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MEMO

TO: Central Bank of Ireland - Consultations

FROM: Insurance and Reinsurance Team, William Fry

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Submission to the Central Bank of Ireland - Consultation Paper 131

Pre-emptive Recovery Planning

This submission is made on behalf of William Fry.

Introduction

William Fry welcomes the publication of Consultation Paper 131 ("CP131", "the consultation paper") on "*Regulations for pre-emptive recovery planning for (re)insurers*". After a number of years during which we are aware that the Central Bank of Ireland ("the Central Bank") has requested many Irish (re)insurance undertakings ("Firms" or "Firm") to prepare pre-emptive recovery plans in the absence of relevant published guidance, CP131 brings welcome clarity to the Central Bank's expectations in this regard. William Fry strongly supports the objectives of pre-emptive recovery planning as set out in Section 3 of the consultation paper. However, we have a number of concerns in relation to certain aspects of the CP131 proposals which we feel would not lead to optimum outcomes towards achieving the stated objectives.

Summary

These concerns may be summarised as follows:

- Proposing to implement requirements ahead of similar developments at a European level (especially as part of the ongoing Solvency II 2020 review) could have adverse implications for Irish Firms, especially to the extent that those requirements may (in the short -term, or even in the longer-term) place a greater burden on Irish Firms than their European peers and competitors.
- We believe that it would be beneficial to carry out a regulatory impact assessment or at least a cost-benefit analysis before implementing such significant requirements.
- By expecting written confirmation of future capital support from parent or related undertakings (where this is proposed as a recovery option by an Irish Firm), we believe there is a risk that, depending on the jurisdiction of that undertaking, such commitment could amount to a contingent liability of the parent or related undertaking and may need to be recorded as such on that undertaking's balance sheet/statement of financial position depending on the accounting standards applicable to the preparation of that undertaking's accounts.
- While noting that CP131 invites specific inputs on the topic of proportionality, we are concerned that the draft regulations as written would mitigate significantly against a proportionate implementation; the prescriptive requirements to project multiple scenarios and consider multiple recovery options against each scenario will generate large volumes of calculations and

require significant use of firms' resources without necessarily adding value in achieving the objectives set out in CP131. We believe this would be particularly true for small Firms, albeit welcome opt-outs for captive Firms are proposed in the consultation paper.
- The time period over which the Central Bank expects scenario projections to be carried out is not made clear in CP131.
- The proposed requirements could cause Firms to repeat significant amounts of content already set out in other documents such as the Regular Supervisory Report, the Risk Appetite Statement and/or the ORSA report, causing an unnecessary duplication of effort.
- It is less than ideal to put forward requirements for recovery planning without also addressing the complementary topic of resolution planning – no indication is given in CP131 of any Central Bank plans in this regard.

Many of the above concerns could contribute to an effect where Irish Firms are at a disadvantage compared to similar undertakings authorised in another EEA member state. Placing additional regulatory burdens on Irish Firms will have an impact on their costs base and competitiveness, costs which may ultimately be passed on to policyholders while reduced competitiveness could have unwelcome implications for Ireland's future attractiveness as a location in which to establish/operate a (re)insurance undertaking. It could also cause groups with existing operations in Ireland to consider investing in other EEA carriers in their group rather than investing further in Ireland.

We expand further on several of the above points in the detailed comments below.

We also wish to address the specific questions posed by the Central Bank in Section 6 of CP131, viz.

