



# Solvency II (and Brexit)

## Whatever next?

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# INTRODUCTION

# Agenda

- **Solvency II external audit**
- **Actuarial Function Report**
- **Opinions on underwriting and reinsurance**
- **Consequences of the EU referendum**
- **Discussion**



# **SII EXTERNAL AUDIT**

# PRA requirements



- **‘Reasonable assurance’ opinion of compliance ‘in all material respects’ with PRA rules and SII**
- **SFCR ‘Valuation for solvency purposes’ and ‘Capital Management’ (both narrative and QRTs)**
  - Accounting assets/liabilities
  - Technical provisions
  - Own funds
  - SCR/MCR
- **Other information in SFCR assessed for consistency**
  - With audited elements
  - With other information available as part of the audit of SFCR and financial statements
- **For year-ends after 15 November 2016**

# Audit approach (balance sheet)

- ✓ **Methodology and assumptions in line with rules, regulations and guidance**
- ✓ **Assessment of key judgements**
- ✓ **Controls/checks over data used in calculations**
- ✓ **Processes/controls with regards to production of results**

# What do you need?



**Documentation**



**Documentation**



**Documentation**

# What do you need?



**Documentation**



**Processes and  
controls**

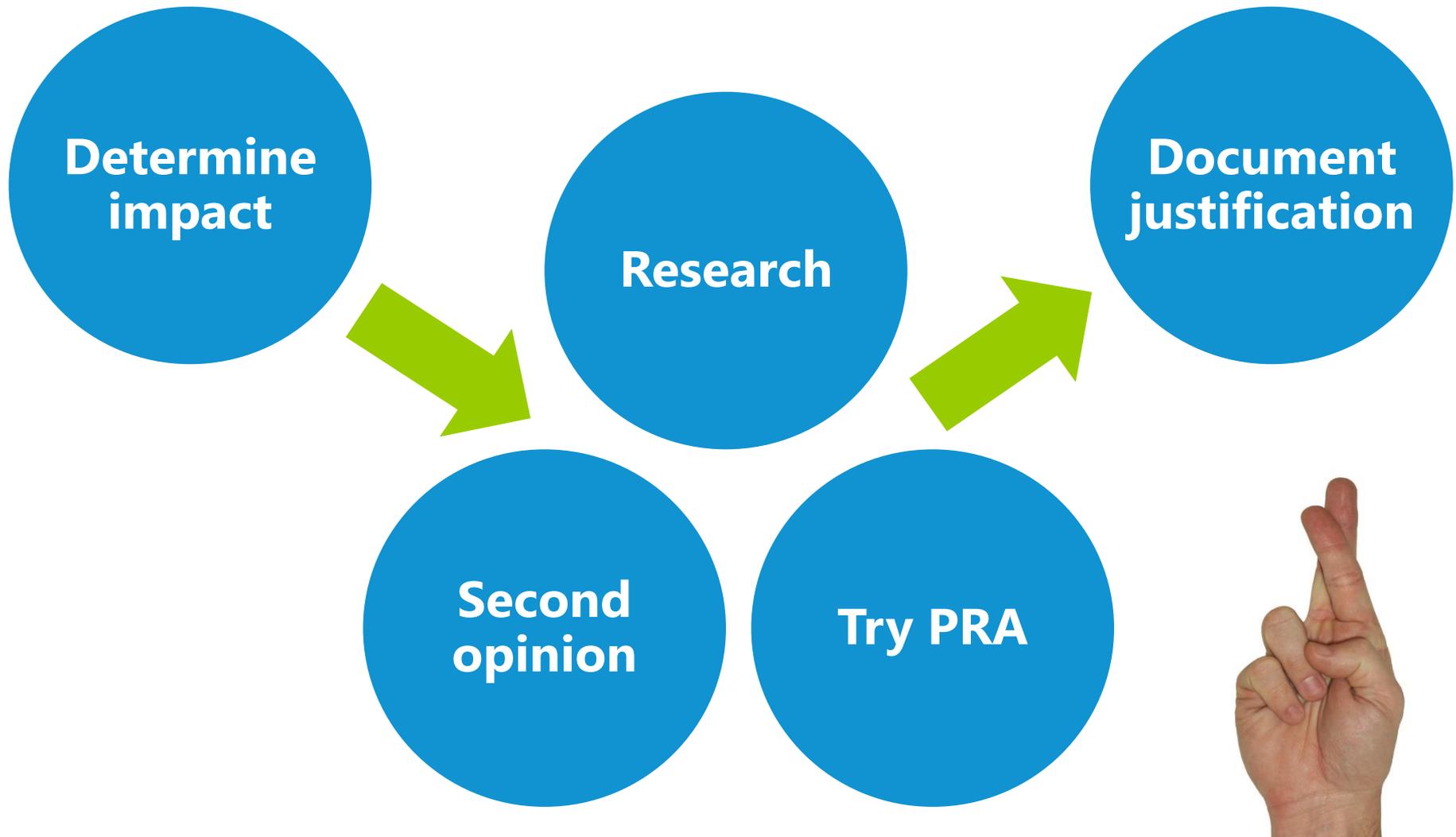


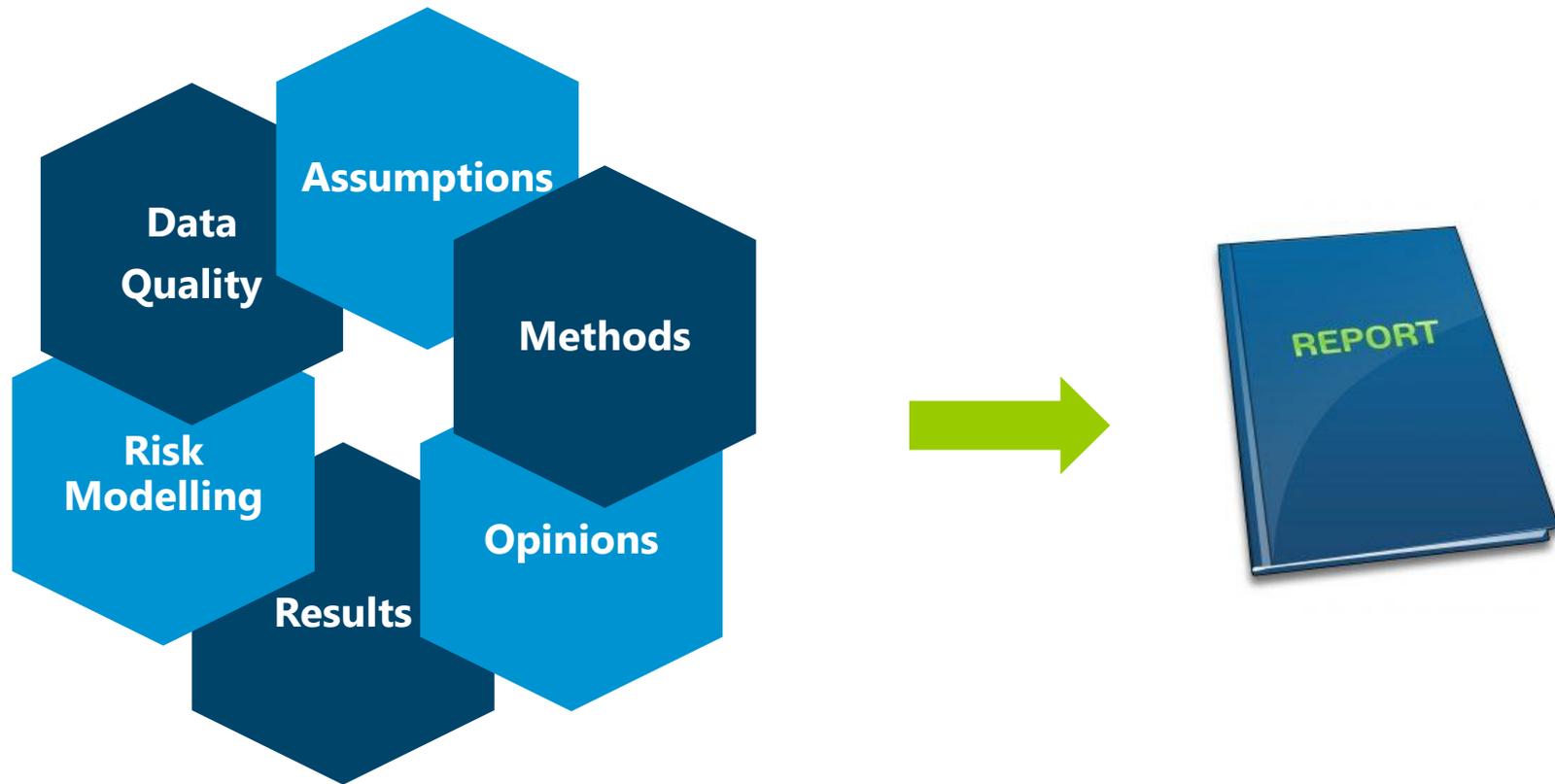
**Evidence**

# Exercise of judgement

- ? **Misinterpretation**
- ? **Simplified/proportionate approach**
- ? **True ambiguity**

# Exercise of judgement





# ACTUARIAL FUNCTION REPORT

# Actuarial Function requirements

**1**

**SII DIRECTIVE**

• Article 48

**2**

**DELEGATED ACTS**

• Article 272

**3**

**GUIDELINES**

• Section 9 of system of governance

- **Technical Provisions**
- **Opinion on underwriting policy**
- **Opinion on reinsurance**
- **Contribute to risk management**
  - **Risk modelling underlying capital requirements and ORSA**

# Actuarial Function requirements

**1**

**SII DIRECTIVE**

• Article 48

**2**

**DELEGATED ACTS**

• Article 272

**3**

**GUIDELINES**

• Section 9 of system of governance

- **Elaborates on Article 48**
- **Includes reporting requirement:**
  - **To administrative, management or supervisory body**
  - **At least annually**
  - **Document all tasks that have been undertaken by the actuarial function**
    - **Results**
    - **Deficiencies**
    - **Recommendations**

# Actuarial Function requirements

**1**

**SII DIRECTIVE**

• Article 48

**2**

**DELEGATED ACTS**

• Article 272

**3**

**GUIDELINES**

• Section 9 of system of governance

- **Group-wide opinion on reinsurance**
- **Explain impact of changes in methods, assumptions, data**
