Institute
and Faculty
of Actuaries

CP 9/18: Solvency II – Modelling of the Volatility Adjustment

IFoA response to Prudential Regulation Authority

11 July 2018

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all of stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

Institute and Faculty of Actuaries

CP 9/18
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

11 July 2018

Dear Sir/ Madam,

IFoA response to Consultation Paper CP 9/18: Solvency II – Modelling of the Volatility Adjustment

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the PRA's consultation paper (CP) on the modelling of the Volatility Adjustment (VA), and in particular, the proposal to allow for a Dynamic Volatility Adjustment (DVA). Our Life Standards and Consultations Committee and Board have been involved in the drafting of this response. Members of the Committee and Board are actively involved with the operation and management of the VA by insurers.

2. The IFoA supports the PRA's proposal to allow firms to apply for a DVA in their internal model. In our response to the PRA's recent consultation CP 22/17 (Supervisory approval for the VA), we suggested the PRA consider allowing a DVA, as this would help support the objective of the VA in avoiding pro-cyclical behaviour by insurers.

3. We also support consistent application of Solvency II (SII) requirements across national supervisory teams. We therefore welcome the PRA's revised position in relation to a DVA, to align with EIOPA's view on this matter. As the PRA note in CP 9/18, allowing a DVA should enhance the competitiveness of UK insurance groups.

4. Paragraph 2.5 of the draft Supervisory Statement (SS) explains that the PRA expects firms to treat the DVA as a new element of the (internal) model. However, our view is that the current denial of a DVA was considered to be a legal imposition, which is now being rectified in the light of clarity from EIOPA. This then means that existing internal models are unnecessarily restrictive and depart from a theoretically correct post-event balance sheet.

5. Allowing a DVA, i.e. amending the VA in a stressed situation to that which is implied by the assets under stress, should therefore not be viewed as a model change requiring separate approval, but as a correction to the model and a minor model change. As such, it should not require approval irrespective of impact. We do however consider it reasonable for the PRA to require firms to explain the impact of a DVA, and then seek to investigate/ open the model to scrutiny, where deemed necessary.

6. Use of a DVA may not be particularly material for some firms. Aside from our comments in paragraphs 4 and 5 above, if a DVA were to be treated as a new element of an internal model as proposed in this CP, the process could be onerous if the reduction in Solvency Capital Requirement were not material. We believe it would therefore be helpful for the PRA to

emphasise that a proportionate approach would be taken to model change in relation to a DVA, based on the materiality of the impact.

Should you wish to discuss any of the points raised in further detail please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk / 0207 632 2146) in the first instance.

Yours sincerely

Jules Constantinou

President
Institute and Faculty of Actuaries