Institute
and Faculty
of Actuaries

CP9/13 - Solvency II: applying EIOPA's preparatory guidelines to PRA authorised firms

Prudential Regulation Authority

Consultative Document

15 November 2013

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
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of Actuaries

Prudential Regulation Authority
Bank of England
20 Moorgate
London
EC2R 6DA

15 November 2013

Dear Sirs

Consultation Paper CP9/13 Solvency II: applying EIOPA's preparatory guidelines to PRA-authorised firms

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. This response has been prepared by members of the Solvency II Steering Group of the IFoA and supported by additional members with relevant experience.

The IFoA believes more clarity regarding Solvency II requirements is required to remove the uncertainty that remains regarding its eventual implementation. EIOPA's preparatory guidelines and the PRA consultation are both helpful in moving the industry towards the implementation of the Solvency II regime.

The IFoA is engaged in detailed discussions with the PRA regarding the practicalities of ensuring that the Actuarial Function is performed by appropriately qualified and experienced persons in the post Solvency II regime. Rather than covering this ground again, this consultation response has concentrated on the broader issues raised by the PRA's proposed approach, which we trust will be helpful to the PRA. Across the insurance industry, actuaries are engaged in helping companies manage their risks (as Actuarial Function Holders and in many other capacities). The views expressed in this response reflect the experience of our members performing these roles.

General Comments

The IFoA welcomes the clarity that the PRA has been able to provide by publishing this document. In particular, clarification that the existing rules in their entirety, with associated responsibilities, will continue in full until 31 December 2015 gives useful certainty. The IFoA agrees with the PRA that in many areas firms will be able to apply the EIOPA preparatory guidelines without generating conflicts with the current regime. The pragmatic approach outlined in 2.8 through to 2.11, and implied through the remainder of the document, is welcomed. However, there are areas where progress will be more difficult as a result of either constraints imposed by the current regime or where an insufficient level of detail is available at this stage. The IFoA is keen to work with the PRA and other stakeholders to minimise these obstacles.

The IFoA recognises that the PRA sees the boards of insurance companies as having primary responsibility for ensuring compliance with Solvency II, and that the PRA does not intend to provide additional guidance beyond the Solvency II requirements. However, the IFoA believes there is much that practitioners can learn from each other as a result of sharing experience in the preparatory period. Furthermore, time and expense will be saved in the industry if as much as possible is done to share this experience and develop thinking around what good outcomes may look like. Members of the IFoA have identified that the publishing of FAQs or other similar documents may help the industry better understand the PRA's approach to the implementation of Solvency II.

Some members have expressed concern that the challenge of maintaining the current regime whilst concurrently preparing for Solvency II will be significant, particularly for smaller firms. The IFoA notes that the PRA has stated that it intends to adopt a pragmatic approach. Further guidance on how this approach may work in practice will help to minimise concerns.

A particular issue of note for the IFoA is the changing role of the Actuarial Function Holder (AFH). As discussed in more detail below, concerns remain that, as firms prepare for Solvency II, existing AFHs may find that the resources and information needed for them to fulfil their current responsibilities become increasingly more difficult to access as firms move towards the new regime.

The requirement, from 2015, to perform forward looking calculations in the ORSA using a Solvency II basis may be practically challenging for some firms to implement, particularly as the detailed calculation rules are not yet available. Some firms may face similar technical challenges in the modelling needed to underpin the ORSA and this is an area where further guidance from the PRA on the acceptability of particular approaches would be helpful. The IFoA is supportive of the requirement to perform forward looking calculations as it ensures that companies are aware of their ability to meet future regulatory solvency requirements. However, if there are further delays in the finalisation of these regulations or to the implementation date of Solvency II, then this requirement should be reviewed.

Much work has already been done by actuaries and others to develop Enterprise Risk Management (ERM) frameworks and associated tools to give boards the holistic understanding of risks they need. Indeed, some boards may already have had an active involvement in this. More could be done to reflect the importance of building on this work in the drafting of Section 4. The PRA will need to consider how flexible its approach may need to be to accommodate firms whose processes for production of the ORSA are likely to be at different stages of development.

Groups

The consultation paper highlights the extra requirements on groups compared with the current regime and the need for groups to actively work towards these additional requirements, but does not explain what steps the PRA would find acceptable (and which they would not). Indication of what actions the PRA would deem appropriate for groups to take to reflect post Solvency II governance requirements in their structure prior to 2016 would be of benefit.

Whilst one of the original intentions of Solvency II was to reduce the capital which well-diversified groups need to hold, the IFoA notes that this is now less frequently referred to. Three additional points of note as a result are:

- Companies that operate cross-border will be interested in understanding the implications for their businesses of potentially different approaches taken by different National Competent Authorities to the preparatory Guidelines from EIOPA. This is an area where, in time, more information from the PRA may be helpful.
- The IFoA is keen to understand what consideration the PRA has given to how these requirements interact with the ICAS regime for insurers that are either subsidiaries of banks or hold banking subsidiaries on their balance sheets.
- How fungible will regulators consider capital to be across groups (including those including non European companies where equivalence will also be a factor)?

