Insurance Ireland response to the Consultation Paper 150 on Guidance for (Re)Insurance Undertakings on Intragroup Transactions & Exposures

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Our members contribute €1.6bn annually to the Irish Exchequer and the sector employs 35,000 people in high skilled careers. The role of Insurance Ireland is to advocate on behalf of our members with policymakers and regulators in Ireland, Europe and Internationally; to promote the value that our members create for individuals, the economy and wider society; and to help customers understand insurance products and services so that they can make informed choices. Insurance Ireland represents over 130 member firms serving 25m customers in Ireland and globally across 110 countries, including 24 EU Member States, providing protection peace of mind to individuals, households, and businesses, and providing a firm foundation for the success of the Irish economy and wider society.

General Comments:

Insurance Ireland welcomes the opportunity to share feedback on the Consultation Paper on Guidance for (Re)Insurance undertakings on Intragroup Transactions and Exposures. It is welcome that the prospective Guidance proposes to not introduce any new requirements on (re)insurers in respect of Intragroup Transactions ("IGTs"), and that the Central Bank has considered proportionality in developing the proposed Guidance and will take a proportionate approach in future supervisory engagements with (Re)insurers. It is important that (Re)insurers have the flexibility to implement the Guidance in a manner that is appropriate to the nature, scale, and complexity of their business models and their inherent risks in line with Article 5 of Solvency II. However, there are a number of areas that our members have identified as going further than simply providing guidance on existing regulations and introduces new expectations for (Re)Insurers and we will set these throughout our response.

In section one the Consultation Paper sets out the Central Bank expectations on Governance and Risk Management procedures in place to manage the risks associated with intragroup arrangements in general, and the second section focuses on the most significant exposures observed by the Central Bank (i) Intragroup Assets, (ii) Intragroup Reinsurance and (iii) Cash Pooling/Group Treasury function arrangements. It would be helpful to clarify where the Consultation Paper refers to “intragroup transactions” and “intragroup arrangements” whether the meaning is the same for both or refer to where they are defined by the Central Bank, as both terms are used interchangeably throughout the Guidance.

It is noted in the Consultation Paper that the Central Bank wishes to clarify its expectations on what compliance with the existing Solvency II requirements might look like for a (Re)insurer. One area where more clarity could be provided in the Guidance is relating to the definition and identification of intragroup transactions set out in Article 33 of Solvency II and how it aligns with the Central Bank Recovery Plan Guidelines (Section 5.6)[1] and the “interconnectedness” definition, given that the Guidance should be read in conjunction with Recovery Plan Guidelines. For the purpose of ensuring clarity it would be beneficial if the final guidance outlines it relates to the ‘significant’ intragroup transactions as set out in Art. 377 of Solvency II, as the the definition of ‘interconnectedness’ within the Recovery Plan or does the Guidance capture all intragroup arrangements.

Our members are generally part of large international groups and benefit from the financial resources and other supports a Group can provide. Intragroup arrangements can facilitate synergies within a Group and thereby lead to healthy cost efficiencies, improvements to risk management, and more effective control and use of capital and funding to the benefit of

[1] https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/insurance-reinsurance/solvency-ii/requirements-and-guidance/recovery-plan-guidelines-for-(re)insurers.pdf

policyholders. The Central Bank recognition of this in the introduction section of the consultation paper is welcome.

However, it is significant that the Guidance recognises perhaps the most important benefit of being part of a (Re)insurance group - diversification of risk. Diversification of risk is central to the concept of (Re)insurance. Diversification of risk provides for greater balance sheet stability to the benefit of policyholders and shareholders. Intra-group transactions provide an essential tool in facilitating the diversification of group wide risks and in so doing, enhance the financial strength of the (Re)insurance group and its subsidiaries. A balance needs to be struck between increasing regulatory expectations on intra-group transactions (IGTs), and a proportionate approach which enables undertakings to make appropriate decisions based on the nature, scale, and complexity of the business, as this can undermine group diversification and financial strength, which in turn can have the counterproductive impact of undermining the financial robustness of the subsidiaries the Central Bank seeks to protect.