- **Assessment of data quality**
- **Experience analysis – report material deviations**
- **Consider interrelations between underwriting, reinsurance and TP**
- **Contribution to internal model**

# Other 'guidance'

**Institute and Faculty of Actuaries**

## Application of the Solvency II actuarial function to general insurance firms

by the Actuarial Function Working Party

RL Williams (chair), J Anzures, R Bulmer, J Buntine, M Byrne, B Gedalia, P Goswamy, J Grant, W Heath, S Keshani, J Shah

2016

**Consultation on Guidance for (Re)Insurance undertakings on the Head of Actuarial Function Role**

Consultation Paper 103

**LLOYD'S**

## SOLVENCY II

GUIDANCE ON THE REPORT OF THE ACTUARIAL FUNCTION

FEBRUARY 2012

**AAE**  
actuarial association of europe

**ACTUARIAL ASSOCIATION OF EUROPE**  
ASSOCIATION ACTUARIELLE EUROPÉENNE

4 PLACE DU SAMEDI  
B-1000 BRUSSELS, BELGIUM  
TEL: (+32) 22 57 03 21 FAX: (+32) 27 92 46 40  
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WEB: [www.actuary.eu](http://www.actuary.eu)

## EUROPEAN STANDARD OF ACTUARIAL PRACTICE 2 (ESAP 2)

ACTUARIAL FUNCTION REPORT UNDER DIRECTIVE 2009/138/EC

**LLOYD'S MARKET ASSOCIATION**

## The Actuarial Function Report

- Underwriting Policy  
- Reinsurance Arrangements

A Short Practical Guide to interpreting Solvency II requirements for Lloyd's Managing Agents

**LLOYD'S**

## GUIDANCE ON THE ACTUARIAL FUNCTION

APRIL 2016

**Model standard of actuarial practice of the Actuarial Association of Europe**  
(Approved by the General Assembly on 31 January 2016)

ESAP 2

CALAI Actuarial Function Report Working Party  
April 2014



# Key considerations

**Content**

**Format**

**Timing**

# Key considerations

**Usefulness**

**Content**

**Format**

**Timing**

# Content

## ARTICLE 48

Technical Provisions	Opinions	Risk Management	Other
<ul style="list-style-type: none"><li>• <b>Co-ordination</b></li><li>• <b>Results and sensitivities</b></li><li>• <b>Data quality</b></li><li>• <b>Methods and assumptions</b></li><li>• <b>Best estimate vs. actual</b></li><li>• <b>Reliability and adequacy</b></li></ul>	<ul style="list-style-type: none"><li>• <b>Underwriting</b></li><li>• <b>Reinsurance</b></li></ul>	<ul style="list-style-type: none"><li>• <b>Risk modelling underlying the (SCR and MCR)</b></li><li>• <b>Contribution to ORSA</b></li><li>• <b>Suitability of standard formula?</b></li><li>• <b>Other?</b></li></ul>	<ul style="list-style-type: none"><li>• <b>SCR?</b></li><li>• <b>TCF/PRE?</b></li><li>• <b>Other?</b></li></ul>

# Format and timing

## Complexity of business

**Format**

**Timing**

Single or multiple reports?

