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The IFoA Conference 2022

22–23 June – etc.venues, 133 Houndsditch, London

Disclaimer

Views

The views expressed by the presenters do not necessarily reflect the views of their employers.

Purpose

This presentation was prepared as a background information for discussing current issues and potential future changes to the prudential regulatory framework in the UK. It has been prepared for general information purposes only and does not purport to be, and is not, a substitute for specific professional advice. While the matters identified are believed to be correct, before any specific action is taken, specific advice on the circumstances in question should be obtained.

Limitations

Some of the summarised material within this presentation has been prepared based on HM Treasury's Consultation Paper and the PRA Discussion Paper on the review of Solvency II published on 28 April 2022. The final changes to the Solvency II legislation are subject to further expert and political negotiations and might result in different outcomes from the consultation and the information stated in this material. Our analysis focusses on the issues relating to life insurers and annuity providers in particular.

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Speakers

David Otudeko leads the development and promotion of the ABI's Prudential Regulation strategy, policy, and proposals on areas such as Solvency II and on wider issues that affect the UK Insurance and long-term savings industry both domestically and internationally.

Kenny McIvor co-led the WTW independent report on the QIS and Solvency II reforms, the WTW responses to the Solvency II Call for Evidence, the PRA's consultation on basic risk-free rate transition and BEIS's consultation on restoring trust in audit and corporate governance.

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Under the Surface of the Solvency II Reforms

Agenda

- Up to now on the Solvency II Review
  - Objectives of the reforms
  - Quantitative Impact Study results
  - HM Treasury Consultation Paper and PRA Discussion Paper
- Industry perspectives
- Analysis of the proposals
- What next on the Solvency II Review?

High-level reform timeline

HM Government

29 Mar 2017

UK invokes Article 50 & Treasury Committee enquiry into Solvency II

HM Treasury

19 Oct 2020 – 19 Feb 2021

Future Regulatory Framework Review & Call for Evidence on Solvency II

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

20 Jul – 20 Oct 2021

Quantitative Impact Study ("QIS") & Qualitative Questionnaire ("QQ")

HM Government

21 Feb 2022

WTW Independent Report & John Glen Speech at ABI Dinner

HM Treasury

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

28 Apr – 21 Jul 2022

Solvency II Review Consultation & PRA Discussion Paper (DP2/22)

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Objectives of the reform

HM Treasury

19 Oct 2020 – 19 Feb 2021

Future Regulatory Framework Review & Call for Evidence on Solvency II

1. *Spur a vibrant, innovative and internationally competitive insurance sector*
2. *Protect policyholders and ensure the safety and soundness of firms*
3. *Support firms to provide long-term capital to drive growth consistent with the Government's climate change and productive finance objectives*

HM Treasury

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HM Government

20 Jul – 20 Oct 2021
Quantitative Impact Study ("QIS") & Qualitative Questionnaire ("QQ")

21 Feb 2022
WTW Independent Report & John Glen Speech at ABI Dinner

The WTW Independent Report, commissioned by the ABI

Item	Business / firms	Scenario A	Scenario B
Matching Adjustment ("MA")	All	-44% (£14.1bn)	-13% (£4.3bn)
Risk Margin ("RM")	Annuity business	-56% (£8.7bn)	-21% (£3.3bn)
	Non-annuity business	-42% (£4.4bn)	-18% (£1.9bn)
Own Funds	All	-4.2% (£3.3bn)	-1.0% (£0.8bn)
Solvency Ratio	Firms with MAP	-8%	-2%
	Annuity specialists	-31%	-11%

1. The QIS Scenario A represented a severe reduction in the MA benefit linking Fundamental Spread to current and short-term average spreads
2. The QIS Scenario B RM was the tapered cost of capital approach calibrated in line with EIOPA* Government has indicated it is seeking a 60-70% reduction in RM for long-term insurers
3. Both scenarios led to reductions in Own Funds Government has indicated a 10-15% release of capital for life insurers, yet PRA's analysis suggests that this will not be achieved on day one of the reforms
4. There was no information in the QIS on how the SCR would be impacted by updated MA methodology, so uncertainty remains around the final impact on solvency ratios

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* Figures based on 16 firms' submissions to the 2021 QIS, representing 75% of life industry Technical Provisions (excl. UL).