Much of the Central Bank guidance is taken from the existing Solvency II regulations and reminds (Re) insurance undertakings that the regulations on risk management and governance which apply at entity level, apply equally to transactions which are internal or external to the Group in which the (Re)insurance undertaking sits. While Solvency II establishes that the regulation of individual (Re)insurance undertakings remains the essential principle of insurance regulation, it also establishes a rich and comprehensive framework for the regulation of (Re)insurance groups. This needs to be recognised by individual National Competent Authorities (NCAs) as an international Group operates across a number of different jurisdictions and a diverging approach by one NCA can undermine the benefits of operating across the Single Market and a consistent approach to regulatory supervision.

It is critical that the final Guidance recognises the importance of the role of Group supervision. The Central Bank contributes to the supervision at Group level through leading or participating in the relevant College of Supervisors. In order to deliver a proportionate and balanced approach to regulatory supervision, the Guidance should recognise the extent of oversight and monitoring of IGTs at the undertaking level that can be informed and condensed because of the work of the Colleges of Supervisors and the Central Bank's engagement within the College. Currently the guidance appears to ignore the Central Bank's work and obligations as a member of the College of Supervisors, and the insights and assurances it will have gained there.

The feedback statement of the Department of Finance and the Central Bank on their consultation on a National Resolution Framework recognised the development of a EU framework for the recovery and resolution of insurance undertakings. The conclusion of the feedback statement not to pre-empt discussions at EU level should be respected and maintained in this Guidance. Any requirements significantly overlapping with group recovery and resolution planning and presenting individual requirements at entity level would be disproportionate.

Part A: Introduction

The CBI expectation in point 3 that (Re)insurers have sufficient local substance and governance procedures in place to continue to operate in a severe stress in the group or even failure is concerning given its potential to undermine the group supervision framework in Solvency II. If the consideration here is intended to include an Irish based undertaking with a Group/International parent, the word “local” should be replaced with “sufficient substance within the undertaking”. A (Re)insurance undertaking will plan to withstand a Group stress or failure in so far as this concerns continued operations following a severe stress. It is also noted that expertise and experience in assessing and managing risk is not linked to the location but rather to the know-how and resources assigned to processes.

Solvency II is not a zero failure regime, nor is its application in the Irish context. This section outlines that local entities should have the ability to continue to operate even if the Group entity fails. This is not always in the best interests of the entity, its policyholders, or the financial system. The important element here is to ensure an orderly failure (if it cannot be avoided) and as noted above, the objective of existing regulation is to ensure this by identifying solvency issues sooner rather than later to allow for an orderly wind up (if necessary).

2. Application of the Guidance

Within point 1.3 of the Introduction section of the CP, it is confirmed that “The Central Bank has considered proportionality in developing this Guidance and will take a proportionate approach in any future supervisory engagement with (re)insurance undertakings.” However, on point 5 of the CP, it is made clear that the captive (re)insurance undertakings are included in the scope of the Guidance, which Insurance Ireland feel is disproportionate given their inherent differences in operations, business, and structure from (Re)insurers. The CP references the Central Bank’s objective of protecting policyholders. Captive (re)insurance undertakings operate as an effective risk management tool to manage the total cost of risk by providing insurance or reinsurance cover for risks of the entity to which it belongs. As a result, the risk universe of a captive (re)insurance undertaking is significantly less than that of (re)insurers as captive (re)insurance undertakings operate with a limited scope in that it will only cover the risks of the parent company and its subsidiaries.

Captives do not service policyholders directly. Captive (re)insurance undertakings typically do not take on third party risks. Captive (re)insurance undertakings allow their parent to increase the overall efficiency of its risk management and financing processes. There is already a divergent approach being adopted with regards to captives and the application of proportionality resulting in a differing national approach than required under Solvency II for example. These requirements have potentially negative impacts on the attractiveness of Ireland as a domicile for international captive (re)insurance undertaking.

The Central Bank has recognised captive (re)insurance undertakings as low risk profile undertakings (for example separate corporate governance requirements) that cover only risks associated with the Group to which they belong, and therefore present a particular risk profile that should be taken into account when introducing new guidance or requirements. These undertakings should not be included in the scope of the Guidance, Proportionality is also important for (Re)insurers who are in run off given the different business models and inherent risks.