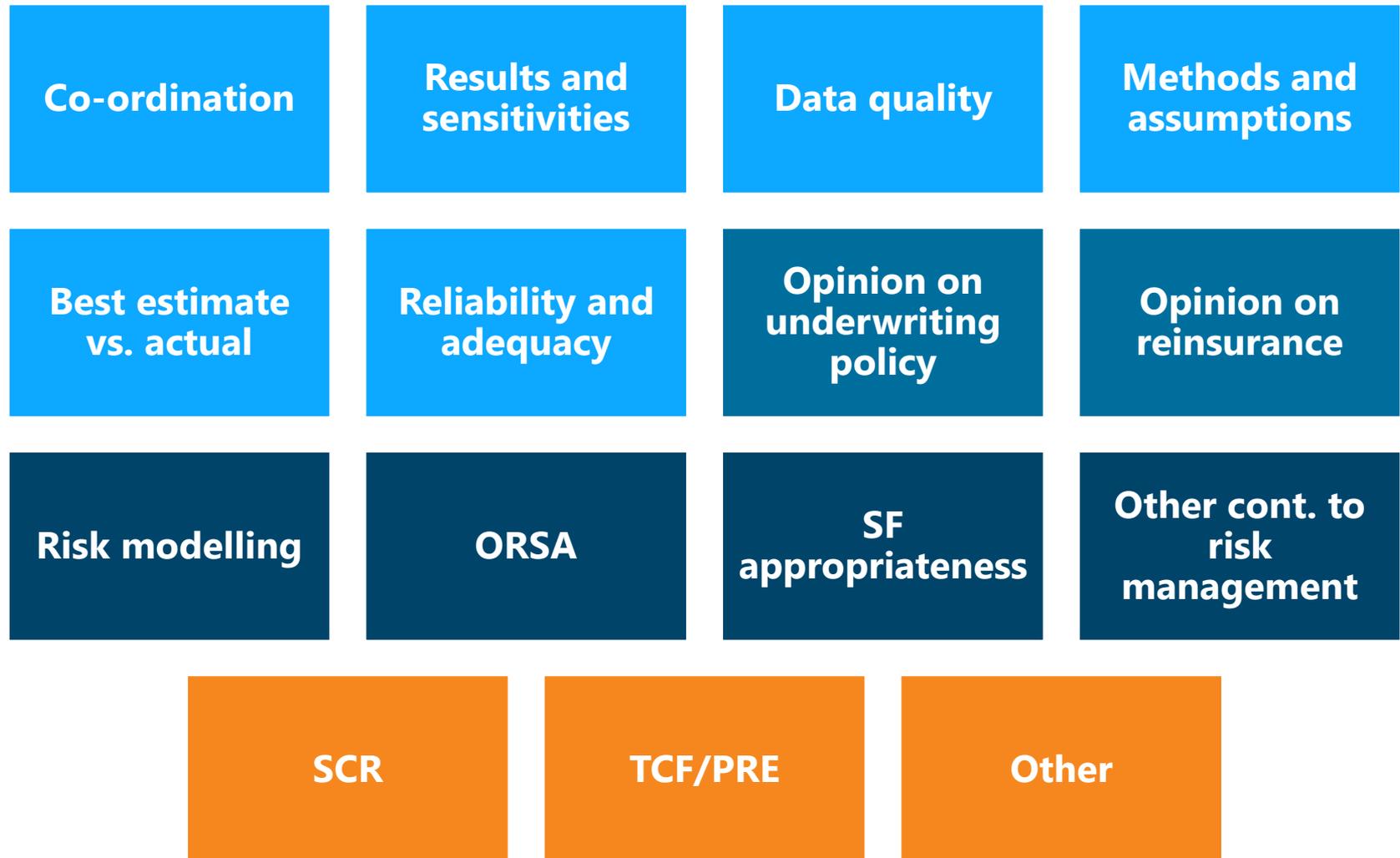
If multiple, how many reports?

Avoid duplication

'Digestible'

Relevant

# Possible approach – building blocks



# Possible approach – ‘complex’ firm

<b>‘Basis Paper’ (pre year-end)</b>	<b>Methods and assumptions</b>
	<b>Best estimate vs. actual</b>
	<i>Co-ordination</i>
	<i>Data quality</i>

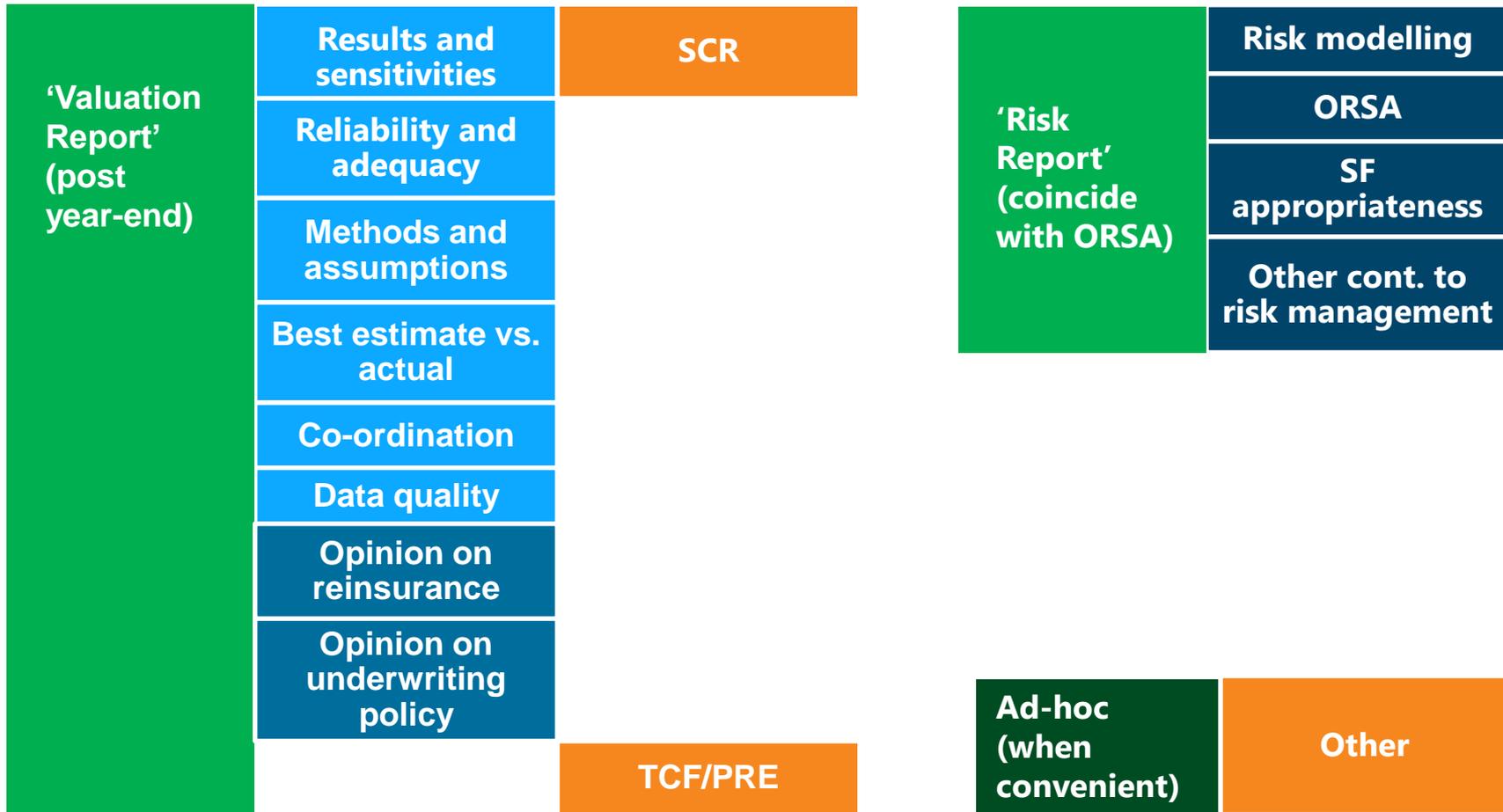
<b>‘Valuation Report’ (post year-end)</b>	<b>Results and sensitivities</b>	<b>SCR</b>
	<b>Reliability and adequacy</b>	
	<i>Co-ordination</i>	
	<i>Data quality</i>	

