New Eyes

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In which I will look at areas including the role of analytics in the Central Bank, culture in firms and the increasing importance of stress and scenario testing.

Good morning. I would like to thank Milliman and Insurance Ireland for inviting me here today; I am pleased to meet those of you I have not met before and am looking forward to a good discussion this morning.

To get things started, my talk today is entitled "New Eyes". Now, the new eyes that I talk of today are not my own. Despite being a relatively new arrival to the Central Bank, and indeed to Ireland itself following my own personal "Brexit", my eyes are old, having spent a career in leadership roles in Insurance businesses across the UK and Europe. Instead the new eyes I talk of are those that the role of analytics are giving us in the Central Bank, the new eyes that we should all have to the culture within insurance firms, and the new eyes that need to be given to stress and scenario testing to ensure that broad enough thinking is applied in this area.

Analytics

The first set of New Eyes that I would like to look at are those that will be provided by the Analytics function within my area.

You will be aware that a year ago the Central Bank set up an Analytics function within the Insurance Directorate. For many of you, the main interaction with it has been on the Solvency II reporting that your firms have submitted so far, particularly the electronic submission of the QRTs. Indeed, for the analytics function, the receipt of this information and building the infrastructure around it have been the key areas of their work in 2016. In this they have faced challenges with the quality of the data that has sometimes been submitted by firms. If you have heard me speak before I make no apology about returning to the issue around data quality. As the CROs of our leading insurance businesses, you should ensure that there are the right processes and controls in place that mean that your businesses are being properly reflected in the returns that are submitted. You cannot rely on the validations within the taxonomy itself to say that your returns are correct. All they will tell you is that they are internally consistent. You need to make sure that you have a process within your firms that ensures that they correctly represent your business in all aspects when they are being submitted. Firms need to make sure that internal governance procedures are appropriate and that their IT tools are sufficiently robust to ensure that accurate data is reported to the Central Bank.

As a lot of the work of the analytics area relies on this data they are obviously passionate about ensuring that it is correct. Given the reliance we then place on it; it is also something important for the Directorate as a whole. To this end, our on-site team will be looking at the governance and internal controls that surround regulatory reporting through their work in 2017. This will involve detailed exploration of firms processes to ensure that the data on their system is the data driving their returns.

Don't wait for us to find the issues though. If you are uncomfortable with the nature of the data that you are receiving or the processes that you have in place do put them on your agenda to improve this year.

But why are we investing all this resource into the analytics area? For me there are three key reasons.

Firstly, Solvency II means that there is vastly increased data available to us as a regulator. As you are having to invest in providing us with that data, the minimum we can do is actually make use of it. I view it as important that we make the greatest utility from the information that we are being provided to ensure that we are properly understanding your firms and the broader industry. Where we have introduced NSTs it is because we view this information as particularly useful to augment the QRT data that we are being provided. We are absolutely not taking this data to just put it on a shelf, we will look at it and use it to drive supervisory action.

Secondly, it enables us to take a different approach to supervision at the firm level. Tasks that a supervisor might have done manually in the past now have the ability to be automated through the use of analytical capability. This will free up supervisors to support our model of more intrusive supervision, by giving them the opportunities to look in more detail at your firms, either through meetings with staff or through on-site inspections. The regular data that we get from the quarterly Solvency II reporting will form a basis of regular dashboards and analysis that will look at trends in your firms and alert us to areas where we should pay more attention. It will also help us in our prioritisation of work, as any emerging issues can be highlighted. Obviously this is only as good as the data we use, so we will also look to augment this data wherever possible with wider information that can help us in our monitoring. For example, we can bring together the asset data reported in your forms with real world asset information in order that we can see who might be exposed to real world economic movements, and drive our engagements accordingly. Whilst we are not yet moving into the world of robo-supervisors, we are very much looking to ensure that we have the insights and data to give the required challenge to your business.

Thirdly, and to me possibly most importantly, it enables us to look more at the macro level. By having a quantum of information on all firms on a regular basis it enables us to look at the industry like never before. On the first instance this will help in looking at peer analysis of firms – looking for outliers and therefore understanding the drivers that may have put them there. However it will also enable us to look more broadly. By doing this we can look at trends and directions to see where it may be heading and look at any concerns there may be for the industry as a whole. In undertaking this we will be looking to pull together not just the information from the QRTs, but also the qualitative information from the broader Solvency II reporting, the ORSAs and other sources of information to build as much richness to our insight as we can.