Part B: Guidance

1. Governance & Risk Management

We welcome the Central Bank recognition in point 12 that appropriate measures should be adopted by (Re)insurers in a proportionate manner, and that the risk associated with IGTs are properly identified and integrated in their capital considerations, governance, and risk management frameworks and that (Re)insurers can demonstrate this if requested to do so by the CBI.

Solvency II regulatory risk management requirements do not generally differentiate between intra group and external transactions, and by introducing a differentiation, the Irish supervisory approach once again diverges from the established Solvency II approach across the Single Market as well as a new expectation for firms to follow. In reality, this also potentially means that firms which have a branch/are domiciled in Ireland and subject to CBI authorisation would have a more onerous regime to follow than those passporting in from other EU Member States, with little associated extra benefit for mitigation of risks to the financial system. This is likely to cause competitive issues where Irish based (Re)insurers incur higher operating and regulatory costs than their competitors.

The practical implementation of Solvency II will necessarily be streamlined for intra-group transactions precisely because of the synergies, close connections, and established information and insight sharing between subsidiaries and Group/Parent, in order to promote risk diversification across Group entities. The relative ease with which intragroup transactions can be implemented, under the control of Group supervision can be invaluable for companies needing to e.g., maintain solvency in a crisis or stress scenario. A proportionate application of the Solvency II requirements would, therefore, recognise the integration of the group in the risk management process for internal transactions compared to external transactions.

With regards to the specific reference to EIOPA's Opinion on the Use of Risk Mitigation Techniques by Insurance and Reinsurance Undertakings in July 2021[2] it is noted that the level of SCR reduction is dependent on the level of accuracy of the SCR standard formula to the real risk profile of the undertaking transferring risk. Differences between the reduction of the SCR and the risk transfer will be impacted.

On point 14 in this section, the Central Bank expects that the (Re)insurer's internal audit function conducts regular audits of IGT risk management. This seems to be a prescriptive expectation in that the internal audit function is being mandated to regularly assess IGT's as a material risk, which goes against the primary objective of an internal audit function in adopting a risk-based approach to which areas of the business to focus on in providing objective assurance, advise and insight to improve the overall effectiveness of risk management, control, and governance processes within a (Re)insurer. We would suggest that the finalised guidance/feedback makes it clear that this is not a mandated requirement, rather a consideration for firms with material IGTs in place.

2. Key Exposures

I. Intragroup Assets

In Box 1 point B, the Central Bank expects that where (Re)insurers enter into intragroup arrangements, detailed metrics on the level/limits of intragroup arrangements (Re)insurers are willing to take on (including single name, sectoral and geographical) are included in their risk register and risk appetite statement. Insurance Ireland is not clear on the the benefit of

[2] https://www.eiopa.europa.eu/sites/default/files/publications/opinions/14.0_eiopa-bos-21-306-opinion-risk-mitigation-techniques.pdf

these particular limits does not believe that limits along these lines are necessary or proportionate.

Insurance Ireland has concerns that some elements in this section seem to go beyond, and possibly contradict Solvency II principles. Regarding Box 2 point C, our understanding is that the Central Bank seeks to distinguish between the risk appetite for the different types of intragroup assets and introduce separate limits for each type. This is not helpful, as ultimately, they all lead to the same risk – a credit risk exposure. The limits by type, could bring unintended consequences possibly in a stressed situation. For point C, the CBI expectation is that no single intragroup asset is significant enough to threaten the (Re)insurer's solvency or financial position, this heightened expectation is more prescriptive and goes further than the requirements of the Prudent Person Principle (PPP) and Solvency II more generally. The finalised Guidance, therefore, should be amended to align with Solvency II principles as noted earlier in this submission.

In considering a company's exposure to a Group entity, an undertaking may perform a comprehensive analysis of the risks this gives rise to. This analysis could consider how the assets would perform in a range of adverse scenarios. The nature of the scenarios is important i.e. is the underlying driver a market wide shock, or an idiosyncratic firm specific issue. For example in considering the impact of reinsuring to a Group entity, the analysis may show that, in the extreme scenarios which cause adverse outcomes, the underlying driver is a stress in investment markets. This indirect exposure to investment markets is not caused by the firm's decision to reinsure to a Group entity, it is an exposure that it would have in any circumstance i.e. if it did not reinsure to anyone, or if it reinsured to a non-group entity it would still have this underlying exposure to investment markets. This is due to the nature of the underlying risk. If the underlying driver of the stressed scenario is idiosyncratic and relatively unique to the group then it may warrant further analysis as to how it might be mitigated, avoided, or diversified.

