Institute and Faculty of Actuaries

IFoA GIRO Conference 2024

18–20 November, ICC, Birmingham

Solvency UK Developments

Solvency II Practical Review Working Party

Amrita Pattni (Chair), Guy Carpenter
Nina Ndebele, Sompo

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Agenda

1. Overview of the Working Party
2. Update on Solvency UK
3. Wider Solvency II developments
4. Key takeaways

Overview of the Working Party

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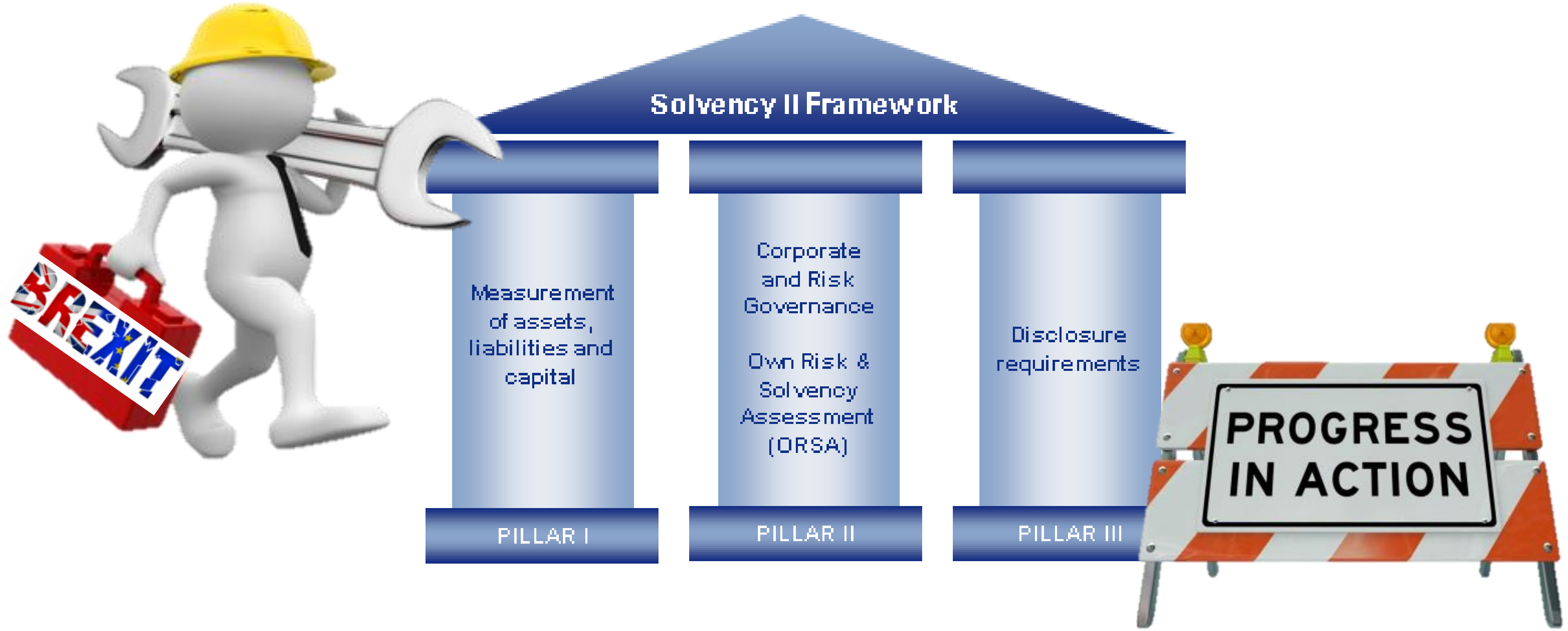
Working party background



<u>Objective</u>: Working Party set up in 2017 to identify practical issues with Solvency II

Working party milestones

Objective	• Working Party set up to identify practical issues with Solvency II
Year 1 - 2017:	• Focus on Pillar 1 – Capital & Pillar 2 – Technical Provisions
Year 2 - 2018:	• Focus on Pillar 3 – Reporting
Year 3 - 2019:	• Focus on regulatory initiatives on Pillar 1, 2 & 3 – EIOPA review
Year 4 - 2020:	• Covid 19 Impact & Solvency II resilience

2021-2022 Break; when reform consultation launched

Year 4 - 2023:	• Solvency UK Update and impact on the industry

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Solvency II Practical Review

by the Institute & Faculty of Actuaries Solvency II Practical Review Working Party

