ICAEW
REPRESENTATION 98/21

REVIEW OF SOLVENCY II: REPORTING (PHASE 1)

Issued 8 October 2021

ICAEW welcomes the opportunity to comment on CP 11/21 Review of Solvency II: Reporting (Phase 1) published by the Prudential Regulations Authority on 8 July 2021, a copy of which is available from this link.

This response of 8 October 2021 has been prepared by the ICAEW Financial Services Faculty. As a leading centre for thought leadership on financial services, the faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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KEY POINTS

1. ICAEW agrees with the necessary review of the appropriateness of Solvency II for the UK insurance market and supports the three objectives for the review:
    - To spur a vibrant, innovative and internationally competitive insurance sector;
    - To protect policyholders and ensure the safety and soundness of firms; and
    - To support insurance firms in providing long-term capital to underpin growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the Government's climate change objectives.
2. We understand that the PRA intends to consult on changes to Solvency II reporting and disclosure in two phases. Phase 1, reflected in this CP, 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.
3. We welcome the policy proposals contained within this CP. We anticipate that the removal of the reporting requirement of certain Quantitative Reporting Templates (QRTs), reducing the reporting frequency of the minimum capital requirement (MCR) via S.28 templates, the amendment of a reporting proportionality thresholds for S.16.01 to provide an exemption for pure reinsurers and the expansion of the PRA's modification by consent to waive certain quarterly returns to all Category 3 firms will reduce the reporting burden on UK insurance and reinsurance undertakings and groups.
4. We note that the PRA proposes an implementation date for these proposals to take effect for quarterly and annual reporting reference dates falling on and after Thursday 31 March 2022. Given the uncontroversial nature of these proposals, and the PRA's comments in paragraph 2.3 of CP 11/21 that the reporting being removed from scope "either has limited prudential value to its supervisory approach or could be derived from other information reported without additional burden" we would encourage the PRA to permit early adoption of these proposals ahead of this date. This would enable many insurance companies to take advantage of the benefits of these in time for the upcoming 2021 annual reporting cycle. This is likely to be particularly welcomed by firms and groups in the case of variance analysis QRTs S.29.01 to S.29.04 which are considered time consuming and challenging to prepare."
5. We understand Phase 2 of the review to be 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 resulting in more extensive changes in order to deliver an overall framework that can be operated more effectively by the PRA, and more efficiently applied by firms.
6. While acknowledging that Phase 2 of the review will require careful consideration by the PRA and sufficient time to complete, we would like to draw the attention to certain areas of the future regulatory regime that we consider essential to review to achieve the previously stated objectives. We have provided detailed recommendations in our response (dated 19 February 2021) to HM Treasury Review of Solvency II: Call for evidence which we attach to this response as an Appendix.

APPENDIX

ICAEW

REPRESENTATION 20/21

REVIEW OF SOLVENCY II: CALL FOR EVIDENCE

Issued 19 February 2021

ICAEW welcomes the opportunity to comment on the Review of Solvency II published by HM Treasury on 19 October 2020, a copy of which is available from this link

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KEY POINTS

1. ICAEW agrees with the necessary review of the appropriateness of Solvency II for the UK insurance market and supports the three objectives for the review:
   - To spur a vibrant, innovative and internationally competitive insurance sector;
   - To protect policyholders and ensure the safety and soundness of firms; and
   - To support insurance firms in providing long-term capital to underpin growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the Government's climate change objectives.
2. We would like to however draw attention to the importance of consideration of these objectives in the context of UK's withdrawal from the EU and how this links to the Financial Services Future Regulatory Framework review.
3. The review and potential future amendments of the requirements of Solvency II is a significant opportunity for greater flexibility.
4. It could also lead to greater transparency over decisions and processes further enhancing confidence in insurance products.

RISK MARGIN

5. The current design and calibration of the risk margin leads to a disproportionately large and volatile risk margin. In the current low-rate environment this leads to providers of long-term insurance, particularly annuities, holding an inappropriately large buffer. The design can also incentivise procyclical behaviour and undermines financial stability. We note that a number of institutions have previously identified these issues, including the Bank of England and the Treasury Select Committee. EIOPA has also recognised this and in the context of providing its advice to the European Commission on the Solvency II 2020 review has made some limited but insufficient steps towards addressing this.
6. ICAEW recognises the need for change and reduction in the size and volatility of the risk margin, and understands that there are a number of ways that this could be achieved. However, it is not in the position to recommend one particular approach.

MATCHING ADJUSTMENT

7. The matching adjustment (MA) was designed to limit its use to a narrow range of long-term products with suitable characteristics within Europe, particularly annuities in the UK and Spanish insurance markets. For this reason, it was designed with a number of rigid constraints both on asset eligibility and calculation approach. As a result, although the MA is an important feature of Solvency II it does not provide sufficient flexibility within the UK insurance market for insurers to invest in a broader range of suitable assets.
8. ICAEW supports the need to introduce greater flexibility in the MA. There are several areas of the MA that should be simplified including scope for eligibility and the calculation. Improvement, however, does not mean that there should be any dilution of the MA for assets that already meet the strict eligibility criteria. It should be recognised that the insurance sector is well placed to invest long-term. An improved, less restrictive MA should be instrumental in boosting this activity.
9. We suggest that regulators continue to consult with industry participants regarding the initial complexities of restructuring portfolios and ongoing portfolio maintenance necessary to

meet MA thresholds. This can be challenging for smaller and/or more specialised firms which are a critical component of the UK insurance market.

