Institute and Faculty of Actuaries

CP27/15 The prudential regime for non-Solvency II insurance firms and consequential amendments

IFoA response to the Prudential Regulation Authority

12 October 2015

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

SII: CP27/15 Response
Jack Middleton
Prudential Policy Directorate
Prudential Regulation Authority
20 Moorgate
London
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12 October 2015

Dear Jack

IFoA response to CP27/15: Prudential Regime for non-SII Insurance Firms

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Prudential Regulation Authority's (PRA) consultation paper on the prudential regime for non-Solvency II (SII) firms. The IFoA's Life Standards and Consultations Sub-committee has led the drafting of this response.

2. The IFoA believes that, in general terms, these proposals represent a pragmatic and sensible approach to achieving the PRA's objectives with regard to firms outside the scope of SII. However, there are a number of issues which cause us concern, primarily in relation to a lack of clarity in the areas described below.

3. As we have previously stated, both in our response to PRA consultation CP22/14, and in a subsequent letter to the PRA dated 14 September 2015, we consider that firms should be required to hold sufficient assets in their with-profits funds to cover all liabilities, and not just with-profits liabilities. We therefore believe that the proposed Chapter 2 in the with-profits section of the Rulebook should be amended accordingly.

4. Chapters 2, 3 and 4 of the Governance Section refer to small non-Directive insurers, large non-Directive insurers and friendly societies respectively and set out separate governance requirements for each. The implication here is that the definition of small or large non-Directive insurer excludes a friendly society as it is difficult to see how two sets of governance proposals could apply to a single entity. However, this does not appear to be consistent with the usage of the terms 'small non-Directive insurer' and 'large non-Directive insurer' in the rest of the Appendices - where some of the requirements do appear to apply to friendly societies and where the requirements for companies are stated in terms of 'non-Directive insurer excluding a friendly society'. For example, in Annex O, where the three types of firm are defined, the natural interpretation is that chapters 8, 9 and 10 only apply to a larger non-Directive insurance company because that would be consistent with the usage in Chapter 3. It may be that there are no friendly societies within the definition of large non-Directive insurer; however it would be helpful to state this explicitly.

5. The requirement for a non-Directive friendly society to hold a resilience reserve (paragraph 16 of Annex 5 of IPRU (FSOC)) has apparently been removed and we cannot find a replacement provision either as a reserve or a capital requirement. It makes sense to align this with the requirement for companies to hold a resilience capital requirement in order to avoid the

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current effect that friendly societies have to hold an additional 4% solvency margin on their resilience reserve.

6. We note that the requirement for a friendly society to take account of “reasonable selling expenses” in the valuation of a piece of land is retained, while the same requirement does not apply to a company. We believe that the approach should be the same for both.

7. The IFoA is concerned over the lack of clarity about the future actuarial requirements for friendly societies. We note that the requirement for an actuarial valuation in Actuarial Requirements 5.1(3) and 7.1 only extends to 31 December 2015. We note that the “reporting requirements” will be subject to further consultation, but we do not believe it is in the public interest that an important element such as the actuarial valuation should be left unresolved at this time. It is difficult to see how the actuarial function can carry out their duties effectively during 2016 without a mandate to advise on assumptions and methods.

8. We note there are apparently no transition provisions for firms whose assets go above or below the £25m threshold. Current European rules provide that the threshold must be exceeded for a period of three years and we believe there should be a similar transition period allowed for between small and large non-Directive firms, to prevent a firm suddenly entering a different category because of a modest change in the market value of its assets.

9. In the definitions ‘small non-Directive insurer’ is defined, but not ‘large non-Directive insurer’. As the text relies on this definition it would be helpful to include it. It is also not clear what is meant by ‘£25m or less’; is this £25,000,000, £25,499,999 or £25,999,999? There also seems to be no provision for this amount to move in line with inflation and we would have expected there to be such a provision.

10. Finally, we think a proportionate approach has been taken towards the ICA regime for smaller firms.

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-elect, Institute and Faculty of Actuaries