February, 2019

Members: Amrita Pattni (Chair); Catherine Drummond (Work-Stream Leader); Susan Yang (Work-Stream Leader); Yuming Mei (Survey Leader); Avtar Singh; Catherine Scullion; Henry Medlam; Jamie Grant; Marilyn Martin; Martin Mak; Nina Ndebele; Rishav Bajaj; Robert Fitzgerald; Shreyas Shah; Timothy Lee; Amit Parmar

Reviewer: Cian Creedon

Executive Summary

The Solvency II Practical Review Working Party was established early 2017 in order identify and evaluate the key practical implications of Solvency II. This was a well-timed initiative following the Treasury Select Committee's inquiry on possible modifications for Solvency II post Brexit. As part of this process, we launched a survey to gather opinion from the market on the issues posed by Solvency II. It gave us valuable insight into the sorts of concerns practitioners have, allowing us to focus our efforts on the areas of greatest interest, such as the Risk Margin, Model change, and Model validation, while still addressing the numerous complexities and subtleties within the technical provision calculation and Standard Formula SCR calculation. Other issues tackled include lack of guidance around the allowance for PPOs in the Standard Formula, no standard definition for ENIDs, problems with using premium as a risk measure, among others. The issues worth reporting on were those that either caused *unintended market behavior*, *overly onerous calculations* or led to *capital levels that were non-reflective of the underlying risk*. The paper suggests possible solutions and where possible analyses the pros and cons of each. The single issue that brings together these elements is the Risk Margin, which is perceived to be impractical and has the effect of creating a competitive disadvantage. Reforming the Risk Margin would this seem to be a priority for the post-Brexit regulatory regime.

2024-5 Working Party Scope

Solvency UK:
Impact and practical challenges on firms and the industry.

Solvency II Review:
Provide an update on the final stage of the Solvency II reform.

Working party members (2024)

Amrita Pattni (Chair) - 2017

Amerjit Grewal - 2019

Francisco Sebastian - 2019

Jeff Courchene - 2023

Madhuri Kumar - 2019

Nina Ndebele - 2019

Schalk van Tonder - 2023

Shanawaz Hirani - 2019

Yuming Mei – 2019

Avtar Singh – 2017

Valerie Teo - 2019

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Update on Solvency UK

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Timeline

Solvency UK

EIOPA Review

2019 | 2020 | 2021 | 2022 | 2023 | 2024+

Brexit

UK Government
announces its post-Brexit Reforms: "Solvency UK," in November 2022.

31 Dec 2023:
RSR requirement removed
CoC Reduced to 4%

PRA
Publishes CP 12/23 covering the first set of proposed reforms.

PRA
Publishes CP 19/23 covering detailed proposed changes to the matching adjustment.

PRA
Final policy to be published during 2024Q2 Including updated reporting templates

15 Nov 2024
Final review of Solvency UK: PS15/24

Implementation
MA reforms effective 30 June 2024 while other reforms effective 31 December 2024.

EIOPA consultations
EC sent a call for advice to EIOPA in February 2019. EIOPA issued public consultations on draft advice.

EIOPA Info Requests
EIOPA carried out information requests for impact assessment.

EIOPA Final Advice
EIOPA's final advice published December 2020.

European Commission Proposal
EC publishes its proposals in September 2021.

European Parliament
In June 2022, the European Parliament's rapporteur published his proposed amendments to the EC's proposals.

European Council
In June 2022, the European Council published its agreed position.

European Parliament
In August 2022, the European Parliament published (over 600) amendments to the rapporteur's proposals.

ECON Vote
The European Parliament Committee on Economic and Monetary Affairs (ECON) vote on proposals 9/23

European Commission
If the Directive Amendments are approved, Delegated Acts could be agreed in 2023/2024.

Implementation
The Member States will be obliged to adopt relevant laws to comply with the amendments by 30 June 2025 and to apply them from 1 January 2026.

Solvency UK

Risk Margin

Group supervision:
- **3rd Country branches**
- **Capital Add-ons**

Mobilisation

Internal Model Flexibility

Reporting & Disclosure

Risk Margin – one year on

Capital relief

- Reduction in Cost of Capital Rate, reducing the size of the risk margin, providing capital relief to insurers.

Market observations

- Several major insurers in the UK market have been able to release capital, either through share buybacks, increased dividends, or strategic divestments.

EIOPA

- The implementation of the new cost of capital rate reduction to 4.75% is estimated to come into effect in early 2026.

Final PRA rules

- Final package of rules relating to Solvency UK were published on 15 November 2024, effective from December 31, 2024.

