JULY 2021

WHAT NEXT FOR UK SOLVENCY II?

Responses to the HM Treasury call for evidence on the Review of Solvency II

On 1 July HM Treasury published a summary of the responses received to its autumn 2020 call for evidence on the Review of Solvency II.

HM Treasury comments

The response document summarises the key responses received by HM Treasury to the call for evidence but there are no specific comments provided by HMT on the detailed responses, and therefore still no real indication of what changes HMT will seek to make. Some general comments are made, however, in particular:

- that the responses provide evidence that aspects of Solvency II are overly rigid and rules-based and the Government agrees with this. The Government would like a regime which includes a "better mix of judgment and rules", although it's not clear what that might look like
- that there is a consensus in responses that the risk margin requires reform and the Government agrees with this
- the Government also agrees with responses suggesting that changes should be made to the application process for the matching adjustment and the calculation of the solvency capital requirement, but no further detail is provided.

Timing

As previously announced by the PRA, a quantitative impact study will be run by the PRA this summer to allow it to model different options for reform. A comprehensive package of reforms will be consulted on in early 2022.

Separately, the Government intends to publish a second consultation on the Future Regulatory Framework Review later in 2021.

Nature of feedback received

A theme running through the feedback on different topics forming part of the call for evidence is that there is quite a multiplicity of views, particularly where detailed feedback has been given. Views expressed in relation to the matching adjustment, for example, included that (i) the principles of the MA are appropriate and it should continue to be used; (ii) the MA is imprudent and has no clear economic rationale; (iii) asset eligibility requirements for the MA should be made more flexible; and (iv) asset eligibility criteria should be tightened.

Specific points from the responses

Given the range of responses received, and the lack of feedback from HMT on which might be taken forward, we have not attempted a comprehensive summary but instead highlighted some points of interest below.

Risk margin

This was the topic which seemed to produce the greatest consensus that reform is needed. Most respondents, however, did not provide details of how they thought reform should be achieved but instead focussed on the size of the reduction thought necessary.

Matching adjustment

There were a lot of specific proposals for adjustments to the MA. A few to note include:

- amendments to improve the calculation of the MA, including changes to the fundamental spread

- changes to the approval process, including a suggestion that the approval process should not simply result in a binary outcome
- asset eligibility rules should be changed to (i) change the fixed cashflow requirement to "highly predictable"; (ii) allow assets with prepayments if mitigating strategies are in place; and/ or (ii) apply eligibility rules at portfolio rather than asset level.

Calculation of the SCR

Some key points in the responses were:

- a number of responses supported more flexible use of capital add-ons - for example in the context of internal model approval, where the PRA might approve an internal model with a capital add-on rather than rejecting it, or as an alternative to requiring a standard formula firm to develop a partial internal model
- many responses suggested changes to the internal model approval process to make it more flexible, in particular in relation to model change
- some responses suggested that internal model firms should not be required (as they are currently) to submit SCR numbers on an standard formula basis as well
- there were a number of granular comments on the standard formula, e.g. that risk mitigation techniques are not always properly taken into account and some risks are omitted
- responses were broadly divided 50-50 on whether risk charges should be recalilbrated to encourage investment in long-term productive and green assets.

Reporting requirements

Over half of respondents wanted reform of reporting requirements to make them less onerous, but a number of respondents thought they should be retained in their current form to limit the costs of regulatory divergence with other jurisdictions.

A number of options for reducing reporting requirements were proposed, including reduction in frequency and volume of reporting.

The PRA has now made some initial proposals for reform of reporting requirements, discussed further below.

Branch capital requirements for foreign insurance firms

The majority of responses on this topic supported the removal or reduction of branch capital requirements for foreign insurance firms. Some respondents did suggest caution, however, on the basis that where overseas prudential requirements are less robust than UK requirements there could be a competitive disadvantage for UK insurers and policyholder protection could be reduced.

Divergence

All of these possible changes would, of course, increase the divergence between the UK and EU regulatory regimes which could result in frictional costs for international insurance groups and also may affect whether or not the EU ultimately decides to treat the UK as equivalent for Solvency II purposes. Some respondents to the call for evidence recommended against making reforms which might be deemed to amount to divergence.

PRA CP11/21 – Review of Solvency II: Reporting (Phase 1)

On 8 July the PRA published a consultation on proposed amendments to reporting requirements under UK Solvency II. The PRA states that it has developed these proposals in line with HM Treasury's review of Solvency II.

The PRA intends to consult on changes to Solvency II reporting and disclosure in two phases. This first phase in focuses on proposals to reduce the volume of financial information reported to the PRA which potentially could be implemented by firms and the PRA relatively quickly and with a low operational impact. The second phase will be a more in-depth review of all the components that make up the UK reporting and disclosure framework, taking into account reform proposals in other areas of the Solvency II review.

The changes proposed in CP11/21 are:

- removal of the requirement to report a number of Solvency II Quantitative Reporting Templates (QRTs) for all insurance and reinsurance undertakings

- the reduction of reporting frequency of the minimum capital requirements (MCR) collected via S.28 templates from a quarterly to a semi-annual basis
- the amendment of a reporting proportionality threshold to further exempt reinsurance undertakings from reporting template S.16.01 on annuities stemming from non-life insurance obligations
- expanding the PRA's modification by consent to waive certain quarterly returns, to firms that the PRA designates as Category 3 under its Potential Impact Framework
- amendments to the PRA's SSs and SoP to reflect these proposed changes, remove sections that are no longer required to be included in the supervisory statements, and clarify references to EU based provisions in the light of Brexit.

The PRA proposes that the implementation date for the proposals would be for quarterly and annual reporting reference dates falling on and after Thursday 31 March 2022. The consultation closes on Friday 8 October 2021.

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