There are extensive requirements in Solvency II regarding investment, concentration, and counterparty risks which preclude the need for such prescriptive requirements on investment assets as currently proposed in the Guidance. As well as running counter to the risk-based principles of Solvency II with respect to the investment of assets, prescriptive criteria on asset holdings cannot in general be tailored to the specific nature of the asset held and in the case of IGTs to the circumstances (including financial strength) of the undertaking/subsidiary and the group. Also for point 2 C "threaten solvency" should not go beyond the existing Solvency II requirements. A comprehensive risk appetite statement will ensure that (Re)insurance undertakings have considered their exposures and risks in a holistic manner. It will allow the identification of the underlying drivers of the risks and the development of a considered approach to the appetite for intragroup exposures.(Re)insurers currently have Board approved intragroup exposures which may be a multiple of their SCR. The absolute size of these exposures should not be the focus of Guidance. Rather, an analysis of the size of and potential for losses in adverse scenarios should be undertaken, in accordance with the principles of Solvency II.

Risk appetite is a tool by which the risk can be assessed and then accepted or rejected. This analysis should be made in the context of the firm's total Own Funds, which is available to cover all risks including those pertaining to intragroup and external assets. Any restriction on the level of intragroup exposure which goes further than Solvency II, could have implications for undertakings and the wider sector.

In box 2 point D, the first sentence which states that (Re)insurers must be able to demonstrate that there is no material conflict of interest introduced by investment in intragroup assets also goes beyond the PPP, which merely refers to how conflicts of interests are managed (i.e. in the best interests of policyholders). This is foremost in the mind of any (Re)insurance undertaking. Similarly in point G, it sets out expectations for stress testing of significant concentrations of intra-group loan arrangements, for example in the ORSA or pre-emptive recovery plans. Any stress testing of intra-group loan arrangements needs to be proportionate, recognising the exposures arising from such concentrations and the purpose of the stress testing. For example, such stress testing should only be included in the ORSA if relevant for the assessment of the overall solvency needs of the undertaking, having regard to its risk profile. Similarly, such stress testing should only be included in the recovery plan if relevant for the purposes of recovery planning i.e. an assessment of the ability of the undertaking to recover from a significant deterioration in its financial position.

Recovery planning at entity level is interlinked with the policies in place at Group level which is also recognised by the European Commission's proposal for an Insurance Recovery and Resolution Directive. Diverging from a pan-EU approach under regulatory initiatives such as IRRD threatens the attractiveness of Ireland as an international insurance hub which appears to contradict whole of Government efforts to increase international investment under the IFS2025. The CBI should refrain from imposing regulatory and supervisory expectations beyond the requirements set out in Solvency II as to do so may disproportionately impair the competitiveness of the Irish insurance sector leaving it at a disadvantage, which goes against the aim of the EU single market level playing field under Solvency II.

II. Intragroup Reinsurance

Insurance Ireland notes that the proposed guidance around intragroup reinsurance is proportionate in nature, but we have material concerns around the proposed requirement of Board review and pre-approval of reinsurance arrangements as it could be impractical in a transactional business such as reinsurance, whereby a transaction with a cedant may trigger a specific intragroup retrocession agreement. A (Re)insurance undertaking can generally use automatic retrocession treaties to cover the majority of its business, however from time to time modifications may be required to the automatic treaties, or in some circumstances a new reinsurance treaty may be desirable.

It is important to have clear delineation between Board and Executive Management responsibilities. The Executive is responsible for the day to day running of the (Re)insurance undertaking and the Board responsibility is to oversee and challenge those decisions, with prudent reporting. There will be many levels of business reinsured and the level of business reinsured under one treaty may be immaterial to the undertaking, and therefore would not warrant Board attention. (Re)insurance undertakings with well-defined risk management controls and techniques may not find it practical or proportionate to require Board approval on every single intragroup reinsurance treaty. Insurance Ireland suggest that the Board of Directors should be able to delegate approval of intragroup retrocession arrangements where they have delegated authority to management below a defined materiality threshold, or where they have approved a retrocession strategy within pre-defined Board approved parameters according to each individual entity's business strategy and risk appetite.