HMT Consultation

HM Treasury

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

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HMT Consultation Paper

Matching Adjustment	Risk Margin
Investment Flexibility	Reporting Requirements

Matching Adjustment

- FS is the Expected Loss plus Credit Risk Premium

$$CRP = X.(Average\ spread\ for\ comparator\ index\ over\ n-years) + Z.\left(\begin{matrix} Difference\ between\ the\ spread\ of\ an\ asset\ and\ that\ of \\ the\ comparator\ index \end{matrix}\right)$$

- Parameters X, Z, n to be calibrated to have CRP equivalent to at least 35% of credit spreads on average

Investment Flexibility

- Easing the restrictions on which assets insurers can include in MA portfolios
- Extending range of liabilities eligible for MA to include morbidity insurance products
- WP / Deferred annuities in WP funds to become eligible
- More streamlined approach to accelerate reviewing MA applications

Risk Margin

- Tapered CoC method preferred
- Proposing substantial reduction
  - 60-70% for long-term life insurers
  - 30% for general insurers
- To be accompanied by a significant strengthening in FS (reduction in MA benefit)

Reporting Requirements

- Removing requirements for UK branches of foreign insurers to calculate branch capital requirements / hold assets to cover
- Doubling threshold* for size and complexity of insurers before the regime becomes required
- Reforming reporting requirements (Phase 2)
- Simplifying transitional measures calculation

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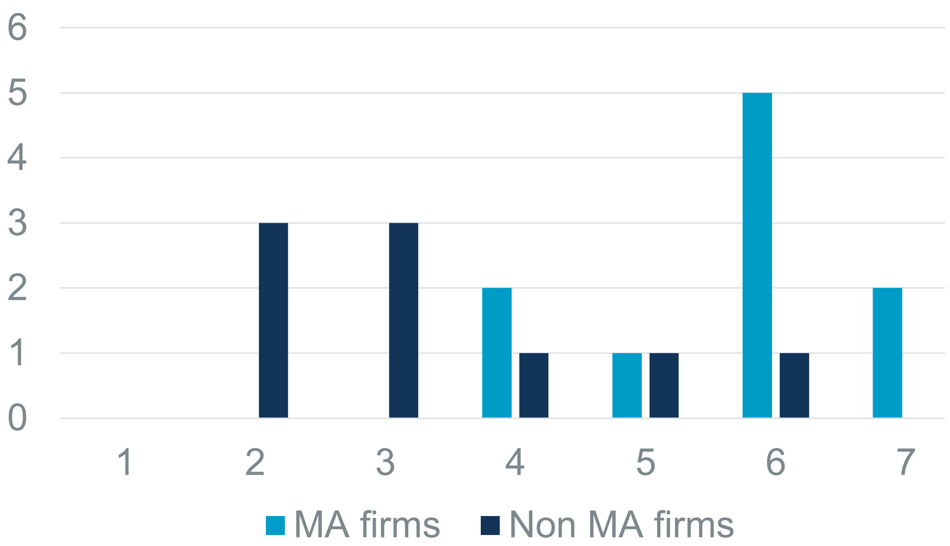
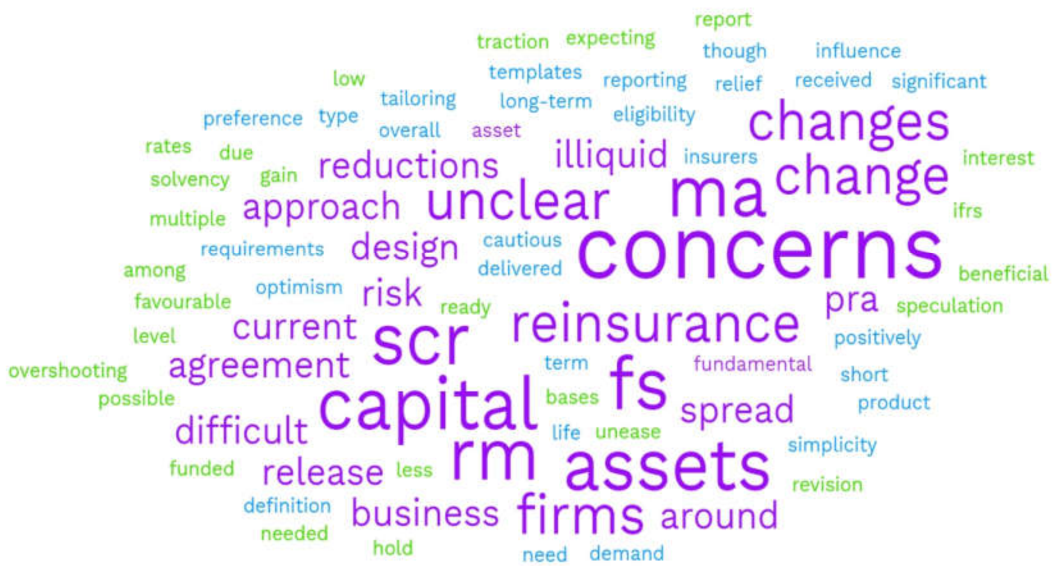
* Current threshold is premium income over €5 million and Technical Provisions over €25 million.