Lloyd’s specifics

- Lloyd's plans to offset capital requirements using UTH instead of 1YTH for capital setting and will amend the QCT process to pass benefits to members.

Internal Model Flexibility – One year on

What is the change?

From complying with all **tests and standards ("T&S")** for approval:

- PRA **grants permission** to use an IM rather than approval of an IM.
- **Internal model ongoing review (IMOR)** framework introduced, adding safeguards (e.g. CAO) to address model that is not wholly compliant.
- Changes to **"Solvency II internal models: Permissions and ongoing monitoring".**

Impact on firm & market

- Firms welcome the **increased flexibility.**
- Possibly **greater incentive** to apply for an internal model.
- **Reduce dependency** on the Standard Formula.
- More firms using a sophisticated Internal Model, **overall market becomes undercapitalised.**

Potential costs

- Does increased flexibility come at a cost…?
- **Analysis of Change exercise.**
- **Annual Senior Management Function (SMF) attestation.**

Residual Model Limitation: Capital Add-On - one year on

What is the change?

- **The RML CAO** is one of the safeguards used to address deviation in the risk profile
- Calculated as a **proportion of the difference between SF and IM**. Reviewed annually
- **Remove requirement** to disclose RML capital add on in SFCR
- Regular summary report on CAO to not **include safeguard details** (publish in 2027)
- **Dynamic CAO** instead of Fixed CAO

Impact on firm & market

- Practicalities issues: **Disincentive,** if process is not sufficiently efficient, proportionate and well timed.
- **Poor choice of metric**: Further away from risk profile?
- Proportion of the difference between SF and IM < 100%.

Potential costs

- PRA: **Application of CAO that is not reflective** of the risk profile (agenda?).
- Firms: Possible **reduction in ownership of model** and diminish effectiveness as tool?

Reporting and Disclosure

What is the change?

1. Fewer templates submitted
2. Removal of Regular Supervisory Report ("RSR")
3. Other proposed changes:
    - *Change in acceptable methods for group SCR (allow SF+IM)*
    - *Amended TCB reporting (to include branch legal entity)*
    - *Amended Group reporting*
    - *No longer bifurcate Heath in EBS*
    - *New template for changes in SCR since prior year-end (AoC)*
    - *Amended IM output reporting to include more granular data*

Impact on firm & market

- **Short term**: change in existing QRT solution – more streamlined
- **Long term**: net reduction in the reporting burden

Unintended Consequence

- Firms who benefit the most are those who have (thus far) **invested the least in automated** processes.
- Benefit TCB and Group most.

Branch capital reporting requirements

What is the change?

Removal of the requirements for Third Country Branches (TCBs) to hold risk margin, SCR and MRC and associated local assets.

Impact on firms

- 130 TCBs expected to be impacted.
- **Additional scrutiny** if home jurisdiction capital regime is not "broadly equivalent."

Potential costs

"The one-off cost for a median third-country branch, using solo firm survey responses as an estimation base, is estimated to range up to **£17,000 and £690,000** for small and large branches respectively" ***PRA CP12/23***

Mobilisation

What is the change?

- **Support new insurers' entry and expansion in the UK.**
- Lower minimum capital requirements during the mobilisation phase, benefitting firms aspiring for insurer authorisation in the UK.

Impact on firms

- **Easier entry for new insurers may heighten competition.**
- Boost the UK's appeal as a business location, potentially attracting foreign insurers and diversifying the market landscape.

