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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

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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

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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

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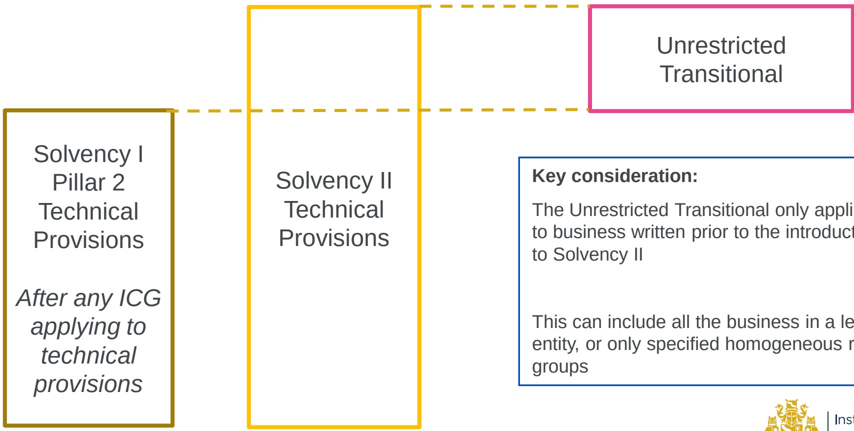
How is the TMTP calculated?

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)



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

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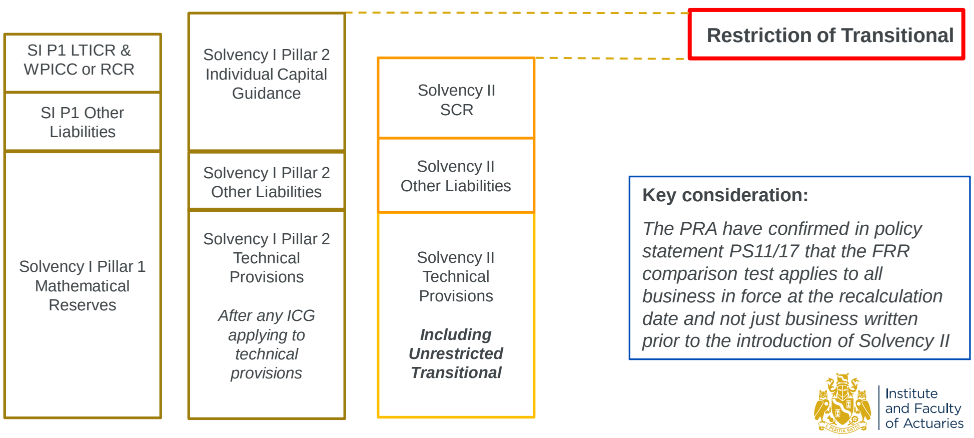
How is the TMTP calculated (continued)?

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



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

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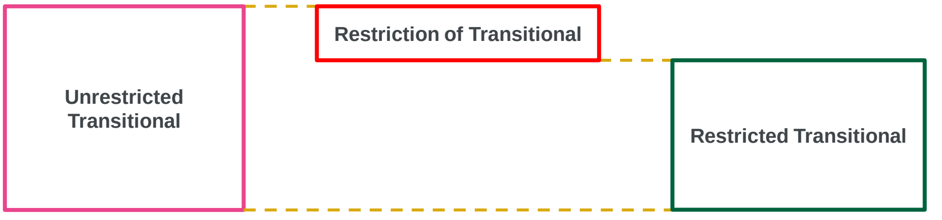
How is the TMTP calculated (continued)?

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

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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

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TMTP recalculation (continued)

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 recalculating 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 recalculation, 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

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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)

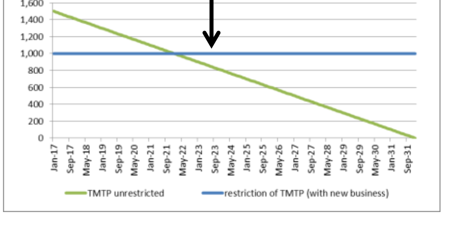
New business in FRR

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

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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 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

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Summary and key takeaways

Risk Margin	Working party view is that the TMTP's primary objective is to mitigate the introduction of the Solvency II risk margin
Soft landing	TMTP provided firms with a 'soft landing' into Solvency II regime over 16 year period
Calculation	The calculation is complex and requires (at least) three stages
Recalculation	Is an ongoing challenge for firms. Simplification allowed and tends to be firm specific rather than standardised across firms
Recent changes	PS11/17 has brought clarity in a number of areas, but challenges remain

If you are interest 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

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Questions

Comments

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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