1. What, if any, other areas should be covered in the Guidelines or in future guidance?

- William Fry view: We believe it would be very valuable to include guidance on the time period over which the Central Bank envisages the recovery indicators being triggered and the recovery options being implemented. Clearly, a catastrophic event could happen at any time, and could be assessed with an immediate-term view, but the more realistic scenarios which a Firm will need to plan for will involve deterioration in one or more aspects of a Firm's business over a period of time, while some potential remedies (e.g. sale of a portfolio or the whole business) will also involve a significant period for implementation (including regulatory approval). In general, assuming a reasonably healthy starting point, the likelihood of getting into difficulties in the next three months will be much lower than the likelihood over the next three years. Further guidance on the Central Bank's expectations of the recovery planning time horizon would be welcome.
- We believe that the Central Bank could usefully clarify, for the avoidance of doubt, that Firms that are in a position where they must submit an immediate recovery plan in accordance with Regulation 146 of the Solvency II Regulations or a short-term finance scheme in accordance with Regulation 148 do not have to update their pre-emptive recovery plan until such time as they have normalised their solvency position (i.e. the Firm is in compliance with its Solvency Capital Requirement and there is not a risk of non-compliance within the following three months).
- The Central Bank could also clarify, again for the avoidance of doubt, that the closure to new business scenario does not apply to Firms that are already in run-off, unless they intend to restart writing new business (which would no doubt require separate notification to the Central Bank as a material change of business plan).

2. Are there any areas where the application of proportionality can be improved or clarified?

- Yes, proportionate implementation of the pre-emptive recovery planning requirements is extremely important. We highlight a number of specific areas in our detailed comments below.

Detailed Comments

Section 2.1:

This section refers to " … *insurance failures … [of] firms operating in Ireland on a freedom of services basis*." It is important to note that the CP131 proposals would not apply to such firms, as they are authorised by competent authorities in other EEA states.

Sections 2.6 & 2.7:

In this survey of international regulatory developments, we note that almost all of the references are to "Recovery and Resolution Frameworks" (while the IAIS paper cited, though exclusively concerned with recovery planning, explicitly promises a follow-up paper addressing resolution). CP131 is silent on any intentions in relation to resolution planning; we believe it would be most helpful to have a clear picture of the Central Bank's intentions in this regard before a new recovery planning regime is introduced.

Schedule 1 – Draft Regulations

Regulation 3(2):

"*(2) Where an insurer provides for a recovery option that involves provision of financial support from another undertaking within a group of which the insurer is part, the insurer shall include in the recovery plan confirmation that it has obtained that other undertaking's written confirmation of the undertaking's willingness and ability to provide such financial support in the scenario contemplated.*"

It is a practical reality that most Irish Firms are subsidiaries of international groups, and that in most instances, provision of capital, liquidity or other support from that group will be the most likely recovery option for a Firm that gets into difficulty. We have particular concerns in relation to the explicit requirement for "*written confirmation*" set out in the above draft regulation. Depending on the legal system and the accounting standards to which the "*other undertaking*" (which may reside in the EEA or a third country) is subject, this commitment could amount to a contingent liability of the other undertaking and may need to be recorded as such on that undertaking's balance sheet/statement of financial position. We believe that this would require groups to treat Irish subsidiary Firms in a different way to those authorised elsewhere and could serve to reduce the attractiveness of Ireland as a location for (re)insurance business.

We believe that this issue could be addressed by rewording draft regulation 3(2) so that the onus is placed clearly on the Irish Firm to consult with the "*other undertaking*" to ensure that any recovery option that would require that other undertaking's support is realistic and practicable in the circumstances under consideration.

For completeness, we note that this same proposed requirement is also referenced in the schedule to the draft regulations, at Part G(c)(iv) (P. 17 of CP131), and also in the draft guidelines, at section 5.5 (point 3) and section 5.8 (point 4).

Regulation 4(2)(a):

This draft regulation requires a minimum annual review of the recovery plan (including Board assessment and approval); while this is appropriate for larger, more complex, higher impact Firms, we believe that smaller and simpler Firms are practically unlikely to see significant changes in their recovery plans from year to year. In any event, the provisions of draft regulation 4(2)(b) will ensure that the recovery plan is updated in the event of material change. We suggest that an explicit allowance for proportionality be included in regulation 4(2)(a), whereby the frequency of review could be related to an Firm's PRISM rating, e.g. annual for high impact, every two years for medium-high impact, otherwise every three years.

Regulation 4(2)(d)

This draft regulation could be amended to clarify that reviews by the risk committee, internal audit or the external auditor are not mandatory at any point.

