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The Irish Insurance Industry: An Evolving Regulatory Landscape

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Introduction

Increased regulatory activity and focus on compliance has been a common theme in most areas of the financial sector, and in almost every developed jurisdiction around the globe. The Irish market, and the insurance sector in particular, has been no exception to this and the pace of change has been swift in the last 18 months.

Ireland remains an attractive and popular destination for insurance firms with strong start-up activity across the life and general sectors, with firms serving both the domestic market and those using Ireland as a base to sell services on a cross-border basis into continental Europe. The market for captive insurance and reinsurance operations also remains healthy, with a steady stream of large foreign and multinational companies from diverse sectors locating such operations in Dublin.

Firms are attracted to the Irish market because of its combination of low tax rates, Euro-area membership and its well-educated, English-speaking workforce. In addition, the concentration of financial sector firms established in Dublin's International Financial Services Centre and its surroundings since its establishment in the late 1980s has built up a significant base of specialized financial sector knowledge.

Unified regulator

May 2003 saw the creation of a new unified financial services regulatory body in Ireland, with the establishment of the Irish Financial Services Regulatory Authority (IFSRA), an autonomous body established within the Central Bank and Financial Services Authority of Ireland. IFSRA takes over responsibility for supervision of both the life and non-life insurance sectors from the Department of Enterprise Trade and Employment (DETE). IFSRA is still developing its regulatory approach and a bill equipping it with enhanced supervisory and enforcement powers has recently been enacted and is expected to come into force in the near future.

However, the regulator is also cognisant of the need for it to balance its regulatory agenda against Ireland's ongoing competitiveness and the Government's desire to continue to attract high-profile international business to set up in Ireland. Indeed following the release of the regulator's annual progress report, a year after its inception, IFSRA Chief Executive Liam O'Reilly reinforced this point by confirming that 'the financial services industry is an integral component of Irish society and it is therefore in all of our interests that it remains competitive and that we continue to work to maintain public confidence in it'.

The Irish regulatory regime for insurance firms was reviewed by a joint IMF/World Bank team in 2000/01, assessing the regulatory framework and requirements of the then regulator, the DETE, against the standards and guidelines set out in the International Association of Insurance Supervisors (IAIS) Supervisory Principles. The review, whilst noting that the approach to solvency and capital requirements was strong, commented on a lack of general guidance or rules on internal systems, use of derivatives or general compliance with the regulatory regime. The DETE released a number of individual guidelines to address some of the issues raised by the IMF and these continue to form a core part of the regulatory universe for insurance firms operating in Ireland.

Over the past few years most of the regulatory developments in the insurance industry have continued to be driven from the European arena as the implementation of legislation coming out of the EU Financial Services Action Plan continues at pace amongst member states.

The life assurance market

The United Kingdom life assurance market has endured a particularly challenging time over the past few years, with the Penrose report on Equitable Life and the UK Financial Services Authority's move to a realistic reporting regime for the reporting of liabilities. However, the Irish Regulator has not indicated any plans to introduce such a revised approach to life assurers' reporting requirements. It would appear that although firms will no doubt be mindful of the troubles in the United Kingdom, it has been acknowledged that the Irish market has not been affected by the same problems to such an extent, as few Irish companies write with-profits business.

General market

Whilst the cross-border and captive insurance markets have seen strong growth, much of the attention the domestic general insurance market has received in the media has focused on increasing premiums and a perceived lack of competition in the Irish market, particularly concerning the motor and employers liability sectors. In addition to the regulatory changes mentioned further on in this article, the Government has launched a number of initiatives to address these public concerns, including the establishment of the Personal Injuries Assessment Board (PIAB) to standardize the process for personal injury claims, and the introduction of a cumulative points based system for driving penalties. The Government has also engaged in discussions with a number of international insurers concerning possible entry into the Irish individual and corporate insurance market to widen consumers choice and increase competition.

Reinsurance

Ireland has become a popular location for international reinsurance operations in the past decade. Reinsurance companies seeking to operate in Ireland are currently not required to seek authorization. Rather they must complete a notification process to IFSRA in a prescribed format providing details of the corporate structure and shareholding, directors and details of proposed reinsurance activities and adequate capitalization.

In April 2004 the European Union published a draft Reinsurance Directive aimed at harmonizing the authorization and supervision of reinsurers in EU member states and permitting such firms being authorized in one member state to conduct reinsurance across the EU.

Both the EU and IFSRA are likely to have regard to the IAIS principles on minimum requirements for supervision of reinsurance in determining the new regime.

In preparation for development and implementation of the directive and in order to gain a better understanding of the reinsurance industry in Ireland as well as the likely issues, it is understood that IFSRA intends to contact all existing reinsurance companies operating in Ireland. The regulator intends to profile the market so that when the regulations come into force it will be appropriate to the level of risk and the nature of the reinsurance market in Ireland.