Industry views

Fundamental Spread Design	Asset Eligibility	SCR	Risk Margin Design	Release of Capital	Reporting Changes	Reinsurance Demand

On a scale of 1 to 7, with ***1 being very satisfied*** and ***7 being very unsatisfied***, how would you rate your reaction to the HMT CP and accompanying PRA DP?

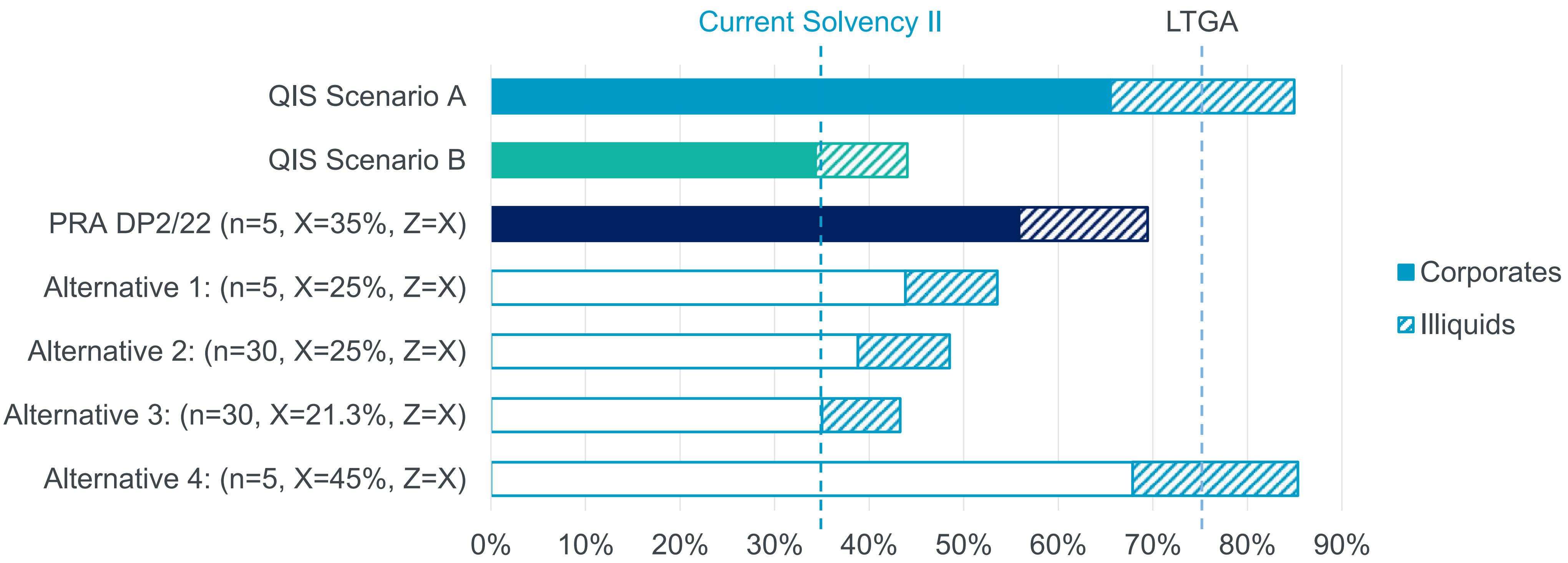




Source: WTW Breakfast Roundtable on 10 May 2022 and bilateral discussions between WTW and life insurers in advance.

WTW analysis of Fundamental Spread ("FS")

FS designs, including alternative calibrations, expressed as percentage of Long-Term Average Spread ("LTAS")



Source: WTW analysis based on a proxy MA portfolio of corporate bonds and 60 basis points loan to bond spread. Current FS assumes 35% of 30-year Long Term Average Spread ("LTAS"). QIS scenarios include Valuation Uncertainty component. Other scenarios are based on alternative calibrations of the DP2/22 model.

