Institute and Faculty of Actuaries

Solvency II: Changes to internal models used by UK insurance firms – CP19/16

IFoA response to the Prudential Regulation Authority

5 August 2016

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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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SII: CP19/16 Response
Min Wei Chan and Amanda Istari
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

5 August 2016

Dear Min Wei and Amanda,

IFoA response to CP19/16 SII: Changes to Internal Models

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Prudential Regulation Authority's (PRA) consultation paper on changes to insurance firms' Internal Models, under Solvency II (SII). The IFoA's Life and General Insurance Boards have been involved in the drafting of this response. Members of these Boards have been actively engaged with the ongoing implementation of SII.

2. As the PRA will be aware, many of the largest UK insurers will have opted for an internal or partial internal model, and such firms are often complex in nature. Therefore, clarity on the PRA's expectations with respect to model change will be of particular benefit to the UK insurance industry.

3. The draft supervisory statement is useful in setting out the factors the PRA would expect a model change application to consider, such as past PRA feedback and model improvement identified through use of the model. The list of information to be provided with a model change application is also helpful in setting insurers' expectations.

4. Paragraph 2.6 of the draft supervisory statement acknowledges that a planned transaction (such as a business acquisition or perhaps more commonly investment in asset classes not covered by the internal model) may take place before any corresponding model change application is approved, or otherwise. We note that the business change cycle across the insurance industry has quickened considerably over the last decade. This means that transactions completing prior to model change approval may be commonplace. It is therefore helpful that the supervisory statement encourages discussion between firms and the PRA to reach interim agreements so that major change to the internal model on an annual basis does not become a restriction to a firm's business developments.

5. Paragraph 2.13 of the draft supervisory statement explains that '...the PRA expects firms to prepare for the possibility that accumulations of minor model change may need to be unwound should the subsequent model change application not be approved…'. It would be unhelpful for both firms and the PRA for the changes to be required to be reversed at a later date, which may be a significant period of time after the change being introduced. We would encourage the PRA's ongoing supervisory work to have sufficient regular monitoring of firms' minor changes so that it would only be in exceptional circumstances that this would be required.

6. Section 4 of the draft supervisory statement sets out the information to be included within a model change application. Such an application, particularly in relation to an accumulation of minor model changes, may include a wide range of different types of model change. It would be useful if a proportionate approach to the information requirements were possible in such circumstances; if so, clarification of this within the supervisory statement would be helpful.

7. Paragraph 4.4 (f) of the draft supervisory statement explains that model change applications should include an updated Common Application Package (CAP), indicating which items of evidence have changed since the last model approval. It would also be helpful if the updated CAP could include just those items which have changed, rather than the whole package. Again, clarification of this within the supervisory statement would be useful if appropriate.

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

C. Wil

Colin Wilson
President, Institute and Faculty of Actuaries