<b>Joint or separate (when convenient)</b>	<b>Opinion on reinsurance</b>
	<b>Opinion on underwriting policy</b>

<b>‘Risk Report’ (coincide with ORSA)</b>	<b>Risk modelling</b>
	<b>ORSA</b>
	<b>SF appropriateness</b>
	<b>Other cont. to risk management</b>

<b>Ad-hoc (when convenient)</b>	<b>TCF/PRE</b>
	<b>Other</b>

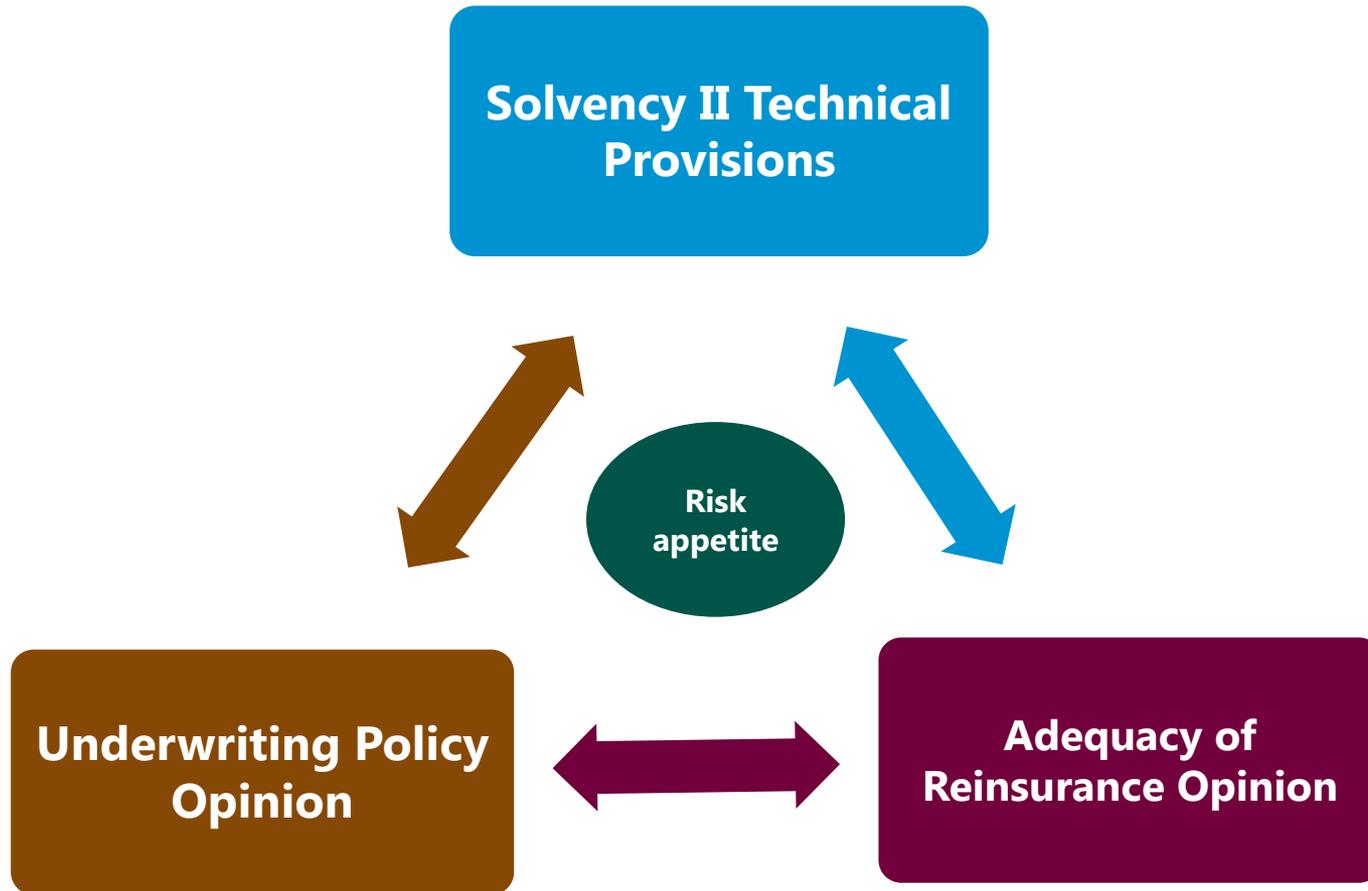
# Possible approach – ‘simple’ firm





# OPINIONS ON UNDERWRITING AND REINSURANCE

# Relationships between TP and Opinions





# OPINION ON UNDERWRITING POLICY

# Why Do We Need an UW Opinion?

Board assurance



Building relationships



CONSISTENCY  
IS THE KEY!

Bus Plan vs TP\*



\*TP = Technical Provisions

# UW Opinion Requirements

Directive - Article 48 (g)

express an opinion on the overall underwriting policy;

Delegated Act - Article 272 (6)

... shall at least include conclusions regarding the following considerations:

- a) The **sufficiency of the premiums** to be earned to cover future claims and expenses, notably taking into consideration the underlying risks (including underwriting risks), and the **impact of options and guarantees** included in insurance and reinsurance contracts on the sufficiency of premiums;
- b) The **effect of inflation, legal risk**, change in the composition of the undertaking's portfolio, and of systems which **adjust the premiums** policyholders pay upwards or downwards depending on their claims history (bonus-malus systems) or similar systems, implemented in specific homogeneous risk groups;
- c) The progressive tendency of a portfolio of insurance contracts to attract or retain insured persons with a higher risk profile (**anti-selection**).

