Banc Ceannais na hÉireann
Central Bank of Ireland
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Enforcement Action

The Central Bank of Ireland

and

PartnerRe Ireland Insurance dac
Partner Reinsurance Europe SE

PartnerRe Ireland Insurance dac and Partner Reinsurance Europe SE fined €1,540,000 by the Central Bank of Ireland in respect of breaches of Solvency II and the Corporate Governance Requirements for Insurance Undertakings 2015

On 16 August 2018, the Central Bank of Ireland (the Central Bank) fined PartnerRe Ireland Insurance dac (PRIID) and Partner Reinsurance Europe SE (PRESE) a combined €1,540,000 and reprimanded PRIID for a total of six breaches and PRESE for a total of three breaches in respect of the:

- European Union (Insurance and Reinsurance) Regulations 2015 (S.I. No. 485 of 2015) (the Solvency II Regulations)
- Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (the Solvency II Delegated Regulations)
- Corporate Governance Requirements for Insurance Undertakings 2015 (the Corporate Governance Requirements)

PRIID and PRESE admit the breaches.

The breaches occurred from the inception of the Solvency II regime on 1 January 2016 and remediation continued up to 30 May 2018. The breaches involved weaknesses in PRIID and PRESE's corporate governance frameworks relating to their internal reporting and internal controls in respect of Solvency II requirements, as set out in more detail below. PRIID and PRESE's corporate governance failings resulted in:

- **Breaches of the Solvency II regime relating to the calculation of their Solvency Capital Requirement for 2016.**
- **The submission of incorrect information to the Central Bank in respect of their solvency for 2016.**

The Central Bank's Director of Enforcement and Anti-Money Laundering, Seána Cunningham, said:

"Solvency II is a harmonised insurance regulatory regime aimed at further protecting policyholders and creating a more resilient insurance sector. This is the Central Bank's first enforcement action in respect of Solvency II breaches.

The breaches in both of these investigations centre around one of the key requirements of the Solvency II regime, the Solvency Capital Requirement. The Solvency Capital Requirement requires firms to maintain sufficient capital to ensure that they can meet their obligations to policyholders.

The Central Bank's investigations found that PRIID and PRESE submitted regulatory returns to the Central Bank, which overstated their solvency positions. This was due to both firms incorrectly calculating their Solvency Capital Requirement. As a result, both entities were required to re-submit their regulatory returns to the Central Bank. This revealed that they had, not only presented the Central Bank with an inaccurate picture of their respective solvency positions, but also in the case of PRIID, it resulted in a breach of its Solvency Capital Requirement.

The accuracy and reliability of information provided by firms to the Central Bank in respect of their Solvency Capital Requirement is critical to the Central Bank's ability to safeguard financial stability within the Irish insurance industry. The Central Bank expects that before a firm submits information to it that the firm ensures that the data is correct and accurate. If, however, there is any doubt as to the accuracy and reliability of the information the firm must take steps to rectify the issues in advance of providing it to the Central Bank.

The Central Bank found that PRIID and PRESE were alerted to the fact that their respective approaches to the calculation of their Solvency Capital Requirement may not have been compliant with Solvency II. Furthermore, both firms were advised to seek clarification from the Central Bank on their respective approaches, which they failed to do. Had the firms acted on this advice, they could have prevented the submission of incorrect Solvency Capital Requirement figures to the Central Bank. It is unacceptable for a regulated firm to knowingly submit potentially unreliable information to the Central Bank.

One of the key requirements of Solvency II is that firms have in place robust governance systems. The Central Bank believes that PRIID and PRESE failed to put in place sufficient processes to identify and report the risks to which the firms were exposed in respect of their Solvency Capital Requirements. As a result, the Boards of both firms were not provided with comprehensive and timely reports regarding the calculation and maintenance of their Solvency Capital Requirements. Therefore, the Boards were unable to fulfil their responsibility take the necessary action to prevent the Solvency II breaches that occurred.

