Institute
and Faculty
of Actuaries

CP47/16 - Maintenance of the ‘transitional measure on technical provisions’ under Solvency II consultation

IFoA response to Prudential Regulation Authority

15 March 2017

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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.

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CP47_16
Henrietta Tait
Bank of England
Threadneedle Street
London
EC2R 8AH

15 March 2017

Dear Henrietta,

IFoA response to Consultation: Maintenance of the TMTP under Solvency II

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the PRA's consultation on the maintenance of the Transitional Measure on Technical Provisions (TMTP) under Solvency II (SII).

2. The IFoA's TMTP Working Party, Life Standards and Consultations Sub-committee and Life Practice Board have been involved in the drafting of this response. Members of the Working Party, Sub-committee and Practice Boards have been actively engaged with the ongoing implementation of SII, including the determination of the TMTP.

3. The TMTP is material to many insurers and clarity on the PRA's expectations on the maintenance of the TMTP over the transitional period is welcome. The consultation is important given the impact of market movements since 1 January 2016, which for many insurers has led to material increases in the risk margins.

4. We believe it is reasonable for the PRA to expect firms to understand the material components and drivers of the TMTP benefit. We expect that most firms will be carrying out this analysis as part of their existing processes and include the output in their ORSA report. We agree that this should facilitate better risk management.

5. The IFoA also expects firms will be assessing the change in TMTP as part of their stress and scenario testing. However, we would expect firms to take a proportionate approach to the inclusion of any additional TMTP analysis within their ORSA, reflecting the materiality of the TMTP within the firm. We do not believe the current proposals in the amended Supervisory Statement SS6/16 allow a differentiated approach to be taken by different firms based on their different levels of materiality.

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Comments on the proposed amendments to SS6/16

6. It is not clear from the drafting of paragraph 3.1 whether in the situation where only a subset of Homogeneous Risk Groups (HRGs) have applied for the TMTP, that the maximum TMTP is based on:

   - only those HRGs with a TMTP; or
   - all HRGs, including those which have not applied for the TMTP.

   Our view is that the maximum limit of the TMTP should include only the HRGs which have applied for the TMTP, and exclude those HRGs for which the TMTP is not being applied. It would be helpful to clarify this point.

7. The PRA explains in paragraph 3.1 that it is aware of firms that may inadvertently breach condition 1 through allowances made for the changes in deferred tax liabilities. It is not clear to us when this would occur, and it would therefore be helpful for the PRA to clarify, or provide examples, of how such a situation could occur. However, if a firm is in such a situation, then the drafting is appropriate.

8. Paragraph 3.5 outlines that the PRA may revisit or reassess the Individual Capital Guidance (ICG) upon request from firms, and will consider a proportionate review of the ICG. We support this change and believe it is a helpful amendment to SS6/16. In particular, we view changes to business due to a Part VII transfer to be pertinent here.

9. In paragraph 4.17A, the PRA acknowledges that a proportionate approach to the calculation of the TMTP may involve the use of estimates, and that these methods should be clearly documented. We welcome this, but believe that additional clarification would be helpful on the level of simplification that may / may not be valid under differing circumstances. Although we recognise that this may need to be firm-specific, further guidance on how the PRA may consider the appropriateness and materiality of simplifications would be beneficial. This could help firms propose approaches the PRA is comfortable with, and reduce review and implementation timelines accordingly.

10. Paragraph 4.17A also outlines that the use of less precise methodologies should not result in the systematic distortion of the amount of the TMTP claimed. It is not clear to us what is meant by a ‘systematic distortion’; nor is it clear whether a methodology which is prudent, i.e. understates the TMTP benefit, would be permitted. Pragmatism and simplifications are required in the demonstration. Otherwise, firms will effectively be required to maintain multiple regimes for the period of run-off.

11. The amended SS6/16 explains that firms need to differentiate between assets and liabilities applicable to business written before and after the introduction of SII, and that the PRA expects only the former to be included in the TMTP (paragraph 4.18A). We accept that this is the correct theoretical requirement of the TMTP regulation. However, there is uncertainty over whether the rules also restrict the Financial Resources Requirement (FRR) to pre-2016 business, or whether the FRR should take into account all of the firm’s business.

12. We believe the requirement of the Audit Committee to form an independent view on whether or not the firm meets conditions 1-3 and 5 set out in Regulation 54 is generally helpful. It correctly places reliance on the firm and their Audit Committee to ensure the calculations are reasonable.

13. However, further guidance on the 24 month recalculation point would be helpful. Greater clarity would be useful in a number of areas:

- does the recalculation require an application to the PRA?
- is it mandatory for all firms with a TMTP?
- do firms which recalculated in close proximity to the 24 month recalculation point still need to recalculate the TMTP?

Should you wish to discuss any of the points raised in further detail please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk / 0207 632 2146) in the first instance.

Yours sincerely

Colin Wilson
President, Institute and Faculty of Actuaries

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