# UW Opinion - What does it mean?

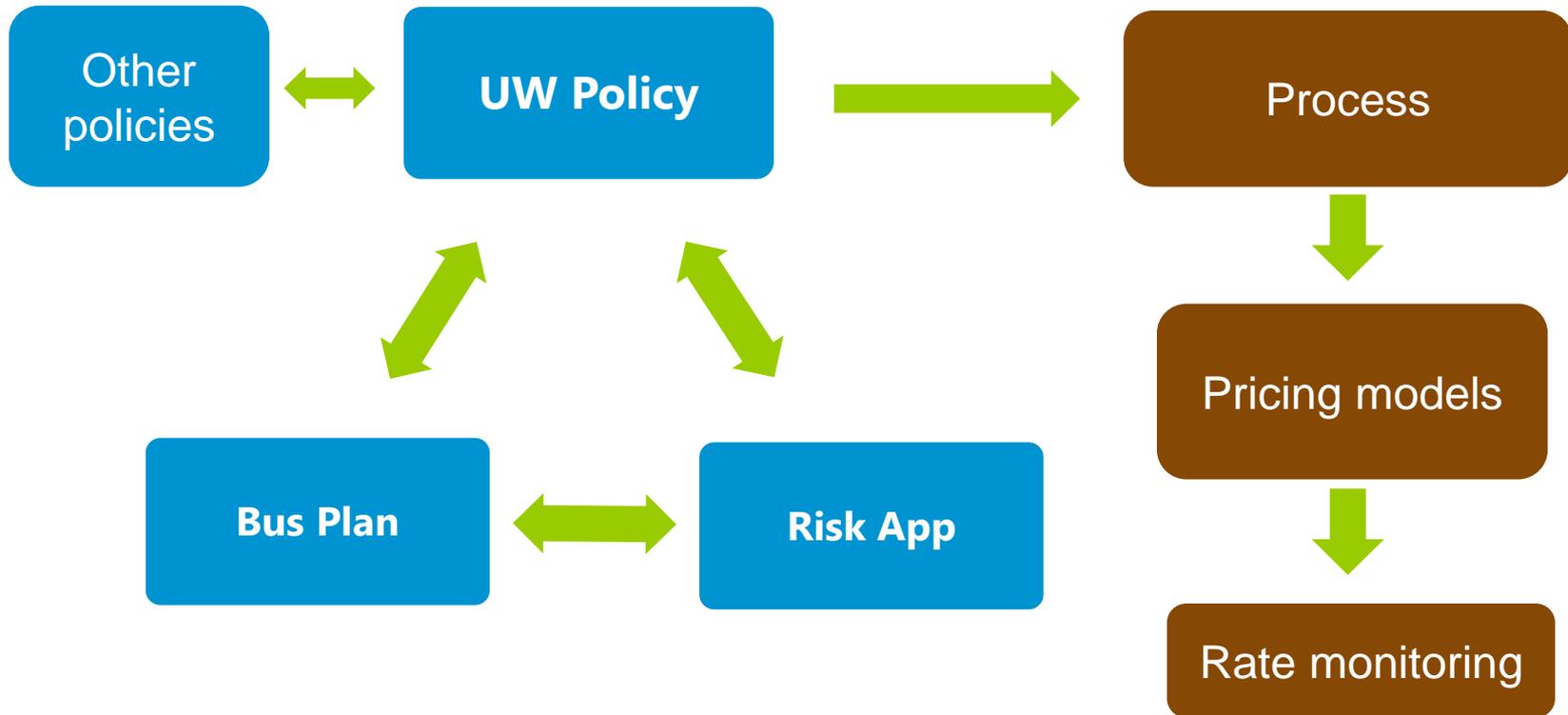
EIOPA SoG guideline 20 - Underwriting policy

UW result is the evidence of the policy

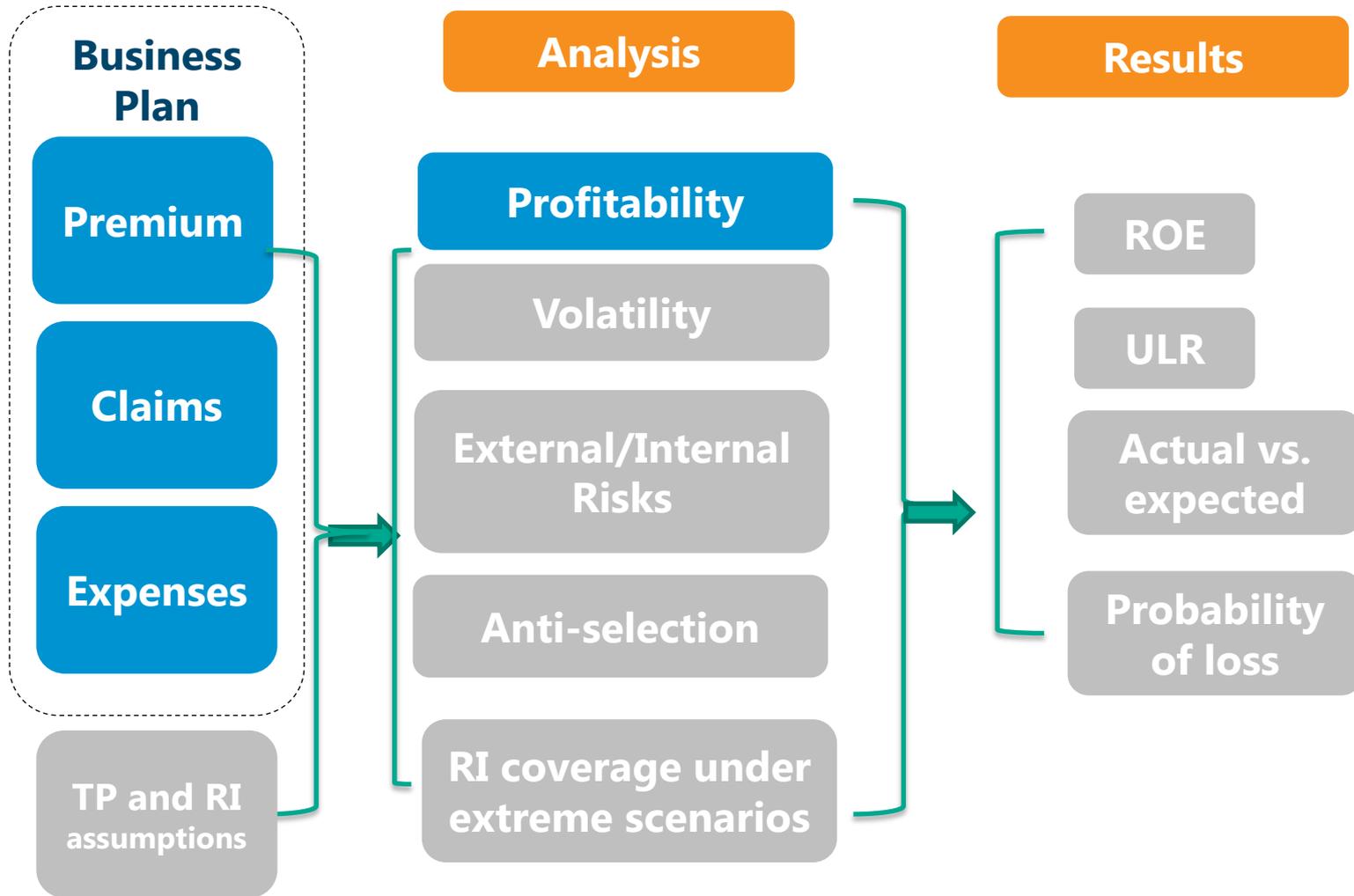
Principle risk factors (forward looking)