The Central Bank investigations also found that PRIID and PRESE failed to design and operate appropriate internal controls to ensure the accuracy of their Solvency Capital Requirement calculations and the monitoring of the Solvency Capital Requirements in line with the stated risk appetite. These failings resulted in inaccurate reporting of information to the Board and the submission of inaccurate information to the Central Bank in respect of their Solvency Capital Requirement and, ultimately, the firms' failure to identify the decrease in their Solvency Capital Requirement.

Effective corporate governance frameworks are essential to enable firms to conduct their business activities in a manner which minimises risks to policyholders and the wider financial system. Prioritising and identifying the value of a strong corporate governance framework is something the Central Bank expects firms to do, not simply because they are required to do so, but because they believe it is the right thing to do.

This enforcement action demonstrates the importance the Central Bank places on firms meeting their regulatory obligations under Solvency II and the Corporate Governance Requirements."

BACKGROUND

PRIID is a non-life insurance company, which has been authorised under the Solvency II Regulations to carry on insurance business in Ireland. It was first authorised on 1 April 2005. PRESE is a reinsurance company, which has been authorised under the Solvency II Regulations to carry on reinsurance business in Ireland. It was first authorised on 20 July 2007.

The Solvency II regime came into effect on 1 January 2016. As insurance and reinsurance firms, both PRIID and PRESE are required to comply with the Solvency II regime and the Corporate Governance Requirements. The Central Bank has responsibility for securing the compliance of firms with the Solvency II regime and the Corporate Governance Requirements.

In October 2014, as part of their preparation for Solvency II, PRESE and PRIID received guidance from an external actuarial firm in respect of PRIID's treatment of a specific non-proportional reinsurance arrangement and PRESE's treatment of a proportional reinsurance arrangement (the "Reinsurance Arrangements") in the calculation of their respective Solvency Capital Requirements (SCR). The guidance alerted PRIID and PRESE that their approach regarding the Reinsurance Arrangements may not be accepted by the Central Bank as it was not fully compliant with the Solvency II Technical Specifications. The guidance recommended that PRIID and PRESE seek clarification on the issue from the Central Bank and noted that if the Central Bank did not accept their approach, their ratio of eligible capital to SCR (SCR coverage ratio), which must be maintained at a minimum of 100% at all times, would decrease significantly. PRIID and PRESE continued with their treatment of the Reinsurance Arrangements and did not seek clarification from the Central Bank on the correctness of their approach prior to the submission of their quarterly Solvency II Quantitative Reporting Templates (QRTs) in respect of 2016. Additionally the Central Bank investigations into PRIID and PRESE identified instances from August 2016 into early 2017, where PRIID and PRESE received guidance from their external auditors which also alerted them to the fact that the treatment of theReinsurance Arrangements would not be compliant with Solvency II for the purposes of the SCR calculation. Again, PRIID and PRESE were encouraged to seek clarification on the issue from the Central Bank. Both PRIID and PRESE failed to do so prior to the submission of their quarterly 2016 Solvency II QRTs.

PRIID's incorrect treatment of the relevant Reinsurance Arrangement first came to the attention of the Central Bank when, on 20 March 2017, PRIID alerted the Central Bank to a potential breach of its SCR coverage ratio in respect of year-end 2016. Regulation 146 of the Solvency II Regulations requires firms to notify the Central Bank as soon as they observe non-compliance with their SCR or where there is a risk of non-compliance in the following three months. On 22 March 2017, PRIID confirmed that it had breached its SCR coverage ratio for Q4 and year-end 2016. PRIID set out a number of reasons for the sudden decrease in its SCR coverage ratio, key among them was the removal of the risk mitigation benefit of its non-proportional reinsurance arrangement from its SCR calculation.

PRESE contacted the Central Bank in April 2017 to inform it that it had incorrectly taken credit for the risk mitigation benefits of the relevant Reinsurance Arrangement during 2016.

