorderly (late) transition scenario	(4%)
Firm 6	Late/no policy action	(1%-14%)

Table 1: Sample Impact to Own Funds following Climate-driven Investment Shocks

4. https://actuaries.org.uk/media/qeydewmk/the-emperor-s-new-climate-scenarios.pdf

The results of these stresses appear to be mainly driven by changes in the value of investments. Some of this variation in the results could be explained by numerous factors, including differing levels of investment in sectors classified as exposed to climate change risk and policy/adaptation actions. Overall, the results shown here do not appear to be in line with the expectations of climate scientists. Such scenarios are likely to also include significant macroeconomic impacts, such as population movements, geopolitical instability, or crop failures, and the impact is unlikely to be restricted to investments. This points to a need to think more broadly about how transition and physical risk might manifest through the global economy.

Where quantitative analysis is used, we expect that firms should ensure that the results are appropriately validated, including via plausibility checks, and that the limitations are fully understood and communicated. The level of model complexity should reflect the materiality of the risk exposure.

Firms may find it helpful to include reverse stress testing to help answer questions such as:

- At what point climate change risk would result in the firm becoming insolvent; or
- What transition path would enable the firm to respond to challenges to the long-term sustainability of the business model.

This approach could be useful in strategy and business planning for the future direction of the firm (See ***ORSA Feedback Part 2 – Strategy & Reinsurance*** on Page 9), both in terms of mitigating risks and developing opportunities identified.

Conclusion

While there have been some improvements to firms' consideration of climate change, there is still more that can be done in this area. Firms are reminded of the amendments to the Solvency II Delegated Acts, which are applicable from 2 August 2022.[5]

The Central Bank's Guidance is also available to assist firms in their assessments. We recognize that firms are at different stages of their climate change considerations, and there is no one size fits all for how firms can assess and deal with potential climate change risks. Nevertheless, assessments of risk exposures should be in line with climate science and firms are encouraged to challenge results where this is not the case. Firms are encouraged to continue to develop their knowledge and understanding of potential risks, particularly as new information becomes available.

Rebecca Prouse & Emily Duffy
Actuarial Function
Insurance Directorate

Additional Resources:
The following resources may be of use to firms developing their knowledge of climate change risks:

- The Emperor's New Climate Scenarios - Limitations and assumptions of commonly used climate-change scenarios in financial services produced by the Institute and Faculty of Actuaries and the University of Exeter.
- Climate Emergency – tipping the odds in our favour - A climate change policy briefing for COP27 produced by the Institute and Faculty of Actuaries and the Climate Crisis Advisory Group

5. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R1256&from=EN

ORSA Feedback Part 2 – Strategy & Reinsurance

During a recent review of firms ORSAs within the Domestic Non-Life Sector, two significant areas of focus included:

a) the linkage between the Business Strategy and Business Plans, and their consideration in the ORSA process, and

b) the significant hardening of the international reinsurance market in recent renewal periods.

Following the conclusion of this review, we wish to share the following industry feedback with all insurance undertakings:

Consideration of Strategy & Business Plan

Following our review, we recommend that firms clearly demonstrate, that the conclusions from the ORSA process are feeding into the strategic planning process, as well as the strategic decisions made by a firm on an on-going basis. The following observations should be considered as part of the 2023 ORSA process:

- The ORSA report should briefly outline the processes conducted in completing the ORSA, in particular those activities aligned with or inputting to the strategic planning process.
- should have in place a robust process for developing, reviewing and updating the strategy and business model, which is appropriately integrated into business planning. While it is not necessary to include extensive information around this process in the ORSA, a summary commentary detailing the linkage and alignment between the business strategy and business plan would be beneficial.

Reinsurance Market

As you are aware, the international reinsurance market has experienced significant hardening in recent renewal periods, particularly in the property and catastrophe market. This follows large catastrophe losses in the US and Europe during 2022, Business Interruption losses relating to the Covid-19 pandemic, and a general increase in insured catastrophe losses over a number of decades.

While Ireland has experienced benign weather in recent years, Irish insurers were not immune to reinsurance market hardening in their 2023 renewals. Experience included material rate increases, tightening of terms and conditions including reinstatement terms, and difficulty placing "working" catastrophe layers. Negotiations were also protracted, with some covers not being agreed until very close to the renewal date.