Analyse by material line of business

# Understanding the UW Framework



# UW Analysis





# **OPINION ON ADEQUACY OF REINSURANCE ARRANGEMENT**

# Why Do We Need an RI Opinion?

Board assurance

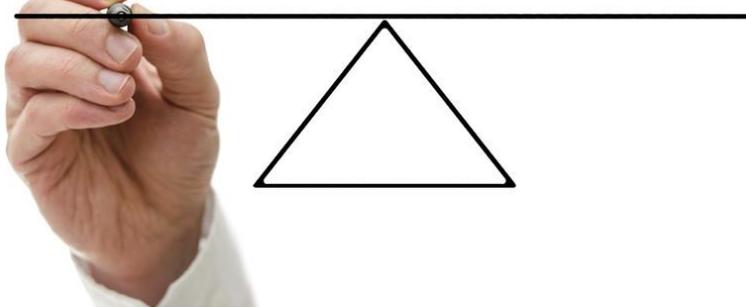


CONSISTENCY  
IS THE KEY!

UW vs TP vs RI



BENEFIT COST



MIND THE GAP



Risk not covered!!

# RI Opinion Requirements

Directive - Article 48 (h)

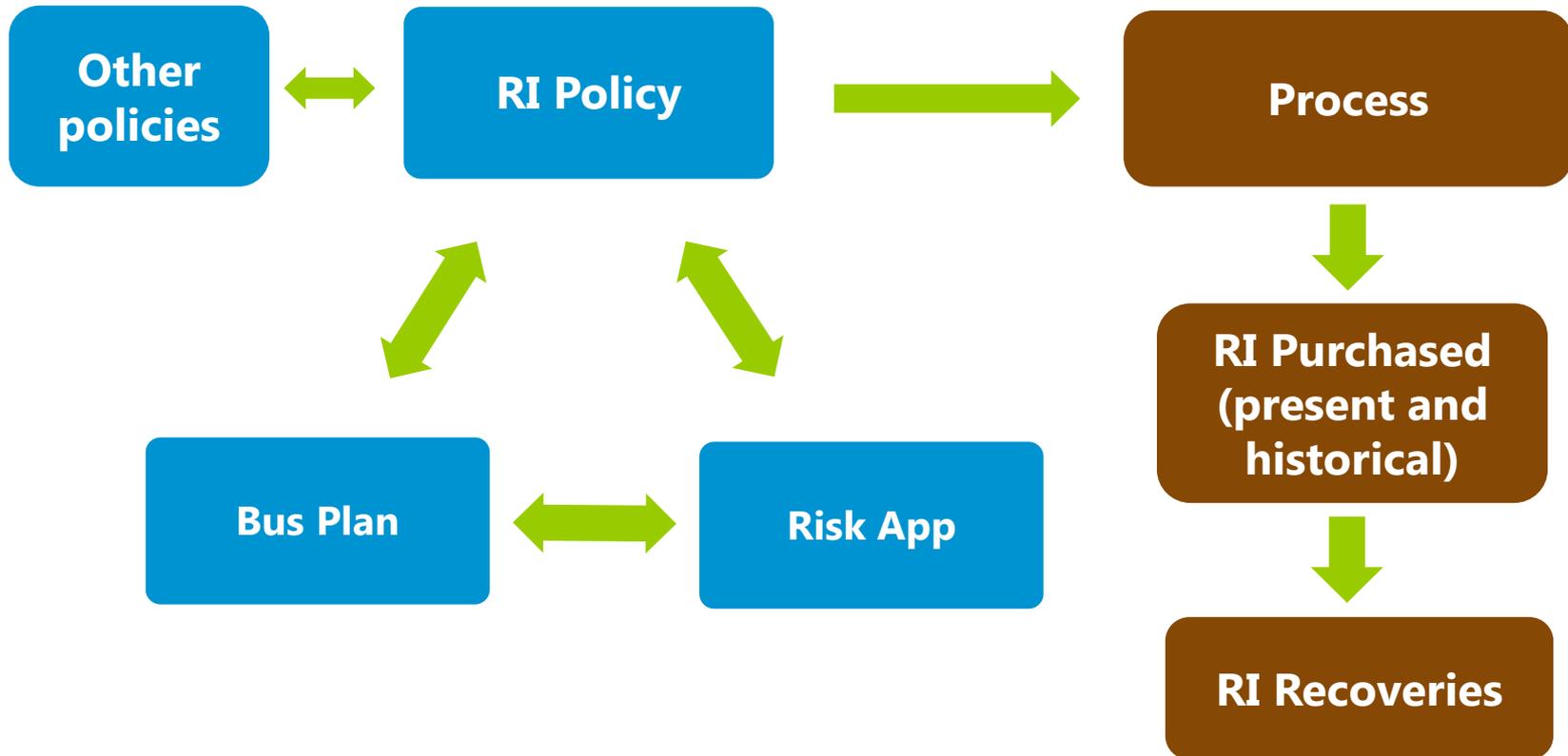
Express an opinion on the adequacy of reinsurance arrangements;

Delegated Act - Article 272 (7)

