Institute and Faculty of Actuaries

22 July 2024

PRA CP5/24 – Review of Solvency II: Restatement of assimilated law

IFoA Response

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 stages of qualification and development throughout their careers.

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the PRA's Consultation Paper CP5/24 – Review of Solvency II: Restatement of assimilated law. We note that, in the main, the PRA's intention is not to change current policy.

2. Members of our both our Life and General Insurance Standards & Consultations Committees reviewed the PRA's proposals within CP5/24. Members of both committees work for a range of insurers or insurance consultancy firms.

3. It is important to note that, as for any IFoA response, we have considered the PRA's proposals from an independent, public interest perspective.

4. We note within CP5/24 that there are several areas where the PRA does propose making a change, some areas where there will be a change in approach but with policy intentions unchanged and some items for further consultation. On the whole, any changes proposed appear sensible and non-controversial to us. We have a small number of comments in areas where more clarity from the PRA would be useful.

5. In our reading of CP5/24 where firms currently need to 'demonstrate to the satisfaction of the supervisory authority' in order to take a certain approach, the PRA appears to be taking two approaches. In some cases, the PRA is simply asking for firms to notify them of the approach being taken (on the basis the firms should be able to objectively assess meeting relevant criteria). In others, firms will need to apply for a rule waiver or modification.

6. Where firms need to notify the PRA, (Table 8F of CP5/24) we do not see anything that sets out the nature of the notice required; for example, the level of detail that may be required, or whether it is as simple as stating that the approach is being taken and the conditions met. In addition, there is no mention of whether the notice needs to be resubmitted periodically. In summary, further detail/ clarity would be welcome on the form of the notice and any ongoing update requirements.

7. The PRA proposes that a waiver will be required for firms to use an increase in deferred tax assets for the purpose of calculating the Loss-Absorbing Capacity of Deferred Taxes (LACDT). A waiver by

consent (minimal application process) will be available for firms with Solvency Capital Requirement (SCR) cover >=175% and where the contribution to the LACDT is less than a moderate percentage of the SCR (before the LACDT). The PRA gives 5% as an example of the moderate percentage. In all other cases, firms will need to apply for a waiver, with supporting justification.

8. We have a number of concerns here:

- the current regulations state that firms need to demonstrate to the satisfaction of the supervisory authority that it is probable that future taxable profit will be available. When the current regulations were changed, firms needed to submit their LACDT policy to the PRA for review, with the PRA either accepting or challenging the policy. The PRA is suggesting that firms will need to apply for a waiver, even if they have not changed their policy (and the PRA previously accepted that policy). This seems at odds with there being no intended change in policy.
- with any policy statement unlikely to be published until late 2024, an implementation date of 31 December 2024 for this change seems very tight, such that firms may struggle to seek and obtain a waiver in time. In our view this change should be deferred until 31 December 2025, to give firms (and the PRA) sufficient time to apply for and obtain the waiver. In addition, no indication is given as to how quickly the PRA will assess waiver applications.
- LACDT can be a troublesome area that practitioners struggle with. The proposed rule will prohibit firms from using an increase in the amount of deferred tax assets that would occur from a loss equal to the SCR pre LACDT. Although CP5/24 refers to the increase in deferred tax asset being justified by future profits, the wording of the rule makes no such reference to future profits. In our view, this may lead to interpretational issues. For example, firms may think a waiver is needed where the LACDT is based upon an assumed reversal or reduction of a deferred tax liability, or a recovery of tax previously paid. It would be helpful for the PRA to clarify these aspects.
- the suggested 5% of SCR cap for a modification by consent seems very low if cover is still >=175%.
- the draft statement of policy suggests that the waiver will be needed for all standard formula calculations, suggesting internal model firms will need to apply for the waiver for comparison calculations, regardless of what has been approved for the internal model. This appears to be an unnecessary burden on all parties.
- the evidence suggested as being required under the full waiver application appears quite onerous and potentially goes beyond current expectations.

9. In addition, further clarity on the PRA's interpretation of 'instantaneous' in the context of the Standard Formula LACDT would be useful, as many firms and auditors disagree. For example, if a company's year-end is 31 December 2024, can the notional loss represented by the SCR before LACDT be offset against profits in both the year to 31 December 2024 and the year to 31 December 2023, as would be allowed under UK carry-back rules? Or should 'instantaneous' be interpreted (as some audit firms maintain) as immediately following the valuation date, such that the notional SCR loss can only be offset against those profits in the year to 31 December 2024?

10. In relation to ring fenced funds, the PRA's proposed new wording can be interpreted in two different ways: one meaning no change; the other a more significant change in the definition which would produce many more occasions for ring fenced funds for general insurers. We suggest that the text should be refined slightly to make it completely clear that the definition is not changing if that is the PRA's intention, or provide some supplementary explanation otherwise.

Should you want to discuss any of the points raised please contact me, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham
On behalf of Institute and Faculty of Actuaries