SOLVENCY II AND PROPORTIONALITY – AN IRISH LAW FIRM'S PERSPECTIVE

Laura Mulleady and Michael Buckley of A&L Goodbody offer an insight into the challenges posed by Solvency II and how they can be overcome

Having worked with and advised the Irish captive insurance industry on a range of legal and regulatory issues for over 25 years, we were aware of certain challenges ahead as Solvency II's transposition date drew closer. In the lead up to 1 January 2016, we saw mounting levels of activity and great diligence among our client (captive and third-party) insurers and reinsurers, as they finalised their preparations. The level of work needed was not altogether surprising, given that Solvency II represents a complete overhaul of the European insurance regulatory regime, bringing with it a new approach to capital requirements, enhanced governance arrangements and comprehensive disclosure obligations. It was an encouraging sign of the wealth of experience within the Irish captive sector to see the work and resources put into captives' Solvency II projects, not least in the context of Ireland's solid reputation as a first choice location for so many well-managed captives.

Challenges

Despite the challenges presented, which included the need to have "capital contributions" re-documented, so as to clearly meet basic tier one own fund requirements and to put in place reinsurance collateral arrangements with any non-EU/EEA reinsurers (particularly relevant for some of our captive clients), the transition into the Solvency II era in Ireland could be described as relatively smooth. Our experience is that preparation for Solvency II saw unprecedented levels of engagement between stakeholders, including industry working groups, bodies and representatives, as well as professional service providers, and a level of preparation, communication and hands-on engagement from the Central Bank of Ireland (the Irish insurance regulator) which was recognised by EIOPA as "top of the class".

So, where are we now, five months down the track?

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Proportionality – general

One challenge that needs to be addressed by regulators on a continuing basis is that of proportionality. With the advent of increased regulatory and general reporting requirements, it can be easy to forget that Solvency II incorporates the principle of proportionality, requiring that regulators apply Solvency II in a manner proportionate to the "nature, scale and complexity" of the risks faced by individual (re)insurers. In simple terms, captives should not be subject to the same regulatory burdens as third-party insurers. It is too early to tell just how proportionality will play out for captive operations in practice. EIOPA has indicated that it will focus its attention on the proper application of the principle of proportionality in the immediate years following Solvency II implementation.

Central Bank's approach to proportionality

While its application of proportionality is evolving, the Central Bank has already recognised the principle within its risk-based framework for supervision of regulated entities (Prism). Prism applies supervisory resources according to the impact an entity may have on financial stability and consumers. Under Prism, the majority of captive (re)insurers are ranked as "low" or "medium-low", reflecting the reduced market risks inherent in the captive model. Consistent with the principal of proportionality, the Central Bank's general approach has been to place less burdensome requirements on captive insurers unless Solvency II requires otherwise. For example, the Central Bank's Corporate Governance Requirements for captives allows for fewer directors and less frequent board meetings than is the case for non-captives.

The Central Bank has recently unveiled its revised supervisory approach for Solvency II low impact insurers and reinsurers. The revised approach includes periodic on and off-site reviews for a sample of insurers. It is more pro-active than previous incarnations. This is to be expected in the post-Solvency II era and is, in principle, consistent with IAIS recommendations regarding the supervision of captives. But all stakeholders are anxious to ensure that this new supervisory approach will be implemented in practice in a proportionate manner, particularly in respect of the frequency and extent of reviews undertaken.

Well positioned for the future

All EU/EEA (re)insurers, including captives, must be prepared for the increased levels of supervisory engagement contemplated by Solvency II. Irish market participants, including captive managers and professional advisors, are well-placed to support undertakings in meeting these new challenges.