Transitional Measure on Technical Provisions
IFoA Working Party
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Agenda

1. What is the TMTP?
2. Why do firms have a TMTP?
3. How is the TMTP calculated?
4. How to recalculate the TMTP?
5. Recent Changes

Recent Changes
What is the Transitional Measure on Technical Provisions (TMTP)?

The Transitional Measure on Technical Provisions (TMTP) is a deduction made to the Solvency II Technical Provisions. It exists as a result of political compromise and broadly ensures that the solvency surplus under Solvency II is no worse than under Solvency I.

Why do firms have a TMTP?

- **Risk Margin**: Working party view is that the TMTP's primary objective is to mitigate the introduction of the Solvency II risk margin. This can be between 10% - 25% of BEL for immediate and deferred annuity business.

- **Soft landing**: TMTP provided firms with a ‘soft landing’ into Solvency II regime over a 16 year period.

- **Short term impact**: Ensures risk margin required on back book does not have material short term impact.

- **Continuity**: Ensure firms can continue to write new business, avoids detrimental impacts to policyholders and ensures proprietary firms can continue to pay dividends.
How is the TMTP calculated?

1. **The Unrestricted Transitional** is the excess of the Solvency II Technical Provisions over the Solvency I Pillar 2 Technical Provisions (after any ICG on technical provisions)

   - Solvency I Pillar 2 Technical Provisions After any ICG applying to technical provisions
   - Solvency II Technical Provisions
   - Unrestricted Transitional

   **Key consideration:**
   - The Unrestricted Transitional only applies to business written prior to the introduction to Solvency II
   - This can include all the business in a legal entity, or only specified homogeneous risk groups

How is the TMTP calculated (continued)?

2. **A restriction of transitional** is applied if the Solvency II Financial Resource Requirements (FRR) are below those of the more onerous of Solvency I Pillar 1 and Solvency I Pillar 2

   FRR are the sum of technical provisions, other liabilities and capital requirements under the respective measure

   - SI P1 LTICR & WPICC or RCR
   - SI P1 Other Liabilities
   - Solvency I Pillar 1 Mathematical Reserves
   - Solvency I Pillar 2 Individual Capital Guidance
   - Solvency I Pillar 2 Other Liabilities
   - Solvency I Pillar 2 Technical Provisions After any ICG applying to technical provisions
   - Solvency II SCR
   - Solvency II Other Liabilities
   - Solvency II Technical Provisions Including Unrestricted Transitional

   **Restriction of Transitional**

   **Key consideration:**
   - The PRA have confirmed in policy statement PS11/17 that the FRR comparison test applies to all business in force at the recalculation date and not just business written prior to the introduction of Solvency II
How is the TMTP calculated (continued)?

3. The restricted transitional is determined as the unrestricted transitional less any restriction of transitional (if applicable)

**Key consideration:**
The restricted transitional cannot be higher in value than the unrestricted transitional, or lower in value than zero

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### TMTP recalculation

**TMTP just running off?**
Initially most firms did not consider how to recalculate the TMTP

But the Solvency II directive includes provision to allow TMTP recalculation

**Risk profile change**
Firms can apply to PRA for a TMTP recalculation if they can demonstrate that a material change in risk profile has occurred

Material risk profile changes include: Part VII transfers, use of matching adjustment, use of reinsurance and changes in operating conditions

**Risk profile criteria**
The main criteria is that impact of recalculation results in a 5% or greater change in solvency coverage ratio, and this is symmetrical

**2016 interest rates**
During 2016 falls in interest rates resulted in 16 of the 33 legal entities approved to use the TMTP applying for a TMTP recalculation as at 30/06/2017

In order to consider how firms (and the PRA) might manage the TMTP going forward the IFoA Life board commissioned a working party on TMTP recalculation
TMTP recalculation (continued)

The working party identified a number of themes which firms need to consider when recalculating the TMTP. Specific examples are covered on the next slide.

Segregation of business
Recalculation of the TMTP requires the segregation of technical provisions to only allow for business written prior to 1 January 2016.

Legacy regime
Recalculation of the TMTP requires firms to maintain aspects of models and methodology from the previous solvency regime and update where appropriate.

Proportionate
Recalculation methodology and practices should capture the material features of the TMTP, whilst not being too onerous to implement and maintain.

Firm specific
Recalculation methodology and practices will vary from firm to firm, reflecting the type of business written, whether the firm is open or closed to new business, the legacy reporting processes and the relative materiality of the firm's TMTP.