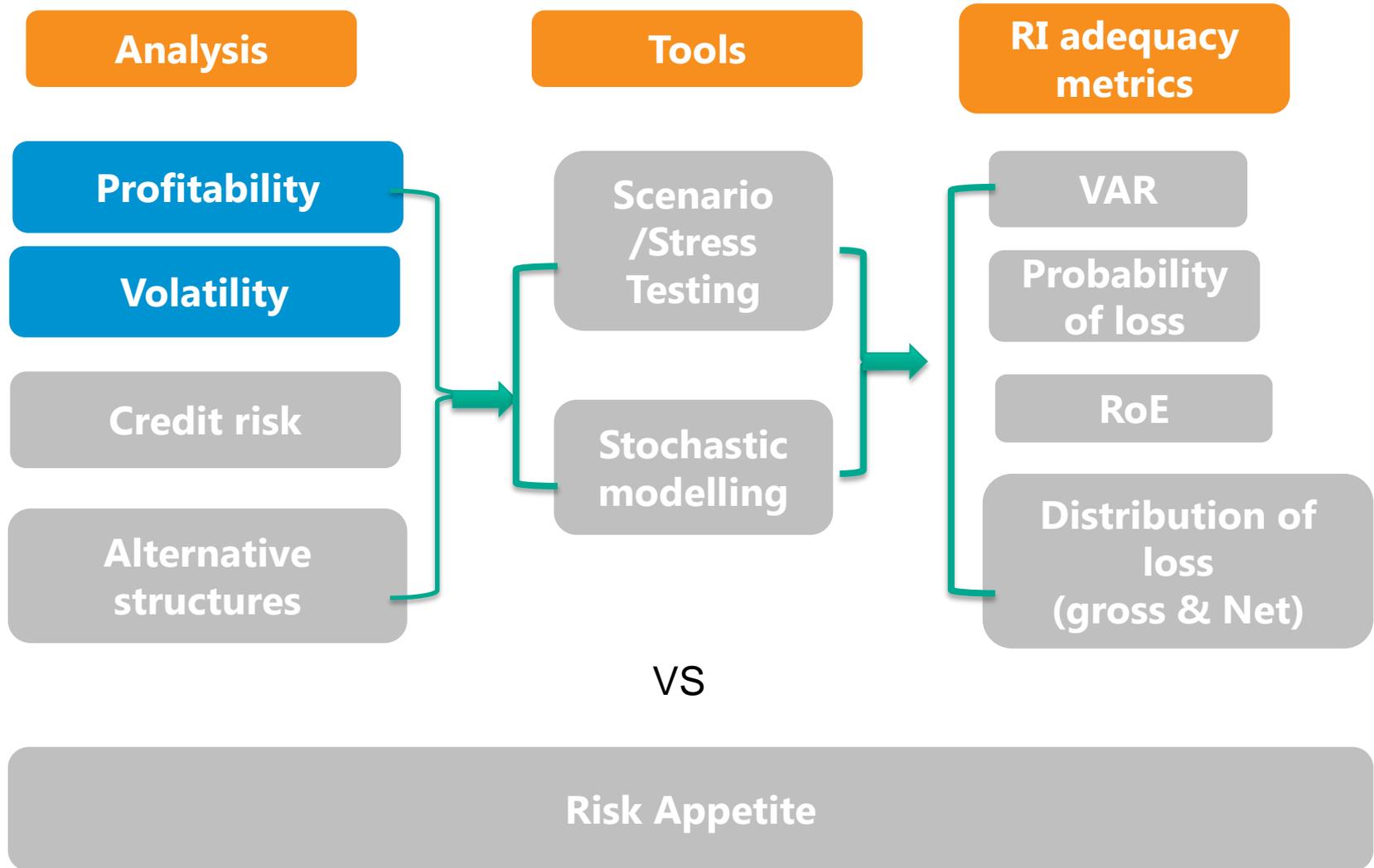
[...] shall include analysis on the adequacy of the following:

- a) the undertaking's **risk profile** and **underwriting policy**;
- b) reinsurance providers taking into account their **credit standing**;
- c) the expected cover under **stress scenarios** in relation to the underwriting policy;
- d) the calculation of the **amounts recoverable** from reinsurance contracts and special purpose vehicles.

# Understanding the RI Framework



# RI Adequacy Analysis



# UW & RI Opinions – Challenges

- **New requirements**
- **How to carry this out in practice?**
- **Board expectations**
- **Actuaries duplicating work?**
- **Conflict of interest**
- **Resources**
- **How much detail is needed?**

# Opinions - Key takeaways

- **Focus on UW results and volatility**
- **Experience analysis is key**
- **Consistent assumptions in all 3 areas**
- **Managing Board expectations**
- **Proportionality**
  
- **Everything evolves around the risk appetite!!**



HERBERT  
SMITH  
FREEHILLS

# BREXIT

## PROCESS AND IMPACT

14 JULY 2016

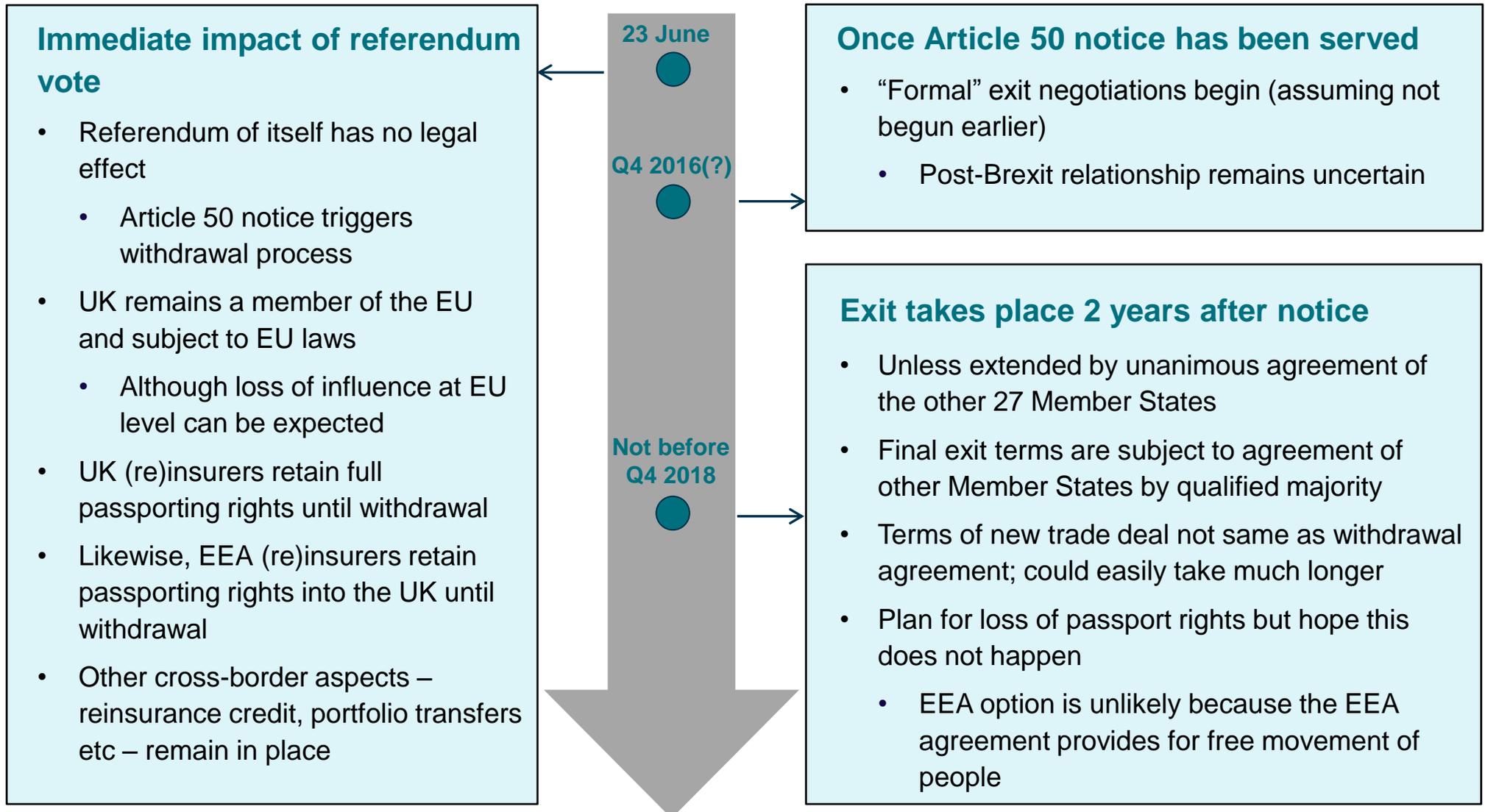
**Geoffrey Maddock**, Partner, +44 20 7466 2067, [geoffrey.maddock@hsf.com](mailto:geoffrey.maddock@hsf.com)