CALCULATION OF THE SOLVENCY CAPITAL REQUIREMENT

10. Currently Solvency II requires firms to calculate their solvency capital requirement (SCR) based on the standard formula (SF) or a separately approved internal model (IM). There are a significant number of UK insurers that utilise the internal model since it provides a better reflection of their specific risk profile. Currently, each and every firm is required to complete the SF calculation even if they follow an internal model (IM) for capital setting. Therefore, the additional SF calculation does not add material value.
11. We recognise that the PRA has clarified in Supervisory Statement SS15/16 that the SF is one of the suite of metrics that can be used to monitor model drift and acknowledged that there may be limitations with the SF calculation for firms with approved IM.
12. While the UK insurance market is broadly comfortable with the SCR calculation there is scope for a more principle-based approach to align firms. Transparency over the IM approval process would provide more comparable information on the SCR. It is felt, that at present, the annual ORSA statements (often enhanced with ad hoc reporting) provide sufficient amount of information to monitor capital assessment.

CALCULATION OF THE CONSOLIDATED GROUP SOLVENCY CAPITAL REQUIREMENT USING MULTIPLE INTERNAL MODELS

13. While it is difficult to provide a solution to highly specific circumstances, we would encourage a more flexible solution when calculating the SCR for consolidated groups.

CALCULATION OF THE TRANSITIONAL MEASURE ON TECHNICAL PROVISIONS

14. The TMTP is an important measure which was introduced on inception of Solvency II to reflect the difference between it and the previous UK regime, and we anticipate that its scale will be impacted by potential reforms such as the risk margin and matching adjustment noted above. We would note the complexity that is associated with the ongoing maintenance of its calculation.

REPORTING REQUIREMENTS

15. The introduction of Solvency II led to a significant incremental increase in the level of reporting compared to the previous UK regime. The present suite of Solvency II reporting requirements is onerous and requires a lot of time and effort to complete and the extent to which it is fully utilised by the regulators is uncertain.
16. The HMT review of Solvency II provides an opportunity to reduce the size and frequency of the reporting burden to focus on those requirements most important to the regulator. The opportunity should be taken to carefully consider whether over the last four years the data supervisors have been receiving (as required by Solvency II) had provided the relevant information and whether the same supervisory determinations could be reached in the absence of such data. The auditability of data should also be considered.
17. The trade-off between flexibility and comparability might allow for more alignment of regulatory reporting with firms' own management information. Following proportionality, the regulator could lead to reduction in reporting frequency and granting waivers and

help with challenges around deadlines.

18. ICAEW supports standing back and looking at the reporting as a whole. Considering the themes listed above would allow for the clear articulation of the objective of the regulation, making it more transparent and helpful in the process.
19. While designing the overall regulatory approach it would also be beneficial to take the following areas into account:

- Taking IFRS 17 implementation and interaction into account
- EIOPA's review of Solvency II
- Integration of climate change risk information

BRANCH CAPITAL REQUIREMENTS FOR FOREIGN INSURANCE FIRMS

20. ICAEW supports the principles of a consistent level of policyholder protection.

THRESHOLDS FOR REGULATION BY THE PRA UNDER SOLVENCY II

21. ICAEW supports the Solvency II objectives of a robust framework for the prudential regulation of the insurance sector. However, this review offers the opportunity to address concerns regarding the reporting burden which may be considered non-proportional for smaller, less complex firms.
22. The appropriateness of current thresholds could be assessed by identifying the data needs of the regulator and the frequency and basis of the waivers provided and challenging whether those commonly waived requirements should be applied more widely via scope modification.

MOBILISATION OF NEW INSURANCE FIRMS

23. Consistent with the commentary above, ICAEW supports the objectives of policyholder protection but suggests that transparency and proportionality be a consideration of the mobilisation of new firms.

OTHER AREAS FOR REVIEW

24. One of the objectives of the UK Government's Review of Solvency II is to create a prudential regime that encourages insurance firms to provide long-term capital to support growth, including investment in infrastructure as well as investment consistent with the Government's climate change objectives. In addition, the Government recently published its Green Finance Strategy which recognises the importance of the financial services sector in tackling climate change.
25. We welcome the Government's aim to create a prudential regime that would help the insurance sector to support the Government's objectives in relation to climate change and investment in infrastructure. However, keeping in mind that the primary objective of a sound risk based prudential regime is to ensure a high degree of policyholder protection with other objectives. As noted above, there is scope to review the asset admissibility rules for the matching adjustment to provide greater incentive to life insurers to invest in longer-duration ESG assets.
26. Therefore, as part of the Solvency II review we would welcome more clarity from regulators

regarding investment management expectations and capital charge calibrations to facilitate the development of an optimal framework for investment in infrastructure and green assets.

27. Finally, we would urge the Government to develop an UK specific sustainable finance taxonomy that is linked to the prudential regime for insurers to support greater allocation of capital towards sustainable economic activities.