Institute and Faculty of Actuaries

CP22/14 Approach to with-profits insurance business

Consultation response to the Prudential Regulation Authority

16 January 2014

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Approach to with-profits business
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Prudential Regulation Authority
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London
EC2R 6DA

16 January 2015

Dear Mr Swain

IFoA response to CP22/14 Approach to with-profits insurance business

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Prudential Regulation Authority's (PRA) consultation paper on the transposition of Solvency II into UK law, specifically the approach to with-profits insurance business. The IFoA's Solvency II Steering Group and Life Current Issues in Solvency II Subcommittee have led the drafting of this response. Members of these groups are actively engaged with the implementation of Solvency II by insurers.

Our response to specific matters follows the order in which they appear in the consultation paper.

General Comments

1. We appreciate how hard the PRA and FCA have been working together to ensure consistent treatment across areas of mutual interest. We note, however, that the different requirements for the allowance of discretionary benefits in liability calculations may cause difficulty in complying with both sets of regulation. We raised this in our response to CP16/14 submitted in November 2014 and would urge the PRA to address this matter through this consultation process.

2. We would suggest that the cost of having to comply with different PRA and FCA requirements should be reflected in cost benefit analysis.

3. The wording of some of the statements suggests a definitive statement can be made when, at times, this will not be possible, thereby creating risk for non-compliance. Some instances we have noted are:

   a. '… affordable, sustainable' future discretionary payments (paragraph 2.12) and Appendix 1, Annex B, section 3.1(1); and

   b. '… distributions … which could endanger the safety and soundness of the overall firm, or which could have a detrimental impact on the benefit security of any group of policyholders …' (Appendix 2, section 4.1).

   We would suggest that these statements are revised to reflect the expectation or the likelihood of being correct, rather than being accurate under all circumstances.

PRA's requirement to use asset share

4. This consultation, taken together with the treatment of surplus funds in CP16/14, may have unintended implications for products that do not see their bonuses driven by asset shares. Whole of life policies, as well as a number of smaller firms, are now brought into a regime with similarities to the current realistic balance sheet regime for larger firms.

5. This CP provides that a firm must maintain assets in excess of liabilities. CP16/14, at Surplus Funds 3.5, indicated that, for non asset share products, liabilities would need to include "future discretionary additions to guaranteed benefits and discretionary payments, in addition to the guaranteed benefits, which are expected to be made when the benefits under the with-profits policy becomes payable but only if and to the extent they are additions to benefits or payments which, if the firm had been able to effect the calculation required by 3.3, are consistent with those for which allowance would have been made in accordance with that calculation".

6. We are concerned that this may cause a 'catch 22' situation, whereby a non asset share driven product is required to justify its provision for final bonus by reference to a system it is inappropriate to use (under the logic of Surplus Funds 3.2). Any drive towards use of asset share to the exclusion of other methods (which is somewhat inherent in the approach in Surplus Funds) will become increasingly outdated, as many funds become predominantly whole of life contracts. We would suggest that prospective methods, which define the liability properly, should not be discouraged, especially as they are consistent with the Solvency II Europe-wide materials.

7. We are also concerned that it is not obvious how the cost of bonus each year would be assessed, given that many smaller firms may adopt Solvency II as the basis for their accounts.

Assets in the with-profits fund

8. As with-profits funds may include non-profit business, the assets in the fund should be sufficient to cover liabilities in respect of both non-profit and with-profits business. It may also be helpful for them to be sufficient to cover the present value of shareholder transfers, as well as planned enhancements from surplus funds.

Distribution strategies

9. Appendix 2, section 4.2: '… strategies which accelerate the transfer of profits outside the with-profits fund …' is not clear; and we would welcome further details as to how 'acceleration' will be defined and measured (i.e. accelerate when compared to what?). Any increase in bonus rates would accelerate such transfers (via the value of future shareholder transfers); such increases in bonus rates may be wholly appropriate under favourable circumstances.

Appendix 2 Supervisory statement – With profits

10. In 1.2(a) it would be helpful and efficient to refer explicitly to the appropriate sourcebooks for both non-Directive friendly societies and non-Directive insurers and avoid reference to inappropriate sourcebooks.

11. We suggest that the PRA (and firms) should also take into account the terms and conditions of court schemes, where relevant – refer, for example, to Appendix 2, Sections 3.1 and 3.4(a) and note that these schemes may have a material effect on the expectations of policyholders.

12. We note the obligation to document requirements and provisions regarding the use of support assets in the firm's records. We presume this does not necessarily require public disclosure, as there may be concerns about sharing any commercially sensitive arrangements.

Should you wish to discuss any of the points raised in further detail please contact Michelle Walsh, Interim Technical Policy Manager (michelle.walsh@actuaries.org.uk 0207 632 1471) in the first instance.

Yours sincerely,

David Hare
Immediate Past President, Institute and Faculty of Actuaries