



Institute  
and Faculty  
of Actuaries

# CP16/14 Transposition of Solvency II: Part 3

Response to the Prudential Regulation Authority

7 November 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.



Transposition of Solvency II: Part 3 responses  
Jack Middleton  
Prudential Regulation Authority  
20 Moorgate  
London  
EC2R 6DA

7 November 2014

Dear Mr Middleton

### **IFoA response to CP16/14 Transposition of Solvency II: Part 3**

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. 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. The IFoA notes the fact that, throughout the consultation, there are many examples where the PRA has transposed the original wording from the Directive, or lower level text. We welcome this approach as evidence of the intention to implement Solvency II consistently across all Member States. The PRA has pledged that it will not gold plate Solvency II requirements and we hope it maintains this commitment through the process of transposition.
2. We have highlighted in the following paragraphs particular areas where it appears the PRA proposals have gone further than may be required in the basic Solvency II requirements:
  - a. There is potential for confusion over the definition of surplus funds for with-profits funds. Confirmation of the FCA's changes to its rulebook would be useful in ensuring a consistent regulatory treatment. There appears to be a transition between an open-fund "surplus" and a closed-fund "surplus". The definition of "with-profits assets" could be viewed as a cumbersome way to allow for profitable non-profit business within the with-profits fund. The allowance for non-profit business could lead to with-profits assets being higher than the total assets within the fund and this should be stated clearly.
  - b. There is the possibility of duplicating some of the information in the ORSA (for example the business model template) for national specific templates (NSTs). We would suggest these should be re-examined to ensure that the NSTs are justified by the real needs of regulators, bearing in mind that the single market requires a single playing field for regulation.
  - c. The ISPV rules may result in more stringent treatment than required under the Directive. To encourage the ISPV rules to be interpreted appropriately, we would urge the PRA to provide more detailed comment on the lack of transitional rules.
3. We welcome the PRA's confirmation at its "Countdown to implementation" conference on 17 October that it is considering waiving the quarterly reporting requirement for category 4 and 5

firms, subject to meeting the MCR requirements. We would encourage the PRA to take this approach on the grounds of proportionality. Alternatively, simple reporting (similar to the current estimated position given at quarter ends) may be more appropriate for these firms. It will also remove a potentially large cost from these smaller organisations and allow them to manage their business by focussing on important indicators. More generally, the IFoA would encourage the PRA to consider how exercising flexibility in its reporting requirements could support smaller firms and new entrants to the market.

## **Section I: Transposition of Omnibus II**

### **The matching adjustment (MA)**

4. We support the approach that the terms of the matching adjustment (MA) should follow the terms as laid out in the Directive. Given the relatively short timeframe to full implementation of Solvency II, we welcome the PRA's publication of Consultation Paper CP23/14 on Solvency II approvals, including proposals on the pre-application process for use of the MA, and we will be commenting in more detail on the MA in response to that consultation. The timetabling constraints mean that firms will have to join the pre-application process by 6 January 2015, before that process can be adjusted to reflect the results of the consultation (which closes on 9 January).

### **The volatility adjustment**

5. We agree that the terms of the volatility adjustment (VA) should follow the terms as laid out in the Directive. We have also previously responded to the HMT consultation on making use of the VA subject to supervisory approval in the UK.<sup>1</sup> We welcomed the PRA's confirmation at the "Countdown to implementation" conference that the criteria for using a VA will be the same, whether or not a pre-approval process is adopted.

### **Risk management for long term guarantee measures**

6. The IFoA would welcome clarification of the nature of the proposed liquidity plan, over and above the contents of the ORSA, and the PRA's view of what it should contain. Our understanding is that the liquidity plan will already be formulated within the ORSA as part of the Forward Looking Assessment of Own Risk, which would be consistent with paragraph 4.7 and is suggested in Appendix 1.12 paragraph 3.1. An alternative approach would be for the PRA to reference the firm's filed ORSA and then consider if the firm needs to provide additional explanation of its liquidity needs.
7. The IFoA understands that extrapolation techniques are not left to a firm's discretion; rather EIOPA has responsibility for specifying the risk-free curve for GBP, as well as the extrapolation method. We are, therefore, unclear of the purpose of paragraphs 4.14 and 4.15 and would welcome further explanation from the PRA.

### **Transitional measures**

8. We note the approach taken by the PRA and we have no further comment.

### **External credit rating assessments**

9. We note the approach taken by the PRA and we have no further comment.

### **Groups**

10. Given the short timetable to implementation, the IFoA would welcome publication of the supervisory statements, as soon as possible, to ensure groups are in a position to meet the PRA's requirements.

---

<sup>1</sup> <http://www.actuaries.org.uk/research-and-resources/documents/ifo-response-hmt-solvency-ii-resolving-remaining-policy-issues-uk->

## **Section II: Transposition of Solvency II**

### **Insurance special purpose vehicles**

11. We are aware that, from a policyholder protection perspective, the PRA will require Solvency II rules to apply as soon as possible. However, we would welcome further details from the PRA on its reasons for not applying a transitional position, particularly as there is a possibility that the UK regime may have a different standard for the treatment of insurance special purpose vehicles to EU Member States. We would recommend the PRA considers this further with other Member State regulators to ensure that there are no unintended consequences for UK firms.