Example practical challenges for a firm recalculating the TMTP are outlined below:

Risk Margin
- Materiality: Very material feature of Solvency II and sensitive to changes in level of interest rates
- Segregation: Needs segregating to only include business written prior to 01/01/16
- Potential solutions: Include full recalculation only include business written prior to 01/01/16, or partially recalculate i.e. rerun 01/01/16 models or rerunning material risks

Illiquidity premium
- Increase in the risk free liability discount rate by an illiquidity premium under Solvency I Pillar II (ILP), and equivalently a matching adjustment (MA) under Solvency II
- Different allowance for best estimate bad debt: MA uses EIOPA fundamental spreads and ILP generally uses an internal view
- Differences in eligible assets: MA tends to be based on a narrower range of assets than ILP
- Potential solutions: Include maintaining four ILP portfolios (split pre/post 01/01/16 and split MA/ILP) or simplify to maintain separate asset allocations for MA/ILP only

Solvency I Pillar II ICG
- Restriction of Transitional: Needs to be considered as part of TMTP recalculating, particularly following a structural business change e.g. a Part VII transfer
- Methodology: What assumptions, calibrations, aggregation methodology should be used? If an internal ICA view changes, should the PRA ICG add-on change or be reviewed?
- Potential solutions: Align Solvency I Pillar II and Solvency II methodology. Derive Solvency I Pillar II ICG from adjusting the Solvency II SCR. PRA are continuing to review ICG on a proportionate basis
Recent changes

In April 2017, the PRA issued PS11/17 which had a number of implications on TMTP

- **Up-to-date information**
  - The Solvency I and Solvency II positions should be derived based on **up-to-date and credible best estimate assumptions**
  - Impact of assumption change since 01/01/2016 should not be included within the TMTP benefit

- **Consistency of assumptions**
  - Whilst Solvency I and Solvency II positions should be derived on consistent assumptions, this **need not mean an equalisation** of all assumptions
  - In particular a firm’s ICG will have considered the aggregate strength of the basis

- **Amount of TMTP applied**
  - The approved value of TMTP (less run-off) is viewed as the maximum amount. A firm may apply less than this maximum amount, subject to maintaining a transparent approach

- **ORSA**
  - As part of an effective risk management process, the TMTP should to be recalculated under a range of stresses and scenarios
  - The results of the stress and scenario testing would likely feature in the firm’s ORSA (Own Risk and Solvency Assessment)

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Recent changes (continued)

The PRA clarified that the **FRR should include all business**, not just business written prior to the introduction of Solvency II

Where a legal entity has a TMTP with a restriction, new business will generally act to reduce this restriction and increase the TMTP

**If the FRR test excludes business written after the introduction of Solvency II...**

- The TMTP may remain on a restricted basis with the restricted value running-off as the business runs off

**If the FRR test includes business written after the introduction of Solvency II...**

- The restriction (pre TMTP) may remain broadly unchanged, whilst the unrestricted TMTP runs off

Under certain circumstances this may result in business written after the introduction of Solvency II benefiting from a TMTP
Recent changes (continued)

There are still a number of challenges remaining

- **Complexity**: The TMTP is a complex calculation, reflecting the difference between large numbers. Firms need to be aware of TMTP complexity when estimating benefits from potential capital initiatives. For example, Part VII Transfers.

- **Opportunity cost**: TMTP recalculation is absorbing management time and resources, which could potentially be spent elsewhere.

- **Application process**: The need for a TMTP approval for changes in operating conditions (i.e., interest rate changes) is onerous. The IFoA working party believe TMTP recalculation should be more dynamic in response to changes in operation conditions and not require an application.

- **Proportionality**: No clear guidance on what proportionality means, and what calculation simplifications are deemed to be generally acceptable.

Summary and key takeaways

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<tr>
<th>Risk Margin</th>
<th>Working party view is that the TMTP’s primary objective is to mitigate the introduction of the Solvency II risk margin</th>
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<tr>
<td>Soft landing</td>
<td>TMTP provided firms with a ‘soft landing’ into Solvency II regime over 16 year period</td>
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<td>Calculation</td>
<td>The calculation is complex and requires (at least) three stages</td>
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<td>Recalculation</td>
<td>Is an ongoing challenge for firms. Simplification allowed and tends to be firm specific rather than standardised across firms</td>
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<tr>
<td>Recent changes</td>
<td>PS11/17 has brought clarity in a number of areas, but challenges remain</td>
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If you are interested in more detail on this topic please see the working party paper on TMTP recalculation available on: https://www.actuaries.org.uk/practice-areas/life/research-working-parties/transitional-measures-tps
Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

If you any feedback on this presentation or the working party please contact the working party chair on:

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