While most firms considered the risk of reinsurance market hardening in their 2022 ORSAs, the stresses applied were not much more severe than actual experience. Insurers rely on reinsurance to manage their risks and support their business strategies, making reinsurance affordability and availability a key risk for consideration in the ORSA. We expect to see a more in-depth consideration of this risk in the 2023 ORSAs. Some points for consideration include:

- Material increase to price of reinsurance;
- Material increase to retention on excess of loss reinsurance due to lack of capacity in the market to cover these working layers;
- Reverse stress testing of catastrophe retentions, to understand the point at which the business model, strategy and capital position would be materially impacted;
- The impact that large catastrophe losses in Ireland could have on reinsurance price and terms. This could reference the 2023 renewal experience in regions that suffered large catastrophe losses in 2022; and
- Operational risk arising from delays to agreeing and finalising reinsurance contracts, e.g. a period where cover is uncertain or not incontrovertible, and potentially not eligible for consideration in the SCR calculation.

The results of these risk analyses should feed into the firm's strategy and recovery planning.

Killian Fitzgerald
Domestic Non-Life Function
Insurance Directorate

Insurance Updates

Recent Stakeholder Engagement

The Central Bank of Ireland undertakes regular meetings and speaking engagements, providing an opportunity to engage with our stakeholders, to outline forthcoming regulatory developments and supervisory plans, to highlight emerging risks, and to summarise the key findings and required actions arising from recent review work.

On 5 July 2023, Domhnall Cullinan, Director of Insurance Supervision, and colleague Brian Balmforth, attended InsTech.ie's "Digitalisation in Insurance opportunities and challenges" event. Brian presented the results of the Central Bank's recent "Digitalisation in Insurance" survey. This was followed by a panel discussion with Domhnall, Brian, Roy Jubraj (CTO, Esure Insurance), Sharon O'Brien (INED, Aviva), and Gary Leyden (CEO, InsTech.ie).

(Pictured L-R: Domhnall Cullinan - Director of Insurance Supervision, Sharon O'Brien, Brian Balmforth, Gary Leyden, and Roy Jubraj)

On the 7/8 September 2023, Domhnall attended the Association of Bermuda Insurers & Reinsurers 16th Annual International Insurance Regulatory Dialogue in Brussels. During the event Domhnall participated in a panel discussion on the "Role of Reinsurance in Closing the Protection Gap".

Head of Division Appointment

We are pleased to announce the appointment of Grace von Offenberg Sweeney to the role of Head of Division - Actuarial, Advisory Services & MIIF (INSA).

Grace has led the actuarial function within the Central Bank's Insurance Supervision Directorate for the past nine years. Prior to joining the Central Bank , Grace worked in the Irish general insurance sector as a pricing actuary before transitioning into investments and broader European roles. She is a fellow of the Institute and Faculty of Actuaries and qualified as a General Insurance Actuary.

Data Ethics within Insurance

Forward-looking risk assessments undertaken by the Central Bank has identified increasing digitalisation as an emerging risk within the insurance sector. For this reason, the Central Bank has undertaken research on digitalisation in insurance, including:

- A survey of (re)insurance undertaking on the impact of digitalisation in general across the sector. The June 2023 edition of Insurance Newsletter outlines related insights and supervisory observations.
- The Data Ethics Within Insurance Project.

Data and data analysis plays a fundamental role in insurance and are the foundations of the operations of insurers' business models. Ethical considerations and the ethical use of data across the insurance value chain is not a new consideration or challenge for insurers and other stakeholders.

However, advances in digitalisation, big data analytics and related technologies including Artificial Intelligence (AI) have the potential to fundamentally transform the role that data plays across the insurance value chain. These developments present opportunities for the collection and processing of more granular and personalised data to inform insurers' decision making and for more efficient business processes, which can result in benefits for consumers and insurers. With these benefits however, there are the potential for new or amplified risks such as the inappropriate use of data and technology, which could give rise to unfair treatment of, and ultimately negative outcomes for consumers e.g. bias, inappropriate use of personal data, and data privacy concerns.

In this context, the Central Bank undertook the Data Ethics Within Insurance Project, which aimed to further develop the Central Bank's understanding of the nature and extent of the use of Big Data and Related Technologies (BD&RT) across the insurance value chain, and the ethical considerations arising from that use. The Report on Data Ethics within Insurance summarises the high-level findings of this research project; outlining the uses of BD&RT across the insurance value chain and the associated potential risks. The Central Bank will continue its work to expand its understanding of the nature and extent of the use of BD&RT in the insurance sector and will evolve its supervisory and policy approach accordingly.

EIOPA Statement on Governance in Third Country Branches

As noted in our March newsletter, on 3 February 2023 EIOPA published a Supervisory Statement regarding governance arrangements in third countries. This statement was issued following discussion on the risks arising from the UK withdrawal from the EU. However, the issues identified and expectations of both EIOPA and the Central Bank are equally relevant for any third country.