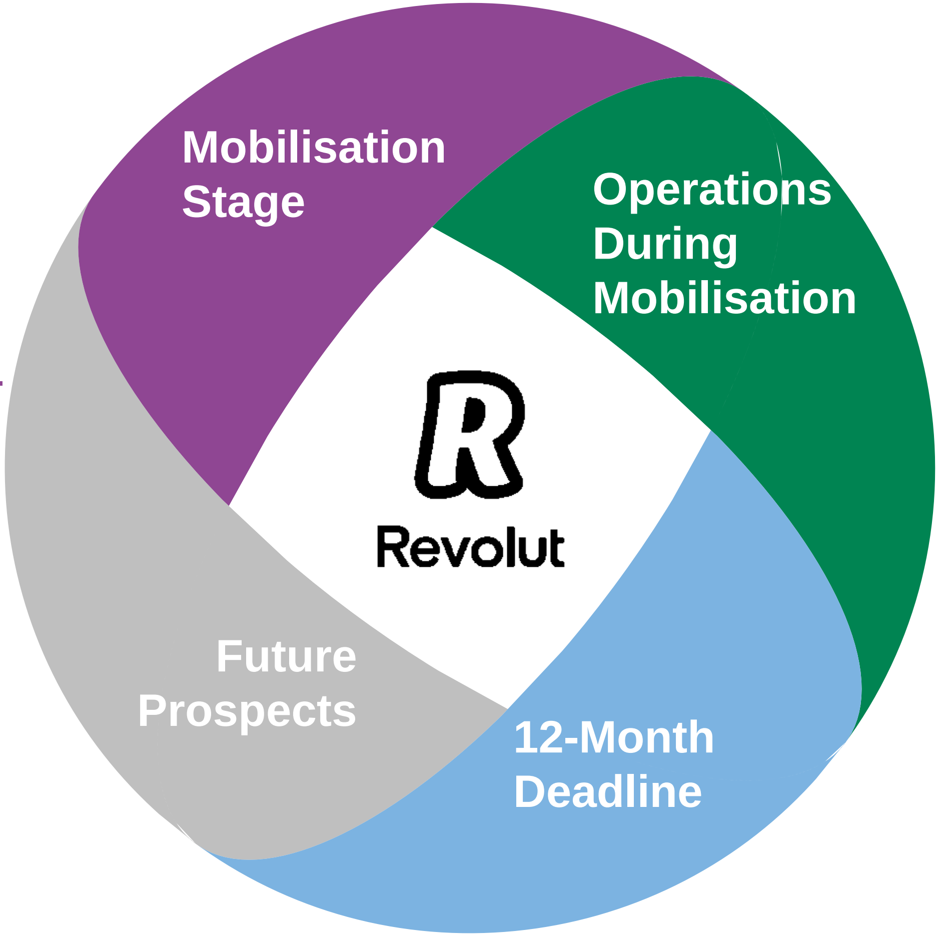
Potential benefits

- **Increased innovation due competition.**
- Market diversification through the entry of new insurance products and services into the market.

PRA Mobilisation Case Study: Revolut Bank

01

- Authorisation with Restrictions: received a banking license but is in the 'mobilisation' stage.
- Allows Revolut up to 12 months to finalise its bank development while continuing as a payment institution.



02

- Continues offering services as a payment institution.
- Plans and preparations for future banking services under the new license.

03

- Releasing new products.
- Expansion plans and new partnerships.
- Expected secondary share sale.

04

- Strict 12-month deadline for exiting the mobilisation stage.
- Requirement to submit a 'Variation of Permission' application three months before the deadline.

Solvency UK – small firms

What is the change?

Increase thresholds from when Solvency UK would apply

- **GWP** increased from **€5 million to £25 million.**
- Group **TP** increased from **€25 million to £50 million.**
- Firms with **Reinsurance** exceeding **£2.5 million in GWP or £5m in gross TPs**

Impact on firms

- Small insurers may now qualify as Non-Directive Firms (NDFs), **falling out of stringent Solvency UK requirements.**
- Firms can volunteer to operate under Solvency UK
- **Reduced compliance complexity, offers flexibility**, and provide new pathways for smaller insurers to manage risk and operational costs more effectively.

Potential costs

- Firms must maintain compliance with thresholds for 3 consecutive years.
- Carefully project growth to prevent unplanned regulatory shifts.
- NDFs still face certain audit expectations, with ongoing discussions around their proportionality.

Other changes

Group SCR

Allowing temporary **combination of multiple SCR calculation approaches** for consolidated Group SCR for up to **two years** during periods of change.

May grant temporary **six-month** permission to use **more than one calculation approach** when calculating Group SCR while developing “clear and realistic” plan to establish group internal model (required for two-year permission to be granted)

Proposes to allow **UK group's overseas sub-group SCR to be included in group SCR**, allowing diversification benefit (Method 2)

Currency Redenomination

The PRA confirmed its intention to proceed with redenomination from **EUR to GBP** in the PRA rulebook - this will become **effective on 31 December 2024.**

Removal of FRR test

PRA confirmed in December 2023 it will **no longer expect firms to carry out the Financial Resource Requirement (FRR)** test when recalculating transitional measure on technical provisions (TMTP), **subject to case-by case assessment**

PPO impact

HM Treasury intends to **extend the scope of Matching Adjustment to income protection liabilities and some other products not currently in scope e.g., Periodic Payment Orders (PPOs) – Not in scope any more**

Lloyd’s – Further requirements

Climate Change

Lloyd’s has sent out a **market survey asking syndicates how climate change has been incorporated into 2025 Capital**, with results to be published next year.

Considerations on SII Technical Provisions e.g. impact on ENID load as a result?