Both PRIID and PRESE resubmitted their quarterly 2016 Solvency II QRTs to the Central Bank on 30 June 2017. PRIID's revised SCR coverage ratios reflected a breach of its SCR coverage ratio from Q2 2016 until year-end 2016. PRESE's revised SCR coverage ratio figures were significantly lower than those contained in the original QRT submissions.

Following these events, the Central Bank identified weaknesses in PRIID and PRESE's governance, risk and operational frameworks and increased the probability risk ratings in the specific areas of Governance Risk and Operational Risk. On 8 June 2017, it issued a Risk Mitigation Programme to both firms. Following which, PRIID and PRESE engaged an external consultant to conduct a review of their Solvency II processes, governance, risk framework and operational management.

On 20 September 2017, the Central Bank notified PRIID and PRESE of its decision to commence an investigation into suspected breaches of the Solvency II regime and the Corporate Governance Requirements.

PRESCRIBED CONTRAVENTIONS

The Central Bank investigations identified a total of six breaches by PRIID and three breaches by PRESE of the Solvency II regime and the Corporate Governance requirements, namely:

Provision of inaccurate information to the Central Bank

The Central Bank relies upon information submitted by firms via their Solvency II QRTs to assess firms' solvency. Therefore, regulated firms must ensure that this information is accurate, up to date and reliable.

Under Regulation 34(4)(b) of the Solvency II Regulations, firms are required to ensure that information provided to the Central Bank in their Solvency II QRTs:

(i) reflects the nature, scale and complexity of the firms and the risks inherent in the firms' business,

(ii) is accessible, complete in all material respects, comparable and consistent over time, and

(iii) relevant, reliable and comprehensible.

From 26 May 2016 until 30 June 2017, PRIID and PRESE provided inaccurate information to the Central Bank via their 2016 quarterly Solvency II QRTs. Both firms incorrectly accounted for the Reinsurance Arrangements in their SCR calculations, which led to an overstatement of their respective SCR coverage ratios. PRIID overstated its SCR coverage ratio by an average of 93 percentage points in each quarter of 2016. PRESE overstated its SCR coverage ratio by an average of 18.6 percentage points in each quarter of 2016.

Incorrect treatment of the Reinsurance Arrangements in calculation of SCR

Regulation 113(2) of the Solvency II Regulations permits firms to calculate their SCR in accordance with either the 'standard formula' (as set out in Regulations 116 to 124) or by using the 'internal model' (as set out in Regulations 125 to 138). The Solvency II Delegated Regulations provides firms with detailed requirements which must be adhered to should they elect to conduct their SCR calculations in accordance with the standard formula. Failure to adhere to these detailed requirements increases the possibility of a firm reporting a false or misleading solvency position, which can undermine a firm's ability to appropriately assess its capital requirements.

PRIID and PRESE chose to conduct their SCR calculations in accordance with the standard formula. As such, both PRIID and PRESE were required to comply with Article 117 of the Delegated Regulations.

From 1 January 2016 until 19 May 2017, PRIID and PRESE, who were party to the Reinsurance Arrangements, incorrectly took credit for the risk mitigation benefits of these Reinsurance Arrangements. In summary:

- PRIID incorrectly assumed full credit for a stop-loss arrangement in its SCR calculation. A stop-loss is a type of non-proportional reinsurance, which protects against catastrophic losses or large shock claims by protecting reserves after a certain threshold is reached. PRIID had an internal stop-loss reinsurance arrangement in place, with another group entity.

- PRESE incorrectly excluded reserves from the volume measure for the reserve risk module when calculating its SCR. The reserves were guaranteed under a guarantee agreement, whereby an external insurance firm retained exposure for claim movements occurring on or before 31 December 2005.

This resulted in the overstatement of their SCR coverage ratios and, consequently, the provision of incorrect information to the Central Bank.

On 19 May 2017 PRIID and PRESE submitted their annual QRTs for 2016 and on 30 June 2017 resubmitted their Q1 – Q4 quarterly QRTs for 2016.