Throughout the Brexit period, as stated on our website and directly in our interactions with firms, the Central Bank has been clear in its expectations, namely:

- Firms must have a substantive presence;
- Firms must be controlled by their boards and local management and not run from elsewhere;
- Firms must be adequately resourced in terms of seniority and expertise commensurate to the nature, scale and complexity of the business, with decision-making taking place in the Irish entity;
- Firms must be capable of managing material risks locally – i.e. risks associated with the business of the entity are governed, managed and mitigated by the Irish entity and its staff.

The EIOPA supervisory statement further supports and elaborates on our expectations, specifically with regard to the use of third country branches (TCB).

Similar to the establishment of a TCB in Ireland[6] (i.e. restricted to business within the state), there is a clear supervisory expectation that a TCB should primarily serve the market in which it is established, with the sole objective of the TCB not to simply support the EU based undertaking. It is permissible for a TCB to also assist their respective EU head offices, however such support should be ancillary, not undermine substance and/or lead to disproportionate dependence.

6. https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/insurance-reinsurance/solvency-ii/requirements-and-guidance/policy-notice-third-country-insurance-branches.pdf

Corporate substance is reiterated as having appropriate presence of board members, key function holders, and a level of staff established in the EEA which is relative to the nature and amount of business being underwritten.

While acknowledging certain niche lines will need UK support, the Central Bank expects all regulated firms with a TCB to review their current business model in light of the supervisory statement. An action plan should be developed where appropriate, setting out steps and timeline to ensure alignment with expectations. Examples of steps may include the build out of certain functions in Ireland over a specific time period to ensure business is underwritten and controlled from Ireland for predominate lines. This action plan should be available for review by the Central Bank.

In summary, supervisory expectations are clear. Firms must ensure adequate substance within the EEA, oversight and decision making should happen locally, and any disproportional dependence should be addressed. Ultimately strategy, oversight and decision making should clearly rest with the Irish firm.

Insurance Protection Gaps

Protection gaps are often broadly defined as the difference between total losses and insured losses. At present, only about a quarter of climate-related catastrophe losses in Europe are insured. As the impacts of climate change intensify, these protection gaps could widen even further.

In its 2023-2026 Strategy, EIOPA highlights protection gaps as a key area of focus within its strategic priorities and commits to stepping up its work on identifying relevant gaps aimed at raising awareness of risks and contributing to finding solutions to address them, e.g., through possible shared resilience solutions. To date, EIOPA has published various NatCat protection gap related materials including its European Dashboard on Insurance Protection Gap for Natural Catastrophes (December 2022) which presents the drivers of a climate-related insurance protection gap, and a joint Discussion Paper with the ECB on Policy Options to Reduce the Climate Insurance Protection Gap (April 2023) .

In July 2023, EIOPA introduced its latest publication on the subject (EIOPA Staff Paper on Measures to Address Demand Side Aspects of the Natural Catastrophe Protection Gap). The EIOPA Paper comprises two studies, aimed at understanding demand side barriers and drivers as well as potential solutions to the NatCat protection gap. These studies focused on analysing consumers' attitudes and perceptions of property insurance and NatCat coverage. EIOPA found that barriers to uptake of insurance where coverage is available include, among others, demand-side factors such as consumer understanding of insurance products, affordability, experience with insurance, risk perception and expectations of public support, and the purchasing process.

The Staff Paper highlights a number of potential options aimed at addressing these barriers including raising awareness on the risks, offers, and benefits of insurance, improving and/or simplifying purchasing processes, and reducing the price and risk. EIOPA invites interested stakeholders to provide feedback on the Staff Paper by **05 October 2023.**

Product Oversight and Governance (POG) – Developments

EIOPA recently published its Peer Review Report on Product Oversight and Governance (POG). The Peer Review was the first such EIOPA review in the area of supervision of conduct of business. The outcome of the review was broadly positive with just one recommendation arising for Ireland, and by extension the Central Bank. The Central Bank is recommended to formulate and communicate to the market a comprehensive set of supervisory expectations covering all the elements of POG requirements applied to Insurance-Based Investment Products (IBIPs).

Insurance Updates

Solvency II Review

On 27 July 2023, the Committee on Economic and Monetary Affairs (ECON) published its draft legislative proposal to amend the Solvency II Directive following on from the European Commission's (COM) draft proposals from 2021.