Schedule to the Draft Regulations

Part A – Summary

The prescribed list of seven sections will militate against Firms preparing a clear and concise summary of the key outcomes from the recovery planning process. We believe better outcomes will be achieved simply by requiring that a summary be produced without further prescription. It is also unclear to us what the Central Bank means by "*overall recovery capacity of the insurer*". If the Central Bank decides to retain this phrase, its meaning should be clarified. (In this latter regard, we acknowledge the content of Guideline 5.9, Point 8, but we still believe that further clarification on "*overall recovery capacity*" is needed.)

Part E – Strategic Analysis

We have concerns that the long and detailed list of required information set out in this part would be both onerous to provide and would duplicate information that is already available in other documents, notably the Regular Supervisory Report. However, we welcome the explicit acknowledgment in the opening paragraph of this part that the information requested should be "*relevant to the plan, important to understanding the plan, and appropriate to the nature, scale and complexity of the insurer*" and believe that it is very important that this proportionate approach is adhered to in practice. One of the key concerns is that recovery plans will become too long and detailed to be of practical benefit and could become mere "tick-box" compliance exercises.

We also welcome the specific provisions for captive Firms, which are clearly more appropriate than the general contents of part E in their circumstances.

Part G – Recovery options

We have a general concern about the breadth and detail of the requirements set out in this part, and in particular the absence of any specific allowance for proportionate implementation, in contrast with the welcome approach taken in part E above.

We believe that identifying the recovery options available, assessing the feasibility of their implementation across a range of different adverse circumstances and identifying likely obstacles to their use is the heart and central purpose of pre-emptive recovery planning. We believe that a simpler, less prescriptive requirement in relation to identifying and assessing recovery options would likely lead to better outcomes.

Part H – Scenario analysis

Again, our main concern lies with the degree of prescription and detail set out in this part, with no explicit acknowledgment within the part of proportionate implementation. With the welcome exception of captive Firms and third-country branches, all Firms, however small or simple, will be required to project a wide range of financials for a minimum of four scenarios irrespective of their relevance or likelihood. We believe that these scenario projections are probably the least important part of the pre-emptive recovery planning process and indeed are something that is more appropriately dealt with as part of the ORSA process. At the very least, we suggest that scenario projections that show a Firm getting into difficulty should only be required in the recovery plan to the extent that these are not already addressed in the most recent ORSA process and report (with reference to management actions document in that ORSA).

Schedule 2 – Draft Guidelines

Section 2.3: Link with System of Governance, Risk Management Framework and ORSA.

We note the Central Bank's view that the ORSA focuses only on solvency and we do not necessarily agree; while solvency will certainly be a primary concern of the ORSA, our experience is that many if not most ORSA's address other dimensions including liquidity and operational events. However, we fully agree with the Central Bank that the pre-emptive recovery plan should be fully integrated into the Risk Management Framework and should be fully consistent with the ORSA and the Risk Appetite Statement

in particular. Furthermore, ideally it should not duplicate content already contained within other Risk Management Framework documents.

Section 3.2 Application of Proportionality

We welcome the content of this section but we note that it appears in the draft guidelines and therefore cannot override the specific content of the draft regulations. We believe that explicit allowance for proportionate application should be set out within relevant parts of the draft regulations, specifically parts G & H of the schedule to the draft regulations as set out above, in a similar way to that already contained in part E of the schedule to the draft regulations.

Section 3.6 Submission of Pre-emptive Recovery Plans to the Central Bank

This section suggests that the Central Bank intends to require first submissions of pre-emptive recovery plans from high and medium-high PRISM-rated Firms at some date in 2021. It is important that a reasonable lead in time for such in-scope Firms is allowed after the finalisation of the requirements proposed in CP131, as compliance will be a major task requiring significant time and resources, and disruption of existing ORSA / business planning cycles should be avoided. Submission of first plans at a date in 2022 may be a more realistic objective. It would be useful also to understand the Central Bank's intended timetable for Firms with lower PRISM ratings – allowing additional time for such Firms would contribute positively to the proportionate implementation of the requirements.

Section 4 Group Recovery Plans

The concept of permitting a reasonable level of reliance on group recovery plans is welcome, but it should be borne in mind that many groups will not be under a regulatory obligation to prepare pre-emptive recovery plans, while those that are may be subject to requirements that are quite different to those proposed under CP131, so this section may not be particularly meaningful in practice.