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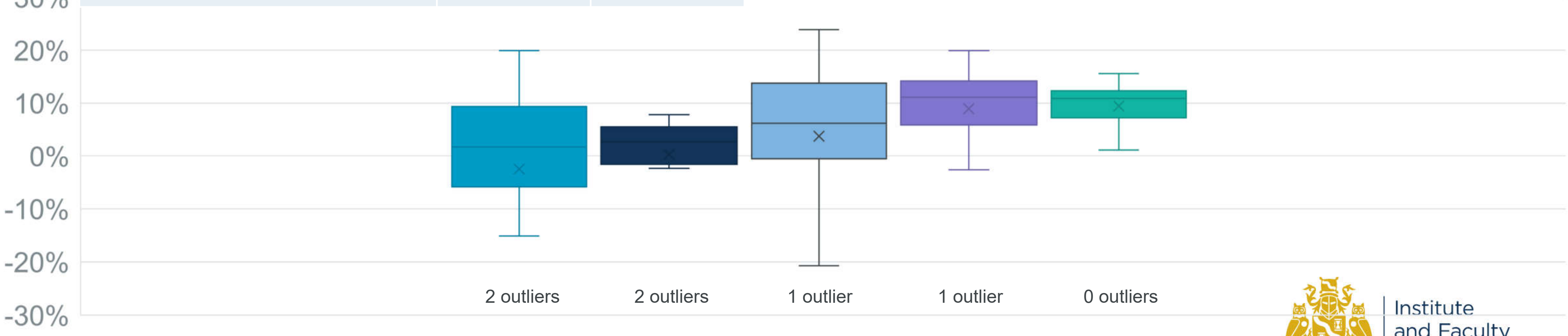
WTW scenario analysis

Estimated change in Own Funds based on data provided by UK life insurers as part of WTW report for ABI (pre-TMTP, excluding SCR)

	QIS Scenario A	QIS Scenario B	PRA DP2/22	Scenario C	Scenario D
Change in RM	-50%	-20%	-60%	-50%	-40%
Change in MA	-44%	-13%	-35%	-13%	-5%
Change in OF (excl. TMTP)	**-2.8%**	**+0.6%**	**+4.5%**	**+10.7%**	**+10.9%**
Change in OF (incl. TMTP)	**-4.2%**	**-1.0%**			

Note that we have not fully factored into our analysis the impact on longer term private assets



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Source: WTW analysis based on QIS data. Percentage change is based on movements in £. Scenarios C and D examples only.

EU-UK divergence

UK		EU
▪ Tapered cost of capital ▪ "60-70% cut in RM for life insurers"	Risk Margin Reform	▪ Tapered cost of capital ▪ Cost of capital rate 5% ▪ Lambda factor 97.5% ▪ No cumulative lambda floor
▪ Major change in design being considered ▪ Linkage of the FS to short term credit spread movements ▪ Potential strengthening	Matching Adjustment Reform	▪ No change in design ▪ Allow diversification benefits between risks inside and outside the MA portfolio

What Next – ABI Policy Perspective

- The ABI is engaging WTW to conduct additional analysis on the impact of PRA and HMT proposals. Output here will be used:
  - In ABI dialogue with stakeholders including the Government on how to progress reform.
  - Along with ABI member feedback to respond to both the PRA discussion paper and HMT consultation paper.
- The industry position on reform proposals will be supported by evidence and the WTW analysis will materially inform this - this will not just be words.
- Two added key developments we will remain mindful of include:
  - The PRA's proposed "technical" consultation later this year – content of this consultation will be crucial in further impact assessing reform proposals; and
  - Developments on the future regulatory framework and the financial services and markets bill. Both are critical in ensuring a fit for purpose prudential regulatory framework going forward.

What Next – ABI Policy Perspective

- ABI goals and that of the Regulators are very much aligned:
  - Policyholder protection matters to insurers because without policyholders the insurance business model does not work. Industry does not want a “weakening of the regime”.
  - Financial stability matters to insurers because no insurer seeks to be responsible for financial instability and history has shown clearly the irreparable damage that this could have on a brand and corporate reputation.
  - But UK Insurers also care about economic growth and international competitiveness and both of these two objectives cannot be subordinated to policyholder protection or financial stability.
  - Ultimately, the ABI is seeking meaningful Solvency II reform that protects policyholders, meets HMT and Government objectives and does not penalise industry.
  - As long term investors, the industry wants to support the transition to a net zero economy and the levelling up agenda. The ABI will continue close constructive collaboration with all stakeholders to achieve this.

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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