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## **Ireland - Increased corporate requirements for Insurers**



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The publication on 17 December, 2009 of Directive 2009/138/EC ("Solvency II") was the first step in a process to strengthen the supervision and prudential regulation of insurance and reinsurance companies. Effective in EU Member States from 1 January, 2013, Solvency II is built on a three pillar structure which seeks to ensure that insurance undertakings will have adequate financial resources (Pillar 1), effective governance (Pillar 2) and increased market discipline through disclosure requirements (Pillar 3).

This piece will explore the impact of Solvency II Pillar 2 on insurers and reinsurers, in particular corporate governance, the principles for internal control and risk management, the requirement to prepare an Own Risk and Solvency Assessment ("ORSA") and capital add-ons; and

It will also address the Corporate Governance Code for Credit Institutions and Insurance Undertakings (the 'Code') published by the Central Bank of Ireland ('CBor') in November 2010, which specifies the minimum requirements on credit institutions and insurance undertakings (life and non-life) to organise the governance of their institutions.

### **System of Governance**

Article 41 of Solvency II requires that insurance undertakings establish an effective system, subject to regular review, of governance to ensure sound and prudent business management proportionate to the nature, scale and complexity of the undertaking's operations.

#### *Governance System*

The governance system required under Solvency II must include:

an adequate and transparent organisational structure with clear allocation and segregation of responsibilities and an effective system for ensuring the transmission of information. Written and implemented policies and procedures for, at a minimum, risk management, internal control, internal audit and outsourcing. The policies and procedures (which will be subject to prior approval by the CBoI) must be reviewed at least annually, or more often if there is a material change.

#### *Fitness and Probity Regime*

Solvency II requires that persons who effectively run insurers and who are involved in key functions must be fit and proper and of good repute.

The CBoI introduced its Fitness and Probity regime in 2007 requiring Individual Questionnaires to be completed and submitted to the CBoI for all directors and for all managers who report directly to the board or to the chief executive as part of the CBoI's due diligence process.

Under the Central Bank Reform Act, 2010 (the "Act"), the CBoI's new statutory powers include the power to veto senior appointments as well as to suspend or remove people from senior positions across the financial services industry. The new provisions even go so far as to permit the CBoI, where appropriate, to prohibit individuals from working in senior industry positions entirely.

Failure to comply with the fitness and probity requirements in the Act and the standards which the CBoI may issue in relation thereto may also be subject to sanctions under the Administrative Sanctions framework.

On 22 March, 2011 the CBoI published a consultation paper regarding its proposed new Fit and Proper Regime ("CP 51"). The consultation period closed on the 20 May, 2011 and it is anticipated that the new Fit and Proper Regime will be effective from 1 September, 2011.

#### *Effective Risk Management*

The focus on governance of Solvency II Pillar 2 is on qualitative requirements essential to complement the quantitative requirements under Pillar 1 (adequacy of financial resources). Pillar 2 requires insurers to put in place sound and effective strategies and processes, to assess risks, to calculate the appropriate capital against such risks and to report these accordingly.

Solvency II requires insurers to establish and operate an effective risk management system. Risk management must be integrated into the organisational and decision making structures of the undertaking. Consideration may have to be given to the adoption of an Enterprise Risk Management Framework. Such a framework adopts a risk based approach to managing the undertaking while integrating concepts of internal control and strategic planning, addressing the need of stakeholders to understand the risks faced by the undertaking while ensuring that such risks are appropriately managed.

While it is possible to outsource, in part, the risk management function, such option is likely only to be acceptable for smaller insurers. All insurers might, therefore, consider the appointment of a chief risk officer or the establishment of an executive level risk committee, or both.

Under Solvency II, insurers will be required to perform an annual ORSA) based on the risk profile, risk appetite and business strategy of the undertaking. The assessment should highlight areas where the risk profile of the undertaking deviates significantly from the assumptions underlying the Solvency Capital Requirement ("SCR") calculation. Both the results of the SCR and the ORSA must be submitted to the CBoI.

Solvency II requires insurers to have an effective internal control system which includes administration and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels and a compliance function.

Solvency II permits the outsourcing of critical or important functions such as the actuarial function or the internal audit function. However, undertakings will remain fully responsible for any outsourced activities.

Undertakings will be required to notify the CBoI prior to outsourcing any critical or important functions as well as any subsequent material developments with respect to the functions or activities. One example of a material development would be a change in ownership of the entity to which the function has been outsourced.

In practice, insurers will need to review, monitor and document their outsourcing arrangements.

#### *Supervisory Review Process*

Qualitative and quantitative compliance by insurers by reference to their operating environments and current and potential risks will be regularly reviewed and evaluated by the CBoI.

Following a review, the CBoI can require an undertaking to remedy any weaknesses or deficiencies. In exceptional circumstances, a capital add-on can be imposed by the regulator where the undertaking deviates significantly from the assumptions underlying the solvency capital calculation or where there are concerns regarding the governance standards within the undertaking.

#### *Corporate Governance Code for Insurance Undertakings*

The CBoI published the Code in November 2010. The Code seeks to ensure that sufficient oversight is exercised by boards of insurance undertakings to minimise the effect of future financial crises. Insurers are given until 30 June, 2011 to implement fully the Code's requirements. Where changes are required to board memberships, the CBoI has granted insurers an extension to 31 December, 2011 to identify and to assess suitable candidates.

The key changes arising from the Code include a definition of "Major Institution" with major institutions attracting more onerous obligations in certain areas; minimum board sizes and board composition requirements and criteria to determine "independence";

There will also be limitations on the number of directorships held as well as requirements as to the role of the board chair.

## **Conclusion**

In Ireland, there is clear emphasis on the need for good corporate governance aligned with robust regulation to secure the long term interests of the insurance sector and to protect the interests of policyholders, beneficiaries and shareholders.

The Code sets out measures which Irish insurance undertakings are now required to take to achieve an appropriate level of corporate governance. It is anticipated that the new Fit and Proper regime which will be effective from the 1 September 2011 will complement the Code while, further, insurers will be required to take all necessary steps to comply with increased regulatory obligations under Solvency II prior to its transposition.

Link: <http://www.actuarialoost.co.uk/article/ireland---increased-corporate-reuirements-for-insurers-356.htm>