Institute and Faculty of Actuaries

Solvency II: resolving the remaining policy issues for UK transposition

Response to HM Treasury

19 September 2014

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

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

Solvency II Consultation
c/o Insurance and Savings Team
Financial Services Group
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

19 September 2014

Dear Sirs

Solvency II: resolving the remaining policy issues for UK transposition

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to HM Treasury's consultation on resolving the remaining policy issues for UK transposition under Solvency II. The IFoA's Solvency II Steering Group and Life Current Issues 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.

Q1: Do you agree with the government's proposal to implement the option provided in the Directive which would make use of the volatility adjustment subject to supervisory approval in the UK?

The IFoA believes that the approval process should be focused on the demands of the Directive and should not impose additional requirements. In the consultation document (3.3) the government proposes that applications to use the volatility adjustment (VA) should normally be approved if:

1. they have correctly calculated the impact of the adjustment in line with what the Directive stipulates;

2. they will not lead to procyclical investment behaviour – noted as "the key policy objective which the VA was designed to achieve"; and

3. the applicant has effective risk management systems that comply with Article 44 of the Directive.

The PRA has ongoing powers under Solvency II to monitor compliance with points 1 and 3, so a formal approval process is not strictly necessary for these. For point 2, we would note that insurers not permitted to use the VA could actually exhibit greater procyclical behaviour, by becoming forced sellers if spreads widen in economic downturns. Despite these concerns, we recognise that introducing a formal approval process may give the PRA greater comfort that the Directive's fundamental objectives in relation to the VA have been met.

We note that applying for dispensations, or supervisory approval, could have significant cost and resource implications, especially for smaller insurers. We would welcome any guidance or templates the regulator could introduce that would minimise the cost of applying for a dispensation, and reduce the risk that firms could be discouraged from applying..

Q2: Do you believe there any circumstances where automatic use of the volatility adjustment may be preferable to prior supervisory approval?

The consultation document recognises (3.2) that the VA may be more suitable for some products than others. For example, “the VA may be much less appropriate for liquid or volatile liability types”. The IFoA suggests there could be a case for allowing less volatile lines of business to use the VA automatically, without having to apply for approval. However, we note that the proposed approval process is framed in terms of applications from “UK insurance undertakings”; we would welcome more clarification of this phrase, given that it would seem to refer to organisations that could encompass several lines of business, which would make it difficult to operate different procedures for different products.

Q3: Do you agree that supervisory approval for use of the VA, as proposed in this consultation document, would be consistent with government’s guiding principles on EU legislation?

We agree that the use of a supervisory approval process is consistent with the government’s principles for implementing EU legislation, although (as noted in 3.6a) regulating the VA without such an approval process would also be consistent.

Q4: Do you agree with the government’s proposed approach to the de-authorisation of insurance and reinsurance undertakings? Alternatively, what would be the consequences, particularly to policyholders, if such undertakings were not permitted to manage and pay claims on their existing insurance contracts?

The IFoA agrees with the Government’s proposed approach to the de-authorisation of insurance and reinsurance undertakings. However, we would encourage the regulations to enable the PRA to adopt the most appropriate approach on a case-by-case basis that would provide the best outcome for policyholders.

If you wish to discuss further any of the points raised in this response, please contact our Policy Manager, Matthew Levine (matthew.levine@actuaries.org.uk / 0207 632 2121), in the first instance.

Yours faithfully

David Hare
Immediate Past President
Institute and Faculty of Actuaries