Prudential issues

Ireland implemented the EU Solvency I Directive (Council Directive 2002/83/EC and 2002/13/EC) as required on 1 January 2004, amending both the 3rd Life and Non-Life Directives 1992. The main provisions of the Directive cover:

- The ability for the Regulator to request preparation and submission of a detailed Financial Recovery Plan from an insurance undertaking in situations where the policyholders' rights are assessed to be under threat. As part of the Recovery Plan the Regulator may discount elements available for the solvency margin that have suffered adversely in market value terms or withhold the issuance of the solvency certificate until it is satisfied that policyholders rights are no longer threatened;
- Technical amendments to the calculation of a firm's solvency margin depending on the classes of business written;
- An increase in the required Minimum Guarantee Fund (to EUR 3 million, subject to certain exceptions).

Whilst Solvency I can be seen as the latest (and most probably final) update of an existing solvency and capital regime in the European insurance industry that has evolved over the last 30 years, preparations for a radical move to a more risk-based approach, entitled Solvency II, are well underway at European level.

Solvency II is expected to take a similar approach to the Basel II capital accord in the banking sector, meaning a more risk-based and market focused approach making more use of internal models for capital purposes.

Currently, although the Solvency II project has been underway for four years, the process is still at a relatively undeveloped state and there remains significant work in the years ahead to turn the outline principles into a set of well-defined rules to be implemented by the European insurance industry.

Business conduct

Whilst regulatory developments in the prudential area can be characterized as an evolution, recent regulatory change in the area of business conduct and consumer protection has been arguably more significant, with developments both specific to the insurance industry and wider cross-sector initiatives launched by the new Irish regulator.

An interim Code of Conduct for insurers was introduced by IFSRA in late 2003, complementing the more established Codes of Conduct applying to credit institutions, insurance and investment intermediaries, investment business firms, stockbroking firms and deposit agents. The Code currently only applies to all insurance business written for Irish resident customers and is therefore not applied to Irish-authorized insurers writing only insurance business outside Ireland on a branch or cross-border basis. The Regulator is currently engaged in a public con-

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sultation exercise to review all the Codes of Conduct, with a definitive set of documents, unified across sectors wherever possible, expected to be in place by Autumn 2004. The high-level aims of the Code are to:

– Strike a balance between adequate consumer protection and avoiding unnecessary regulations;
– Utilize international best practice, where possible;
– Facilitate competition by ensuring a level playing field;
– Ensure equal protection for consumer regardless of product or provider used.

Further changes in business conduct and the sales process used by insurers Europe-wide are expected as a result of the EU Insurance Mediation Directive, which is required to be in force in all EU member states by late 2004, introducing the requirement for intermediaries to be authorized in their home state and permitting them to provide services freely throughout the European Union. It also introduces rules concerning the analysis of the customer's needs and the suitability of advice provided, aimed at increasing the protection of consumers. Whilst intermediaries have commonly received little regulatory attention in many areas of continental Europe, no doubt increasing the significance and change required to implement the Mediation Directive in many jurisdictions, the vast majority of the provisions contained in it have already been implemented in Ireland under the Investment Intermediaries Act, 1995 and subsequent legislation and guidance. Therefore existing authorized intermediaries in Ireland will be in a strong position to exploit growth opportunities across the expanded EU as the market for cross-border services opens up.

Although the general prospect of additional regulation may provoke fear in an industry where international competitiveness remains a key determinant in attracting and maintaining international business, IFSRA have, since inception, sought to dampen these fears by conducting a number of 'best practice' review visits to fellow financial sector regulatory bodies in the United Kingdom, Canada, Denmark, Hong Kong and Norway. Additionally, external consultants have been retained with the aim of maximizing efficiency in the regulatory process.

The Regulator is firmly committed to an open consultation process involving key industry representative bodies and public submissions in its rule-making and since the beginning of 2004 it has issued a number of consultation papers for comment covering such areas as the proposed methods of industry funding of the Regulator, the sectoral Codes of Conduct discussed above and mandatory competence requirements for those staff engaged in selling retail financial services products. Liam O'Reilly recently told the Irish Government's Joint Committee on Finance and Public service that 'the consumer is at the very heart of what we do … the implementation of our strategy is intended to deliver to the consumer more and better information in a safe financial market that is fair and gives better value.'

Conclusion

In conclusion, whilst the pace of regulatory change appears to be somewhat of a whirlwind, with significant developments coming down the track, it would appear that Ireland's reputation as a business-friendly destination for insurance firms and other financial sector business remains strong. Indeed, in the current climate of enhanced transparency and unprecedented global interest in regulation and protection of the consumer's rights, Ireland's enhanced regulatory regime under IFSRA must be seen as another positive factor in continuing to attract new market entrants to the growing international insurance industry choosing to locate in Ireland.

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