Failure to identify deterioration in PRIID's financial condition

From 1 January 2016 Regulation 144 of the Solvency II Regulations required firms to have procedures in place to identify deteriorating financial conditions and to immediately notify the Central Bank if such deterioration occurs. The Central Bank expects firms to have robust internal controls in place that allow appropriate assessment of financial conditions on a regular basis.

From the inception of the Solvency II regime, PRIID failed to have effective procedures in place, which allowed for the appropriate validation and accuracy of data used in its SCR calculations and therefore it was unable to correctly and contemporaneously identify a deterioration in SCR coverage ratio and to immediately inform the Central Bank of same. PRIID's SCR coverage ratio started to deteriorate at the beginning of 2016. However, PRIID's lack of effective procedures resulted in its failure to identify any deterioration in its SCR coverage ratio until mid-February

2017. At this point weaknesses in PRIID's internal controls relating to its SCR calculations prevented PRIID from confirming the deterioration in its SCR coverage ratio for a further four weeks, after which it notified the Central Bank of the deterioration in SCR coverage ratio.

Breach of PRIID's SCR

Regulation 113(1) of the Solvency II Regulations requires firms to hold sufficient capital to cover their SCR at all times. This is a key regulatory obligation under the Solvency II regime. It is designed to ensure that firms hold enough capital to withstand a one in two hundred-year event. By holding insufficient capital to meet its SCR, a firm may not be in a position to withstand an event of this nature and will consequently put policyholders at risk.

PRIID failed to meet the requirement to hold sufficient capital to cover its SCR in quarters 2, 3, 4 and year-end of 2016.

Breach of PRIID's risk appetite

Section 15 of the Corporate Governance Requirements requires the board of an insurance firm to understand the risks to which the firm is exposed and to define and document the firm's risk appetite. The board's documentation of its risk appetite is referred to as a 'Risk Appetite Statement'. A firm's Risk Appetite Statement should provide clear parameters within which the board of an insurance firm can make decisions, based on its understanding of the firm's risk profile. It is the responsibility of the board to ensure that an insurance firm complies with its Risk Appetite Statement.

From 31 December 2016 until 21 March 2017, PRIID breached its Risk Appetite Statement in respect of the US South East Coast zone wind exposure. During this period, PRIID's net CAT exposure in respect of US South East Coast zone wind exposure was $17.3 million, which was $2.3 million above PRIID's Risk Appetite Statement for a single CAT risk and therefore constituted a material deviation from its Risk Appetite Statement. PRIID reported the risk appetite breach to the Board on 21 March 2017 and the Board resolved to increase PRIID's risk appetite in respect of CAT risk for the US South East Coast zone wind exposure by $2.3 million. However, the quality of the information provided to the Board incorrectly led the Board to view the risk appetite breach as immaterial. On 10 April 2017, PRIID's Board was informed that thedeviation from its risk appetite was a material deviation and, as such, required notification to the Central Bank. PRIID then notified the Central Bank of the risk appetite breach on 10 April 2017. The failure by PRIID to provide timely, accurate and sufficiently detailed information to the Board resulted in PRIID notifying the Central Bank of the risk appetite breach three weeks after the Board was first informed of the breach.

The Central Bank found that PRIID's Board failed to ensure:

- PRIID's risk management systems and internal controls reflected PRIID's risk appetite, as required by Section 15.3 of the Corporate Governance Requirements,
- adequate arrangements were in place to ensure regular reporting to the Board on compliance with its risk appetite, as required by Section 15.3 of the Corporate Governance Requirements, and
- that it received timely, accurate and sufficiently detailed information from PRIID in respect of its risk appetite compliance, as required by Section 15.6 of the Corporate Governance Requirements.

Weaknesses in corporate governance arrangements in respect of internal reporting and internal controls

Section 6.3 of the Corporate Governance Requirements sets out the key features of robust corporate governance structures within firms. The provision of comprehensive and timely information to boards is central to effective corporate governance arrangements. Equally, boards must engage in robust interrogation and challenge of the information provided. Without this, a board cannot appropriately assess the risks to which a firm is exposed and, in turn, fulfil its role of effectively overseeing the activities of the firm. Firms must also have adequate internal control mechanisms in order to conduct their activities in a compliant and prudent manner.