### **Third country insurance branches**

12. We welcome the general approach of the PRA to third country branches; this is a practical step that would allow those branches to plan for their inclusion in Solvency II. We would also ask the PRA to confirm its own requirements in dealing with the implementation of Solvency II in different jurisdictions. The PRA's requirements may be firm-specific, depending on the global reach of a firm's activities; however, publication of any requirements, in respect of those third countries that contain a number of branches, may be beneficial for the broader UK market.
13. We note that the required Standard Capital Requirement (SCR) and the Minimum Capital Requirement (MCR) are only the Branch SCR and MCR, rather than a worldwide SCR and MCR. Again, this is practical and useful to the branches.
14. We note the new requirements for third country reinsurance branches. We believe it is appropriate that branches should be subject to Solvency II in respect of their own business.

### **Surplus funds**

15. We are concerned that there is some evidence of "gold plating", compared with the requirements of the Directive for with-profits funds. Specifically:
  - a. We would suggest that the cost of capital risk margin should be included in the calculation of technical provisions for the calculation of surplus;
  - b. We would welcome a clearer definition of the extra discretionary benefits that would be given as a distribution of the estate;
  - c. We would welcome more detail on firms that have already allocated some part of the estate into their asset shares;
  - d. We would expect that negative technical provisions for non-profit policies can be allowed for, within the with-profits fund, to increase the assets available for with-profits policies and, hence, the amount of surplus; and
  - e. We believe there should be an allowance for shareholder transfers as a liability in a proprietary fund.
16. We would also urge the PRA to require that the treatment of enhancements, including the residual estate, is consistent with the economic effect of any specific commitments, or legal obligations, that apply in each particular case. It is not clear from the consultation document whether planned enhancements should be included, or excluded, from with-profits liabilities. We believe strongly that they should be covered within with-profits liabilities, not surplus. If this is not the case, the residual estate would be included within surplus funds, even in instances where it is expected that the estate will be distributed to with-profits policyholders (e.g. due to a commitment made by the company in its PPFM, or a legal obligation created by a scheme of demutualisation). We understand that the objective of this approach is to ensure consistent presentation between companies. However, the IFoA is concerned that this uniform approach would not have regard to the differing nature of commitments made by different companies. Consequently, the approach

may produce results that are inconsistent with those commitments and do not realistically reflect their economic impact.

17. We would also suggest that the PRA consider requiring firms to compare technical provisions for Solvency II with the asset shares, if available, for those policies. The firm could state in its ORSA how it is managing bonuses, to ensure that its obligations under FCA rules are met. Given the public interest element, this statement could become part of the PPFM and be a public statement by firms set out on their websites.
18. The changes above would allow mutual insurers to operate under the same rules as proprietary insurers, allow closed funds to operate under the same rules as open funds, and add greater transparency to the process.

#### **Cancellation of dividends on ordinary shares**

19. We agree with the PRA that dividends should not, ultimately, be guaranteed on any Tier 1 capital. We would encourage the PRA to liaise with other supervisors to ensure a consistent approach across the EU.

#### **National specific templates (NSTs)**

20. We note the PRA's comments that the NSTs may be subject to review, following the finalisation of Regulations. There may be an issue emerging on providing revenue accounts, when IFRS is likely to remove most of the revenue account of a linked insurer, and replace the items with "margins". We are unclear on the possible use of revenue accounts, where there are differing recognition rules between types of business.
21. We would question whether all of the templates listed in the consultation are necessary to allow for effective PRA supervision of the UK market. We would encourage the PRA to provide specific examples about how the templates may be used.
22. We would also ask the PRA to consider whether all the requested data will be available. As an illustration, the calculation of the cost of bonus is not likely to be undertaken within the Solvency II software. We would also welcome clarification of why the cost of bonus would be discounted at rates other than the risk free rates established by the Solvency II directive.

### **Section III: Responses to feedback on CP12/13**

#### **Approach to Lloyd's**

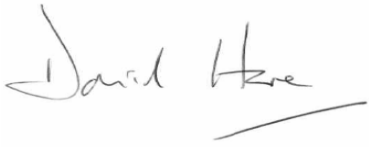
23. We would recommend a clarification that the agent may obtain the Statement of Actuarial Opinion either from the internal actuarial function, or from an outsourced external adviser with suitable qualifications.

#### **Public disclosure of capital add-ons**

24. We note that the two years option is favoured by the PRA and we would agree that this would be an appropriate option in the public interest.

Should you wish to discuss any of the points raised in further detail please contact Matthew Levine, Policy Manager ([matthew.levine@actuaries.org.uk](mailto:matthew.levine@actuaries.org.uk) / 0207 632 2121). in the first instance.

Yours sincerely

A handwritten signature in black ink that reads "David Hare". The signature is written in a cursive style with a long horizontal flourish extending to the right.

David Hare,  
Immediate Past President, Institute and Faculty of Actuaries