In point 27, the Consultation Paper outlines the CBI's expectations that where intragroup reinsurance results in a reinsurance asset featuring on the balance sheet of the (Re)insurer, this asset contributes to the exposure to group, and must be considered under the arm's length criteria and the Prudent Person Principle (PPP). It would be beneficial if the final Guidance could clarify CBI expectations here and distinguish between the different types of reinsurance asset, particularly those which may be of an investment nature, and those which primarily represent a reduction or offset in the insurance liabilities. It would also be expected that the Guidance recognises the material impact of these arrangements and is applied proportionately.

The PPP relates to the investment of assets whereas traditional reinsurance reduces the risk associated with liabilities. For example, insurance companies hold balance sheet reinsurance recoverable and receivables directly corresponding to and offsetting insurance balance sheet liabilities. A large reinsurance receivable, for example following a major catastrophic event, is not the result of an investment decision, but rather the outcome of an insurance event. For this reason, the requirements in Solvency II regarding the risk management of reinsurance and other risk management techniques are sufficient for the management of risks related to reinsurance. The PPP, which relates to invested assets, is not relevant or proportionate in this regard. While these arrangements should be managed prudently, the application of PPP to intragroup reinsurance would appear to be disproportionate given that Solvency II refers to PPP in the context of investments, rather than the entire balance sheet.

In point 29 of the Consultation Paper, the CBI expects (Re)insurance undertakings to include robust Group counterparty risk stress tests and reverse stress tests in their ORSA, including a scenario of Group failure, and the resulting impact on the (re)insurer's SCR and the MCR. While it may be prudent to carry out stress tests on group counterparty risks as part of overall stress testing in the ORSA, such stress testing needs to be proportionate to the extent of the group transactions in place, and the risks faced.

In line with the Solvency II regulations, it should only be necessary to include group counterparty stress tests in the ORSA where those IGT's are relevant for (Re)insurers overall solvency needs having regard to their risk profile (and related to this the risk profile of their group). The intention of the ORSA is for it to be a tool used by companies to assess their own risk and capital position using stress scenarios that are defined by themselves according to their view on the materiality of the risks they are exposed to in the short or long term. Group Counterparty Risk stress tests and reverse stress tests should only be considered in the ORSA if deemed material by a (re)insurance entity.

Within this context, it would seem disproportionate that there is a blanket expectation to test group failure in the ORSA, and this could undermine the company's own assessment of key risks, diverting attention and resources from the risks more pertinent to the (Re)insurance undertaking's risk profile. A blanket expectation completely contradicts the principle of proportionality and removes the ability of firms to apply the guidance in line with the nature, scale, and complexity of its business. The assessment of own risks in the ORSA, is compromised if that assessment is disconnected from the likelihood of the risk materialising i.e. group failure in this instance.

Even in the event of failure, the Group may remain in a position to honour the majority of its obligations to the undertaking. The analysis of group failure in the ORSA needs to be proportionate and reflect its overall purpose. Stress testing group exposures may be useful to the (Re)insurance undertaking in identifying, measuring, managing, and reporting risk exposures. However, it would be helpful if the CBI clarify in the final guidance that the purpose of such analysis is not to undermine proper group capital management.

It would be beneficial if the final guidance can provide clarity that the expectation is not that (Re)insurance undertakings are capitalised to withstand the failure of the group. Expecting all (Re)insurance undertakings to be capitalised to withstand the failure of a Group would preclude the benefits of group diversification permitted under Solvency II regulations and would directly undermine Group supervision as envisaged by Solvency II.

Similarly, the analysis of group failure or downgrade in the recovery plan needs to be proportionate and appropriate given the recovery plan's purpose to assess the capacity of the undertaking to recover from a severe stress scenario. Where group failure or downgrade is not sufficient to trigger the implementation of the recovery plan, it is unlikely to be appropriate for inclusion as a scenario in a (Re)Insurance undertakings specific recovery plan. Additionally, a pragmatic assessment of the impact of group failure on a subsidiary undertaking would necessitate a group wide assessment of a severe stress or group failure, including the conditions or scenarios under which that failure would take place i.e., a group wide recovery and resolution plan. The proposed effect of this proposal, the mandating of a group wide resolution plan, is a responsibility which should rest with the group supervisor.