TAS 100 also includes requirements for Actuarial teams to consider climate change and ESG in workings – firms need to consider whether payment patterns remain relevant.

IMO Reporting with PRA

LMA is looking into whether **IMO reporting can be reduced / simplified to avoid remaining onerous to syndicates.**

This includes syndicates providing unformatted capital outputs directly to Lloyd’s rather than adjusting to fit templates.

However this could have logistical issues e.g. large data files taking up all memory storage and so remains an open issues.

Reporting Requirements

- Removal of P&L Attribution as a requirement
- More focus on the Analysis of Change document provided as part of Capital submissions
- TPD 599/699 to be replaced as at Q4 2024 with RRQ and RRA
- Discussions regarding an overhaul of the current QMA

Full Internal Model requirement

Lloyd’s exploring whether a full internal model is needed for all mature syndicates:

(A) Market Survey to follow
(B) Could a partial internal model be used instead?

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Wider Solvency II developments

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Wider Solvency II developments

EIOPA consultations

- Proportionality framework
- Enhanced supervision of cross-border activities
- Liquidity management of insurers
- Macroprudential analysis*
- Exceptional sector-wide shocks
- Insurers under dominant/significant influence or managed on a unified basis
- Standard formula requirements for investments in crypto

**consultation closed*

Solvency II developments – open consultations

	Title	Details	Closing date	Link
Solvency II review	Liquidity risk management plans	Sets out which entities must conduct medium- and long-term analyses. It also specifies what these plans should include and how often they should be updated.	2 Jan 2025	Link
	Criteria for the identification of exceptional sector-wide shocks	Helps supervisors identify exceptional sector-wide events. During these shocks, insurers with vulnerable risk profiles may need to restrict/ suspend dividends, halt share buybacks or stop bonus payments.	2 Jan 2025	Link
	Undertakings under dominant/significant influence or managed on a unified basis	Aims to help supervisors identify insurers that are under dominant or significant influence, as well as those managed on a unified basis.	2 Jan 2025	Link
	Relevant insurance and reinsurance undertakings with respect to the host Member State's market	• Enhances cooperation and information exchange between supervisors in the case of significant cross-border activities. • Defines conditions and criteria for assessing cross-border activity relevance.	2 Jan 2025	Link
other	Technical advice on standard formula capital requirements for investments in crypto assets	EIOPA's draft advice regarding capital requirements for crypto-assets held by EU insurers, including current rules, their appropriateness and proposes necessary updates.	16 Jan 2025	Link
	Criteria for selecting insurers to run macroprudential analyses	Proposes quantitative and risk-based criteria that supervisors can use to determine if insurers should include macroprudential analysis in their ORSA and the Prudent Person Principle.	9 Jan 2025	Link

Reporting and Disclosure – Solvency II

As a result of the review, on 22 September 2021, the Commission tabled a proposal for a directive amending Solvency II (the "amending proposal"). The changes the amending proposal would include:

1. **Adapt the reporting requirements for low-risk profile undertakings**, based on meeting relevant criteria:
   - Captive (re)insurance; or
   - No significant cross-border activity,
   - Compliance with the SCR and no capital add-on being imposed, and
   - GWP of less than €100 million and inward reinsurance constituting less than 50% of GWP.
2. **Modify the structure of the SFCR** in **Article 51** Solvency II, splitting its content into parts addressing policyholders and other stakeholders; and introducing auditing requirements for the prudential balance sheet. Using (P)IM, insurance companies would have to report regularly an estimation of the solvency capital requirement.
3. **Introduce a new Article 45a on climate scenario analysis**, whereby insurers would have to identify any material exposure to climate change risks and assess the impact of long-term climate change scenarios on their business.
4. **Modify Article 212 to facilitate the identification of entities that form a group**, and more specifically defining "insurance holding companies," both empowering the supervisory authorities to force a group restructure.

Sources:

1. *Proposal amending the Solvency II Directive*, European Parliamentary Research Service (EPRS)
2. *Highlights of the European Parliament's draft amendments to Solvency II*, Arthur Cox

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Key takeaways

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Key takeaways

1. Solvency UK: Risk margin reduction, Internal Model flexibility, Mobilisation, Reporting simplification. **As of 31st Dec 2024, these requirements will be in force.**

2. - **Deploy new found capital**, where appropriate.
   - Reduced risk mitigation – retain more risk due to increased capital?

3. **Re-think internal model** and analysis of change requirements.

4. **Pillar 3 reporting**: Plan for this change.

5. EIOPA Solvency II review final phase.

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.

Any other questions?