One of the key broader areas that is being led by the analytics area is the development of country risk reports. As you will know, Ireland has within it a very international insurance industry, and as home regulator for a number of businesses that have branches across Europe we view it as important that we understand those branches and the markets they operate in. We are therefore investing in language skills and relationships with our peer regulators in order to bring these insights to our work and ensure that we have a sound footing for our supervision of this business.

Whilst we may only be at the start of our journey with analytics, I think it is a very exciting one for us to be taking. It has lots of possibilities to improve our supervision of your firms and our view of the industry as a whole. Like any good journey it needs proper preparation before you start which is why we are focussing so much on ensuring that the data you submit to us is correct. By better representing your businesses you will get better engagement with the Central Bank, so please do ensure that your firms are taking data quality seriously.

Culture

The second set of new eyes that I would like to bring in are looking at culture. One of the developments that we have been making in the Central Bank over the past year has been in our focus on the culture within firms. We are developing our approach within the Insurance Directorate, and the wider bank has also been working with the Dutch regulator the DNB who lead in Europe in their thinking in this area.

However, as CROs, culture is something that should be as part of your radar when looking at your firms as it is within ours. This includes both having a handle on your corporate culture as well as the risk culture within the business.

The corporate culture is a clear driver of the performance and security of firms. As CRO you should be able to look at those areas where the culture is not good enough; a domineering CEO, a complacent Board, a culture of secrecy for example, and call it out. A good driver to look at is that of diversity. As a Central Bank, we would encourage the development of diversity within businesses as a driver of good challenge through the use of different viewpoints. There are obvious markers of diversity within a business, such as gender or race, but there are also less obvious ones such as educational or cultural background. I know this is on your agenda as Insurance Ireland launched its year of inclusion last week. But it should be pertinent to you as CROs anyway. Part of a good risk culture are a diversity of views, and you need a diversity of people in order to generate them.

I once worked in the leadership of an insurer where the common denominator was about being a man in or around your 50's, from a certain background, for both the executive and the board. Personally, being a man just a little bit younger than that made me the diversity element around the table. We would hope that you would hold yourselves up to a higher bar for diversity than that. However, even in that firm being that bit different, and a bit challenging, was perhaps not what they were looking for as their culture was not open to this. Therefore, the challenge for yourselves is not just do you have the diversity that drives the right culture, but also do you have the culture that welcomes diversity? Are you the sort of firm that could say "we tried recruiting an external person once. They thought differently to us so it didn't work so we got rid of them"? If so, as CRO you should be part of highlighting this as a risk for your firms and challenging the Board to take actions to address this.

Your other challenge as CROs is to be honest about the risk culture within the firm. If you looked at it with new eyes, would you see it as embedded as you would like? Are people just going through the motions? Or does it rely on you? If you moved off tomorrow to the shiny new job of your dreams, or maybe the retirement of your dreams depending on your aspirations would your business carry on managing, reporting and analysing risks as they do today? Or would they slowly move back to bad habits? If you are the key person for owning and caring about risk, then you need to make sure that others care and feel ownership too, on the first line as well as in your second line team.

There is a challenge if you are CRO of a firm that you have been part of the first line for many years in terms of having enough independence of position and independence of view to look at your firm – the new eyes if you will. When I held my position as Risk Director in my career it was within a business that I had been part of for many years. Whilst this helped in terms of getting a new risk framework embedded initially, in the long term I knew that it would not work as I was too emotionally involved in the business to be able to take that step away to the second line. Therefore, do look at your position with new eyes. Are you walking the line between independent and influential correctly? Are you involved, but not *too* involved? Is the risk culture relevant to everyone across the business and embedded with them, or are you and your team doing the heavy lifting every month?

You know your businesses better than I do, but you need to look honestly at both the risk culture to see if it is embedded and the broader culture to see if it is effective for strong governance and diverse thinking to succeed.