The most effective means of reviewing group supervision of recovery and resolution plans is through the College of Supervisors and placing trust in the Group supervision process. The proposed guidance in this section creates ambiguity as it potentially drifts into the management of other Solvency II regulated entities and how those entities are regulated by their respective supervisors. It is for these reasons that recovery and resolution planning is recognised in international standards and emerging EU regulation as a group wide exercise for most insurance groups. Article 7 of the proposed EU Directive on Insurance Recovery and Resolution (IRRD) requires recovery planning to be carried out at group level, reflecting the reality that the insurance group and entity recovery are closely interconnected. Where the proposed IRRD provides a possibility for the local supervisor to request a subsidiary plan, this is only under the specific circumstances where the group wide plan either does not exist or does not sufficiently capture local entity considerations. Insurance Ireland therefore calls on the CBI to refrain from increasing expectations on recovery planning within the proposed Guidance at this point, particularly with respect to the linkages between group and solo recovery, until such time as the IRRD is codified in EU law.

Separately in point 31, the Guidance refers to the EIOPA Opinion on the use of Risk Mitigation Techniques (RMTs) and uses this reference to support the commentary that "any reduction in SCR arising from the reinsurance arrangement should be commensurate with the level of risk that is transferred." However, the EIOPA statement importantly refers to a "significant deviation of the SCR due a reduction in the SCR…". The underlined text recognises that the Standard Formula is neither designed nor intended to capture the specifics of every reinsurance arrangement. The EIOPA opinion further outlines how to apply the "commensurate" consideration in its opinion, noting in particular that "a reinsurance arrangement should be considered to be material for this purpose where it could individually affect the assessment of the adequacy of the overall reinsurance arrangements, or if all reinsurance arrangements together may lead to a significant deviation of the risk profile of the undertaking from the underlying assumptions of the SCR". It would be helpful if the final guidance referred to the full EIOPA opinion on RMT as using selective sections of the Opinion limits its usefulness, which should be read in its entirety.

It would also be helpful to clarify in Box 3 - *Central Bank expectations in relation to Intragroup Reinsurance*, Point C which refers to "(re)insurer's counterparty risk policy". Counterparty risk is dealt with as part of the Reinsurance, Investment, and Credit Risk Strategy and in policy documents as required under Solvency II. It is not clear if the intention is to introduce a new requirement over and above the current Pillar 2 requirements or is the expectation to align with existing Solvency II requirements? There is also a reference to the Standard Formula, (for example but not limited to points 28, 30 and 37), and Insurance Ireland would suggest that clarity is provided that these requirements are only applicable to the Standard Formula and not to Internal Model firms.

Finally, in this section we reiterate our concerns about the Central Bank expectation in point 32 that all intragroup reinsurance arrangements are to be considered and approved by the Board prior to the arrangement coming into effect. Insurance Ireland believes that the need for these arrangements to be referred to the Board for consideration and approval and the frequency of such, should depend on the materiality of such arrangements in the context of the Board approved risk appetite and latest monitoring metrics, recognising that the nature and competitiveness the market means relying on timely decision making by executive management. Given that many contracts are annual, (Re)insurance undertakings would need January 1st renewals to be ready for Board approval by end of November, which is out of kilter with the current market practice of arranging 01/01 contracts which may leave Irish Insurance undertakings at a competitive disadvantage.

III. Cash Pooling / Group Treasury Arrangements

As outlined in the Consultation Paper and this submission, many (Re)insurers in Ireland are part of international groups and they benefit from the financial resources and other supports a Group can provide and there is less information asymmetry within a Group. Cash Pooling enables a group to benefit from more efficient cash management, and Insurance Ireland notes the points made in this section of the consultation paper.

Conclusion

Finally it would be important that our members get a pragmatic lead-in time when the CBI expects the Guidance to apply from a supervisory perspective. The consultation period runs until 23rd September and if finalised before year end the timing could be unachievable from a practical perspective, for risk appetite metrics and Jan 1st reinsurance contracts.

ENDS.