



**Address by Assistant Director General,
Financial Institutions Supervision, Jonathan McMahon
to Solvency II Insurance Forum**

11 May 2010

Good morning.

I would like to start by welcoming you to our forum on Solvency II.

This morning we will be discussing some of the key issues arising from Solvency II.

But before doing so I would like to say a brief word about changes within insurance supervision at the Central Bank.

As many of you will be aware, Patrick Brady has been promoted to Assistant Director General with responsibility for Policy and Risk.

Patrick is, of course, respected highly within the insurance industry, and his departure is a loss, if not a complete one given that he will remain responsible for Solvency II in his new role.

We have advertised for his replacement, and I would expect to be able to announce his successor in June.

The large attendance here today is clear evidence that the insurance industry is preparing for Solvency II. We welcome this opportunity to discuss issues with you, to raise awareness of key requirements, to hear your concerns, and to inform you of our thinking on particular matters.

Introduction

Solvency II introduces new concepts for all firms to address, such as what constitutes eligible capital (Own Funds); how you measure the risk margin on your technical reserves; the Own Risk and Solvency Assessment, the ORSA, and a significant increase in your reporting and disclosure requirements.

I believe it is appropriate that the emphasis of our first forum this morning is actually on Pillars 2 and 3, covering governance, risk assessment, reporting and disclosure. One of the lessons of the banking crisis is that the implementation of Basel II (The Capital Requirements Directive) led banks and regulators to place too much importance on models and their outputs. High quality models are important, but risk management ultimately depends on intelligent human intervention.

Indeed, the ordering of the Pillars in Solvency II is possibly unfortunate as it might be taken to imply an order of importance or priority. That is not the intent of Solvency II, nor is it how we see the world.

So, we would encourage you, as you prepare for Solvency II, to allocate significant resources to the implementation of Pillars 2 and 3. They should not be an afterthought once you have calculated your Solvency Capital Requirement. We will take a close look at these areas during our supervisory visits.

Pillar II and governance

As you will know, the Commission is now addressing issues relating to governance under Solvency II.

In Ireland, we have recently published our own proposals on corporate governance for banks and insurance companies. We consider these proposals appropriately update our regulatory regime, and in the process create a firm regulatory foundation for effective corporate governance.

Of course, setting standards for corporate governance is easy – execution in the boardroom is the challenge. We will, therefore, be looking closely at the substance of corporate governance arrangements; naturally, our focus will be on those insurers who conduct business with and for retail customers in Ireland and the EU.

Pillar 3

The purpose of Pillar 3 is to impose market discipline on firms; to be open and upfront in describing their business, their risks, performance and financial position.

We consider that there are advantages for an insurer's customers and counterparties from the publication of comprehensive Pillar 3 disclosures. We also think there are benefits to an insurance company. The lucidity, or otherwise, of Pillar 3 disclosures will say something about an insurer's risk management culture. For this reason, we will review the Pillar 3 disclosures of our largest insurance companies.

Supervisory review

So, this is what you will have to do. What about our workload?

Solvency II will change the way in which we supervise insurers. At the same time, the risk model that Patrick's new team is building will change our interactions with the industry.

I am aware that there are some concerns within the industry about whether the Insurance Supervision Department is appropriately staffed to deal with the supervisory requirements of Solvency II.

We are recruiting to increase our complement of staff in key areas such as our actuarial unit, our supervisors and our inspection teams. We have already had significant success in this area, but there is more to be done. Headcount in the insurance supervision department has increased from 42 to 58 in the last year. We intend increasing our capacity to 120 by 2012 as we continue our preparations for Solvency II implementation.

While increasing our complement is necessary, I would like to say that I have been very impressed by the quality of our people in insurance supervision, in particular their knowledge and professionalism. We need to grow, for sure, but strong foundations exist.

Other activities

I would also like to mention some other activities that are ongoing or are being planned at the moment on Solvency II.

We have contacted firms advising them of our intention to hold a forum on Solvency II issues for independent directors. We will contact firms again with further details about this soon.

At the beginning of May, we held workshops to assist firms with their entry into the pre-application process for internal model approval. The majority of the 52 firms who indicated their intention to seek internal model approval participated.

For those firms intending to use the standard formula to calculate their Solvency Capital Requirement, I can advise that we will be holding workshops on QIS5 in the coming months. We expect all firms to participate in QIS5.

Before concluding, I want to cover four other areas.

Reinsurers

Given the importance of the reinsurance industry in Ireland, we are also thinking through our future approach to regulation of this sector. To this end, we will engage later this year with the industry on the design of the future regulatory regime for the sector. To be clear: our starting assumption is that our future approach will continue to reflect the important differences between the insurance and reinsurance sectors. Given the current and projected growth in this area, however, we think now is the right time to revisit these issues.

Captives and other niche players

In the same vein, we also want to acknowledge that captives and other niche players in this market have distinct business models which call for a deft regulatory approach.

We will therefore implement regulatory requirements in a risk-based way for these firms, and we shall soon also provide further guidance on the application of the proportionality principle.

We do not, however, want to set unrealistic expectations: CEIOPS' interpretation of the proportionality principle will mean that many insurers will need to make additional investments in their governance and risk management arrangements.

Variable Annuity Writers

Continuing the theme of governance and risk management, I am pleased to announce that today we are publishing a consultation paper on Variable Annuities (VAs).

This document, which is the product of excellent work by our actuarial team, proposes rigorous new standards for insurers who write VA business in Ireland. These are complex products which require high quality, well resourced risk management arrangements. Our proposed regime creates a comprehensive regulatory framework for firms who wish to do this business. However, I do want

to make clear that if we identify firms not meeting the letter and spirit of our requirements, we will seek to curb their involvement in VA business. In other words, we will step in where we observe practices dangerous to the insurer itself and the wider reputation of this insurance centre.

Compliance with solvency requirements

There has been much focus recently on insurance solvency requirements given our application to place Quinn Insurance Limited into administration.

On one level, this has been a straightforward issue of an insurer failing to meet our solvency requirements. In dealing with it, however, we have been mindful that serious damage could have occurred to Ireland's international reputation, and in the process this insurance centre, if there were a perception that enforcement of solvency requirements differed between domestic and foreign insurers. Solvency requirements are blind to an insurance company's ultimate nationality, and our duty is to uphold them. Many jobs depend on us doing so.

Conclusion

I hope you find the forum informative. We would encourage you to participate fully, and we welcome your questions and comments.

Thank you.