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Briefing note

Barnett Waddingham on Solvency II - September 2014

445 days to go!* Solvency II is looming and there is a lot going on. Over the summer there has been activity from the Prudential Regulatory Authority (PRA), the European Insurance and Occupational Pensions Authority (EIOPA) and the Treasury. Meanwhile, firms have been working hard on a wide range of areas including; the data collection exercise, Own Risk and Solvency Assessment (ORSA), Internal model application, Reporting and looking at what the Matching Adjustment means for them.

> Over the summer there has been a push of activity from regulators and firms have been working hard on a wide range of areas.

At Barnett Waddingham we keep abreast of the issues and this update provides:

- a round up of consultations, briefings and deadlines
- a look at what is coming up in the future
- our insights in some of the areas that may be keeping you up at night

Round up of consultations, briefings and deadlines

25 July – PRA Update

The PRA published an update to set out its expectations in certain areas, including the availability of group funds, the matching adjustment, deferred tax, and pension schemes. See *our blog* for more details.

6 August – Treasury consultation on Solvency II

This *consultation* is intended to complete the process on how the Government should implement Solvency II in the UK. It closed on 19 September. The key area covered is the proposal for requiring supervisory approval for use of the volatility adjustment (VA) and the process that this would involve. It also covers how the PRA would exercise its responsibilities in the event of an insurance company failing to meet its minimum capital requirement (MCR).

11 August – PRA consultation on Transposition (CP16/14)

This is the third *consultation paper* on how the PRA intends to deal with the transposition of Solvency II in the UK. It covers changes required as a result of the recently agreed Omnibus II directive, such as the long-term guarantees (LTG) package and other areas not considered in the previous two consultations, or where the PRA's approach has developed since. In particular, it includes proposals on the treatment surplus funds as well as information on 11 proposed national specific reporting templates.

* As of 13.10.14

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> The PRA has sent a number of updates this summer to reduce uncertainty for firms.

19 August - PRA Directors’ update

This open letter to all insurance CEOs recognises that there are some important areas of Solvency II where uncertainty is creating unnecessary challenges for firms. The letter also includes a timetable of activity which includes more information on when the PRA will be communicating with firms and confirmation of a matching adjustment pre-application process in Q1 2015.

22 August – Deadline for the PRA’s data collection exercise

All responses were due by 22 August 2014. A summary of upcoming data collection exercises can be found in *our blog*.

29 August – closure of EIOPA consultation on Set 1 of Implementing Technical Standards

The EIOPA consultation on set 1 of the Solvency II guidelines closed on 29 August. EIOPA expects to publish a final report and to submit the Implementing Technical Standards for endorsement by the European Commission by 31 October 2014.

1 September – PRA update

This update provides clarity on:

- The relationship between the risk margin and the calibration of non-hedgeable risks; the key message is that these are separate concepts when validating the strength of the capital requirement. The example given is the longevity calibration.
- Assessing credit risk for matching adjustment portfolios. Within the solvency capital requirement (SCR), the PRA’s view at this time is that the amount of credit risk capital should not be dictated by the matching adjustment calibration that applies to the calculation of technical provisions. In particular; the use of a ‘mechanistic re-application’ of the matching adjustment following a stress is discouraged. However, the PRA recognises this is a developing area and expects firms to maintain flexibility in their modelling methodologies.

What’s up next?

So what is expected to happen in the run up to 2015?

For Q4 there will be supervisory approvals, changes to the Approved Persons regime, and rule changes to the prudential regulation of with-profits business. We set out below the timetable for the rest of the year when the PRA or EIOPA are expected to publish further information.

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It is crucial that firms do not underestimate the effort required to get approval and the potentially short timescales involved.

The PRA is on a journey but it is not the one driving the bus!

Date	Publisher	Topic
September	PRA	Update on SII from PRA Directors including: standard formula, national specific templates.
October	PRA	Communication on other approvals: USPs; group choice of calculation method, matching adjustment, ancillary own funds.
October	PRA	Communication on approvals application process.
October	PRA	Communication on third party review of the technical provisions.
October	PRA	Update from PRA Directors including: summary of information from the 17 October PRA Solvency II conference.
31 October	EIOPA	Submission to the European Commission of the Set 1 of the Implementing Technical Standards
November	PRA	Responses on CP16/14 described above.
Q4	PRA	Communication on: volatility adjustment, transitional measures (risk free rate and technical provisions), own funds not on list, group centralised risk management, group solvency and financial condition report, third country branches, third country equivalence.
Q4	PRA	Communication of the PRA position on requirements for regulatory reporting.
Q4	PRA	Communication on standard formula appropriateness.
Q4	EIOPA	Public consultation on the Set 2 of the Implementing Technical Standards opens.
Q4	EIOPA	Public consultation on the Set 2 of the Guidelines.

So what is keeping you up at night?

Hopefully you are all sleeping well and Solvency II implementation is going well. However there are a number of things which may be making you nervous. Here are our top four.

We think the biggest fundamental issue is there is a lot of regulatory uncertainty. The PRA does acknowledge this but this might not give firms the comfort that they are after. The issue is that the PRA is on a journey but it is not the one driving the bus! They are commenting on the areas they can and firms need to ensure that they keep on top of these to ensure they are aware of what is happening. Hopefully our updates will help.

There are lots of technical issues still unresolved and firms will need to build flexible models to ensure that they can deal with these uncertainties.

All firms will have completed the data collection exercise using the standard formula and many have found that the Standard does not stand for SIMPLE. Time needs to be spent ensuring that rules have been interpreted correctly and to implement a robust process to calculate the SCR.

The matching adjustment will be keeping the annuity providers busy, for some not getting approval to use it would be a disaster. Those hoping to just use the VA will be disappointed if the Treasury decide that an approval process will be required for that as well. It is crucial that firms do not underestimate the effort required to get approval and the potentially short timescales involved.

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Solvency II services

Solvency II is a big change to the regulatory requirements and implementation should not be underestimated. At Barnett Waddingham we are able to use a tailor made approach to help insurers meet their targets.

Our clients range from small to medium firms looking for a full range of expert advice and support to the largest firms who are typically looking for additional resources or specific independent expert input and review.

We have specific expertise in:

- ORSA production
- Pillar I implementation
- Internal model validation

In particular, we have developed a specific spreadsheet-based Solvency II tool. It has the ability for standard formula SCR calculations as well as aiding governance through balance sheet projections and scenario analysis.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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