Stress & Scenario Testing

One of the key areas where diverse thinking is important is where you are looking at stress and scenario testing. A key theme of 2016 appears to have been people being surprised by events, with Brexit and President Trump the two most prominent of them. However, I see any unexpectedness as a failure of imagination rather than events that should be a genuine surprise.

The day of the Brexit vote saw the biggest ever one-day fall in sterling because the markets had decided that the uncertainty that they had priced in in the weeks and months before was no longer there, despite the polls all showing that it would be a close vote and within the margin of error either way. It was perhaps their world view that led to this confidence – they knew no-one who would be voting for Brexit so obviously it would not occur. Whilst the polls in the US election were not quite as close, they were still within a margin of error and there were many more paths to victory for Trump, as was proved, than the 1% chance that some people were giving him.

This is the sort of thinking that needs to be guarded against, particularly when looking at stresses and scenarios within an ORSA perspective or more generally within your organisation. I think there has to be a very high bar for saying that something cannot happen. Whilst you obviously need to prioritise and take a proportionate view to your stresses, you also need to challenge your thinking. You need to look at both sides of an issue or situation to see just how it might impact you, particularly as events change.

The economy is an obvious area where new eyes may now be required. For many years now the key risk has been "low for long" when it comes to interest rates, with high interest rates being as alien to us now as interest rates of less than 1% would have been a decade ago. However, as we saw a decade ago things can move dramatically, and quickly. Higher interest rates and higher inflation are now more likely than they would have been a year ago thanks in part to the election of President Trump. Therefore, there is a far greater range of probable outcomes in play, even before you look at the improbable outcomes, that need to be considered in your stress and scenario thinking.

One of the easy traps to fall into is to allow the same stresses to be used year on year, because they are "part of the process". This does not demonstrate the understanding that we would be looking for.

Whilst doubtless the nature of some risks may remain constant, their scale may change and others will change as your business does. This is a process that is about running your businesses, not acting as a tick box for the regulator.

To be clear, the ORSA is your firm's document and we are not going to be prescriptive as to what is in it. However, it should evidence the range of thinking that has taken place. One of the areas that we will be focussing on this year in our interactions are the stresses and scenarios that are part of your ORSA process, so do try to be sure that it reflects your firms in the best light.

Talking to the United Kingdom Institute for Government last month, Andy Haldane, Chief Economist of the Bank of England, referred to the failures to predict the financial crisis, and the pessimistic outlook after Brexit, as economist's "Michael Fish" moments, after the UK weather forecaster who famously failed to predict the hurricane of 1987.

However, there is actually a subtler message from his story rather than just giving a wrong prediction. What was said at the start of the bulletin was actually:

"Earlier on today, apparently, a woman rang the BBC and said she heard there was a hurricane on the way... well, if you're watching, don't worry, there isn't! The weather will become very windy but most of the strong winds incidentally will be down over Spain and across into France"

No-one remembers the second line, partly because the opening line was so clear and memorable (and with hindsight wrong). The second line though does start to introduce something that did actually happen, even if he also places it in the wrong place, focussing on Spain and France rather than southern Britain and downplays the strength. Therefore, if you are using your stresses and scenarios to say an event "X" won't happen, but a similar event "Y" could, is there a risk that the message your Board is taking away is that event "X" won't happen, and they stop listening after that. Therefore, when event "Y" eventually happens, does it come as even more of a surprise than it should do?

The day after the 1987 hurricane, Michael Fish and his colleagues from the UK Met Office were arguing that they had given the message that it would be windy, and even that the "hurricane" referred to was elsewhere. However, as it is sometimes said in politics, if you are explaining you are losing. Therefore, if you are as I would hope making sure that you have a diversity of thinking within your stresses and scenarios and are looking at them with new eyes, ensure you are then communicating them in the right way that people know when to worry, and how much they need to worry. Make sure that not only your thinking is broad, but your communication is clear as well.

Today I have looked at three areas where we either we or you should be using "new eyes" to look at things differently. I hope you now have more of an insight into our analytics area, and the journey they are taking. I hope that you are thinking about both the culture in your firms and the embeddedness of your risk culture. And I hope that you are thinking broadly generally, to ensure that you look at a diversity of stresses and scenarios and don't end up being remembered for one wrong message like Michael Fish.