The role of Actuarial Function Holders within life companies prior to introduction of Solvency II

The IFoA notes that, as part of the more general requirement to continue complying with the current rule books, the Actuarial Function within life companies must comply with all existing guidelines until 2016. The IFoA has considered how responsibilities change between the current and new regimes and notes that this may create practical difficulties for AFH's as companies design information flows and management structures to support the new regime.

More detailed points

1.4 The clarity provided in this point is helpful.

2.5 The IFoA suggests that asking firms to "implement the substantive provisions of the guidelines in order to achieve the intended outcomes" may benefit from more detailed refinement. The document does not explain which guidelines are substantive (and which are not), or articulate what the intended outcomes are. The IFoA understands that this reflects practice in European Law where courts are influenced by intention as well as the letter of laws and regulations. Nevertheless, actuaries advising firms would find it helpful if the PRA could provide greater clarity on how they will make these judgements.

2.8 The IFoA suggests further consideration might be needed of "firms will be expected to apply the guidelines in a way that is appropriate to the nature, scale and complexity of their business". Whilst appreciating the sentiment of this statement the actions of the PRA's enforcement teams will in time give greater clarity as to what this means in practice and how the PRA will retain consistency across different businesses.

2.10 The consultation paper mentions a set of thresholds being used for the submission of information to the PRA. Early clarification of what these thresholds amount to would be beneficial to those preparing submissions.

3.4 It is important that systems of governance develop in a way that is appropriate for the firm. The IFoA welcomes the fact that the PRA recognises that the approach taken will need to reflect the history and particular circumstances of each firm. With specific reference to the statement, "the PRA expects firms, when asked, to be able to explain what governance changes they need to make to satisfy the guidelines", the IFoA notes that, for general insurance firms, this will include the formalisation of the Actuarial Function. The IFoA seeks clarity on the timescales within which the PRA expects firms to achieve this.

3.5 Clear guidance on what the PRA hopes firms will action and what requirements they will place on firms is desired.

3.9 The IFoA finds the clarification, "...this is not intended to duplicate roles at group and solo level" to be useful.

3.10 The IFoA notes that although the PRA may approach "key function holders ahead of Solvency II", there is not currently an actuarial key function holder in general insurance companies. It is important for the PRA to identify who will be an appropriate contact point within general insurance firms to assess the progress being made to establish the actuarial function.

3.14 Within the general insurance context, Periodical Payment Orders (PPOs) are increasingly being used to settle liability claims and, whilst their numbers are currently small, they are unusual in the long duration over which future payments are expected to be made. General insurance actuaries will be keen to understand how the requirement to hold assets that are appropriate to the nature and duration of liabilities impacts the approach to reserving for PPO claims.

3.15 Clarification of what is intended by the sentence, “In keeping with the PRA’s proportionate supervisory approach, firms are expected to take suitable steps to adapt to the new investment regime”, would be of benefit. PRA has identified that the transition will place a strain on the resources of small firms. This will not be the only place where small firms will face such pressures and there may be other aspects of this process where the proportionate approach identified here, could help.

3.19 Rewording to remove reference to Solvency II Pillar 1 valuations is helpful. While the work of the actuarial function in the preparatory period can now focus on “co-ordinating the technical provisions, providing an opinion on the underwriting policy and reinsurance arrangements and contributing to the development and performance of the internal model”, this leaves unsaid that the AFH in a life company continues to hold substantially more responsibilities than this up until Solvency II is introduced and will need appropriate resources to support them in exercising those responsibilities.

3.23 The IFoA requests further clarification of the point: “...interdependencies between risks and between different entities should also be systematically addressed in groups”. Whilst this is good practice, it may constitute an extension of the current regime. As such, clear definition is required as to what ‘systematically addresses’ entails. Furthermore, guidance is required as to who is responsible for discharging this responsibility and how the PRA will measure progress to ensure firms adequately achieve this.

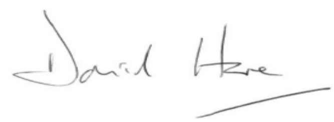
4.3 The IFoA seeks further clarity on what a “pragmatic approach” to the development of ORSA will entail. Firms are encouraged to work towards ensuring their ORSA adequately captures “all known risks”. More proportionality may be of benefit here and this may be better reflected by the use of the phrase, “all material risks”, as an alternative.

4.8 The IFoA notes that the concept of the forward looking assessment is approached from the perspective of being a new development. A different approach may be required for firms that already have in place well-established risk management frameworks and are already producing ORSA reports for the board. The IFoA suggests that the focus should be on requiring firms to demonstrate that the board takes risk management frameworks and risk and capital discussions seriously.

4.13 The PRA will be aware that many insurers will have been doing projections under various scenarios as part of their financial conditions report for many years. The IFoA questions whether the drafting of this section could do more to reflect the current state of developments here.

As already highlighted, the IFoA believes that this document is a useful contribution towards the eventual adoption of Solvency II and stands ready to assist the PRA in contributing to a smooth implementation. Should you want to discuss any of the points raised, please contact Paul Shelley, Policy Manager (paul.shelley@actuaries.org.uk or 07917604985) in the first instance.

Yours sincerely,



David Hare
President
Institute and Faculty of Actuaries