By way of reminder (see March 2021 and December 2021 newsletters), the Solvency II Review has a broad remit – with potential changes being made to the calibration of interest rate risk; a rebalancing of other items in the regulatory framework; and enhancements being made to the regulatory toolbox with the addition of macro-prudential tools.

The ECON proposal is expected to be adopted by the European Parliament by end-September 2023, at which point the process will move into the "trilogue" phase, where the ECON proposal is discussed alongside the original COM proposal and also the general approach published by the Council of the EU ("Council") in June 2022.

There is no set deadline for the conclusion of the trilogue phase, although we understand that there is an ambition for the discussions to conclude by the end of 2023 – with an ultimate implementation date for the reforms to be on 1st January 2026. Those dates are subject to change.

Generally, during trilogue negotiations, discussions focus on points of differences between the proposals, and parties either opt to choose one approach over the other – or find a compromise position. The Central Bank will be advising the Department of Finance over the coming months as to how the various sets of alternative proposals could have an impact on the Irish insurance markets, and the Bank's supervision thereof.

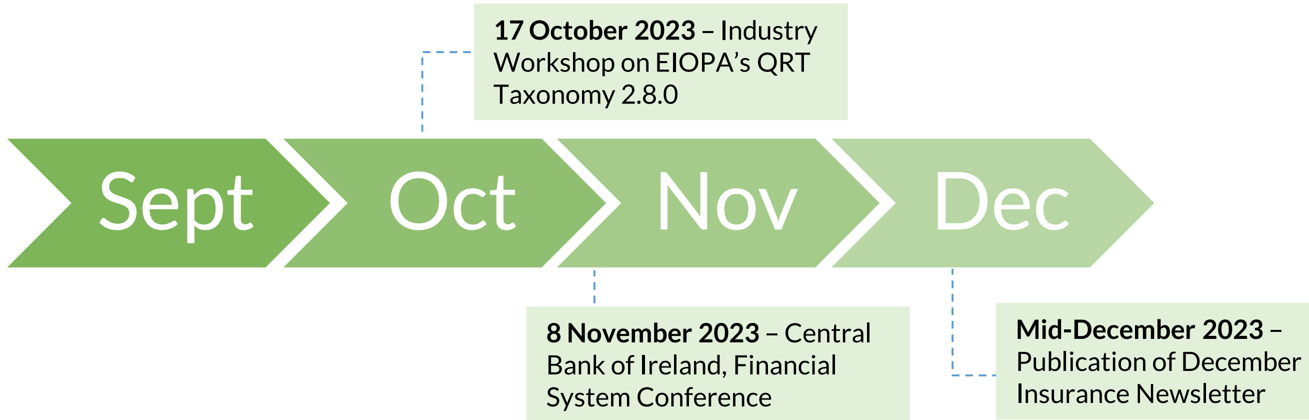
NST Taxonomy Update

The Central Bank is updating the taxonomy of its national specific templates (NSTs). There are no changes to the information collected within the NSTs, but a number of technical changes will apply to the underlying data dictionary. This NST taxonomy update is being undertaken in order to maintain alignment with the changes to EIOPA's QRT Taxonomy 2.8.0. The revised NST taxonomy will be published in early November 2023, with external user acceptance testing (UAT) taking place following its publication. The NST taxonomy will have an effective date of 31 December 2023.

As outlined in our June 2023 newsletter, on the morning of 17 October 2023, the Central Bank will host an Industry Workshop on the revisions to the reporting and disclosure requirements arising out of EIOPA's QRT Taxonomy 2.8.0. This is intended to be an interactive workshop with questions and discussion. Invitations to the workshop will be issued in due course and attendance is encouraged across all firms from individuals with significant involvement in the compilation of the Solvency II returns.

Forward Planner

Upcoming Dates



Central Bank of Ireland – Recent Speeches/Publications

Date	Topic	Link
21 September 2023	Labour market dynamics and the inflation outlook - Remarks by Governor Gabriel Makhlouf at University of Galway	https://www.centralbank.ie/news/article/speech-labour-market-dynamics-and-the-inflation-outlook-remarks-governor-makhlouf-university-galway-21-sept-2023
19 September 2023	Central Bank Quarterly Bulletin	https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2023/quarterly-bulletin-q3-2023.pdf?sfvrsn=2dc49c1d_5
1 September 2023	Navigating the risks of geo-economic fragmentation - remarks by Vasileios Madouros, Deputy Governor, Monetary and Financial Stability	https://www.centralbank.ie/news/article/navigating-risks-geo-economic-fragmentation-remarks-vasileios-madouros-deputy-governor-1-september-2023

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