However, the ultimate responsibility for identifying, assessing and mitigating the risks of a firm remains with the board.

The Central Bank's investigations into PRIID and PRESE identified weaknesses as follows:

- The Central Bank found that neither the Boards, nor the Risk Committees of PRIID and PRESE were provided with critical information in respect of uncertainties raised by an external accounting firm and an external actuarial firm regarding PRIID and PRESE's treatment of the Reinsurance Arrangements in their 2016 SCR calculations. The resultant impact of which was that both PRIID and PRESE overstated their SCR coverage ratios which they disclosed to the Central Bank via their quarterly 2016 Solvency II QRTs.

- The Central Bank identified a failure by PRIID to provide timely, accurate and sufficiently detailed information in respect of its risk appetite to the Board. This resulted in the misrepresentation of the materiality of PRIID's non-compliance with its risk appetite to PRIID's Board. This ultimately delayed the provision of information by PRIID to the Central Bank regarding a material deviation from its risk appetite.
- The Central Bank found that PRIID and PRESE's internal control frameworks did not facilitate the delivery of accurate and reliable 2016 SCR calculations and, consequently, the submission of accurate quarterly Solvency II QRTs to the Central Bank in respect of quarters 1, 2, 3 and 4 for 2016.
- The Central Bank found that PRIID's internal controls were not sufficiently robust to enable regular and effective monitoring of its 2016 SCR coverage ratios. As a result, PRIID was not in a position to identify a deterioration in its SCR coverage ratio for more than a year after such deterioration began. This, in turn, impeded PRIID's ability to notify the Central Bank regarding the deterioration of its SCR coverage ratio.
- The Central Bank found that PRIID's internal controls were not sufficiently robust to enable effective risk appetite compliance. PRIID exceeded its risk appetite limits in respect of the US South East Coast zone for three months. Had PRIID put in place sufficient internal controls regarding its risk appetite compliance, it could have avoided taking risks outside of its prescribed limits.

Subsequent to the identification of the breaches outlined above, both PRIID and PRESE acted promptly and engaged with the Central Bank in their efforts to remediate the breaches. The Central Bank required that PRIID and PRESE engage in efforts to remediate the breaches. The Central Bank required PRIID and PRESE to resubmit their 2016 quarterly QRTs which was completed on 30 June 2017. The Central Bank notes that initial remediation efforts began in Q2 2017 and were enhanced in Q4 2017. These actions related to the implementation of significant enhancements to PRIID's and PRESE's governance arrangements in respect of the internal reporting and internal control framework for the formulation of the PRIID's and PRESE's SCR calculations, ratios of eligible own funds to SCR and in the case of PRIID, its risk appetite compliance.

As of 30 May 2018, PRIID and PRESE were in a position to demonstrate that the majority of the improvements resulting from the aforementioned actions were operational and that it had engaged in control and validation checks in respect of same. As such, the Central Bank notes that PRIID and PRESE demonstrated adequate remediation by 30 May 2018.

PENALTY DECISION FACTORS

In deciding the appropriate penalty (which breaks down as €910,000 for PRIID and €630,000 for PRESE) to impose, the Central Bank considered the following matters:

- Seriousness with which the conduct is viewed, particularly given the knowledge and information available to PRIID and PRESE in advance of the submission of their 2016 Solvency II QRTs to the Central Bank.
- Weaknesses identified in the Firms corporate governance relating to aspects of its internal reporting and internal controls.
- The Firm’s failure to meet the regulatory standards required and expected of insurance firms in this jurisdiction.
- The co-operation of PRIID and PRESE during the investigations and in settling at an early stage in the Central Bank’s Administrative Sanctions Procedure.
- The actions taken by PRIID and PRESE to remediate the breaches.

The Central Bank confirms its investigations into PRIID and PRESE in respect of these matters are closed.