



**Address to the Irish Insurance Federation Annual Lunch
by Matthew Elderfield, Head of Financial Regulation
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Good afternoon. My thanks to the Federation for their kind invitation to join you today.

Even before I came to Ireland four months ago, from another jurisdiction that has a leading place in the insurance world, it was clear to me that the insurance sector is a very important part of what makes Ireland a successful international financial services centre and that it makes a very important contribution to the Irish economy. Insurance companies with head offices and branches in Ireland employ some 15,000 people. Those companies – the members of the Federation – contributed almost €36 billion of gross written premium in the latest figures available. As a result, getting insurance regulation right – getting the balance right so that Ireland can continue to thrive as an insurance centre while also maintaining high standards of regulation – getting that balance right is a high priority to me in my new role. There is a lot going on in the world of regulation generally and in Ireland specifically, across all sectors and certainly including insurance. Time is limited today, so I just want to very briefly mention three priorities for insurance regulation for the year or so ahead. I fear I will not do any of the subjects justice in the short time available before lunch, but at least I hope I can put them on your radar screen and my staff and I are glad to engage in further dialogue with the Federation on the details.

The three priorities are: Solvency II implementation, risk-based supervision, and corporate governance standards. If I may, I will spend just a minute or two on each.

Solvency II implementation is clearly the number one regulatory priority for the insurance market in Europe but also across the world. I say across the world, because the lack of definitive international solvency standards means that Europe is setting the pace globally in insurance regulation. And for all practical purposes, European standards are being exported internationally through the so-called equivalence provisions of the directive. This means that non-EU countries must broadly match the requirements of the directive if companies from that jurisdiction, like Bermuda, Switzerland or the US, want to have access to EU markets on the same basis as EU firms. This is hugely important, meaning that the ripples from Solvency II are spreading far and wide and that companies all over the world are sizing up the implications of the directive.

One central calculation is to decide on the optimal organisational structure to take advantage of Solvency II. I can see this leading to more non EU companies choosing Ireland as a base of operations and for more EU companies deciding to centralise their operations here.

This means that Ireland must have the right resources and supervisory approach for insurance, which I'll talk about shortly. It also means we must be absolutely ready for the policy changes required by the directive.

Solvency II implementation is a very high priority for the Financial Regulator and we are on track for implementation of the Directive. For example, we are gearing up our resources and remain highly engaged in the work of CEIOPS, the EU committee of insurance regulators.

But when I say "we" must be ready, I also mean that the companies that are members of the Federation need to be well prepared for the directive. That

is my principal message to you today: I encourage you to make Solvency II implementation a top priority for your Board, your management team and your company. Please don't underestimate the impact of the directive. The changes to solvency standards will impact the economics of particular business lines in ways that are both dramatic and subtle. The more exacting standards for risk management will require firms to raise their game and, through model approval, allow them to optimise their capital. The new disclosure requirements will create new public metrics to judge the financial health and risk profile of insurance companies.

We know the amount of change can be daunting for companies. We are committed to taking a proportionate approach. We will work with industry to find pragmatic solutions to the challenges that will be thrown up. And we will work closely with the Federation and other key bodies to communicate the new requirements as they are finalised. But I encourage you, the members of the Federation, to make sure that your Solvency II preparations are where they need to be. The scale of change that is coming means that this is not just a regulatory challenge but a profound commercial one too.

The second priority on our agenda is developing and implementing a system of assertive risk-based supervision underpinned by the credible threat of enforcement. That is quite a mouthful of regulatory jargon to digest at lunch, so let me leave our approach to enforcement for another day and seek to boil the new risk-based supervisory approach down to three core propositions.

The first proposition is that the Financial Regulator will need the right quantity and quality of resources to do supervision effectively, and that the level of supervisory engagement should be calibrated to the inherent risk profile of the firm in question. I've been surprised at the thin level of resources available for supervision generally, and that applies to insurance too. In particular, we need to ensure that those insurance firms with the

biggest inherent risk profile due to their size, complexity or retail involvement have the right level of supervisory cover and engagement. That is clearly going to cost more and mean higher fees.

The second proposition is that supervisors need to make a more systematic assessment of risk at the higher impact firms. Think of this like a regulatory version of an ERM – an Enterprise Risk Management assessment – involving a rigorous review and scoring of different aspects of business and control risks. This should allow for more clarity about our priorities in the supervisory relationship.

The third proposition about risk-based supervision to put on your agenda is to underline the emphasis on an “assertive” approach. Broadly speaking, this is about encouraging our supervisory teams to be more challenging and sceptical. But more specifically, it is about ensuring that risks are not only identified in our process but are effectively mitigated. We should give the senior management at an insurer the opportunity to push back on our analysis of risk or to develop their own response to our concerns. But our new approach means that if the stakes are sufficiently high and we are not convinced by management’s plans, we must be prepared to insist on our own solution.

Let me turn from risk-based supervision to say a few final words about corporate governance.

As you may be aware we have recently published a consultation paper setting out proposals for corporate governance standards for banks and insurance companies. Strong and effective corporate governance in an insurance company is not only important for commercial success but is a hugely important source of regulatory comfort, providing protection to policyholders through rigorous assessment of controls and probing challenge of management.

Unfortunately, it is clear that there have been some spectacular failures of corporate governance during the financial crisis both abroad and here in Ireland. And as recent events have shown, those failures have not just been in banks but have touched the insurance industry. It's wrong to tar the whole industry with this problem and I'm sure there are strong corporate governance practices at many insurers. But in our judgment now is the right time to set some exacting minimum requirements for Boards, to raise standards at those companies where corporate governance practices are lagging and to strengthen the regulatory framework for the protection of policyholders and depositors.

The standards we have published are designed to do just that, by proposing limits on the number of directorships that may be held, by encouraging more independent challenge of executive directors and by curtailing the elevation of CEOs to Chairman, for example. Ireland's reputation as an international financial centre will be even stronger if it can knock on the head the lingering perception that corporate governance is sometimes compromised by concentrated personal business relationships that have the effect of deflecting effective challenge around the Board table. This is an unfair generalisation to be sure, but when governance failures occur, as they have, this problem often surfaces and the reputation of Ireland as a financial centre as a whole is tarnished. That is why the changes we propose, challenging as they may be for some firms, are the right step for the insurance industry and for Ireland. They not only provide an important defence against future problems but they also provide tangible, robust, and indeed enforceable standards that will stand up to international scrutiny and deny the sceptics of the Irish success story an all too easy line of attack.

So, I encourage the Federation and its members to read our proposals closely and to consider your responses in light of this background. The proposals are still consultative and we stand ready to engage in dialogue with

industry to revise them to make sure they deliver their intended policy objectives in the most effective manner.

Solvency II, risk-based supervision and corporate governance are, of course, not the whole regulatory agenda for the insurance industry. My colleague Jonathan McMahon, the new Assistant Director General for Financial Institutions Supervision, will be announcing the publication of new regulatory standards on variable annuities later this week. And at some point, I think it will be important to take a searching look at the question of how insurance compensation schemes operate in Ireland and Europe. On these issues too, we are committed to a close dialogue with the Federation and other key stakeholders. In the meantime, I hope these brief remarks today have given you some insight into the immediate priorities on our regulatory agenda for the insurance industry.

Thank you.