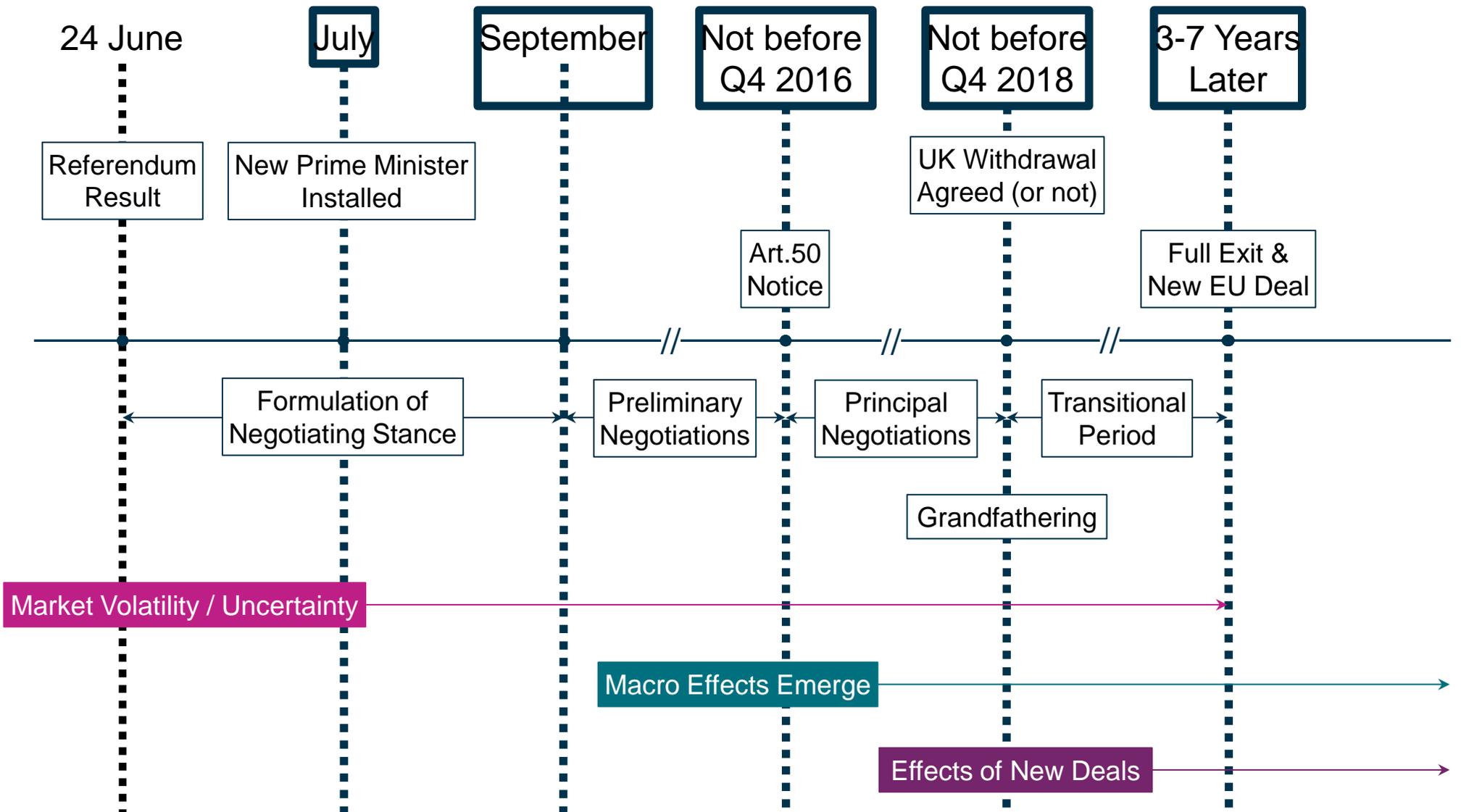
# SESSION OBJECTIVES

- 
- Legal impact of referendum vote
  - Brexit process
  - Possible models for future EU/UK relationship
  - Likely approach to regulation of UK (re)insurers
  - Process for adopting new UK regime
  - Equivalence; passporting; third country access to EU; EU access to UK
  - Restructuring tools

# BREXIT – WHAT NEXT?



# INDICATIVE TIMELINE



# EXISTING ALTERNATIVES COMPARED

	Contribute to EU budget	Free movement of people	Schengen open borders	Participate in EU Law Making	EU Market Access – goods	EU Market Access - services	Financial services “passports”	Trade treaties with third countries
EU (UK terms)	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
EEA (Norway)	Yes	Yes	Yes	No	Yes	Yes	Yes	Some
FTA (Switzerland)	Yes	Yes	Yes	No	Yes	Limited extent	No	No
Customs Union (Turkey)	No	No	No	No	Yes	No	No	No
(Canadian) CETA	No	No	No	No	Largely Tariff Free	No	No	No
WTO (Most of rest of world)	No	No	No	No	Most Favoured Nation Tariffs	No	No	No

# IMPACT ON THE UK LEGAL FRAMEWORK

## Mind the gap!

- After 43 years of interconnectedness, much law applicable in the UK consists of:
  - Directly-effective EU legislation
  - Legislation/regulation implementing EU Directives or supplementing directly-effective EU law
- Without “replication” or “reform”, Brexit would leave huge gaps in the UK legislative framework



An extensive law-making effort to 'plug the gap'



### Replicate

Preserve existing EU law in new domestic legislation

### Reform

Amend existing EU law in divergent domestic legislation

### Repeal

Scrap existing EU law - deregulation

# REPLACING LAWS

## Solvency II Directive

- Implemented into UK legislation and regulation
- As so implemented, could continue to apply post-Brexit
- Amendments needed to reflect post-Brexit structure e.g. references to EIOPA will need to be replaced

## Solvency II Delegated Regulation and Technical Standards

- Have direct effect in UK
- No application in UK apply post-Brexit
- Will need to be incorporated into UK law (legislation or PRA rules), with appropriate amendments to reflect post-Brexit structure

## EIOPA Guidance

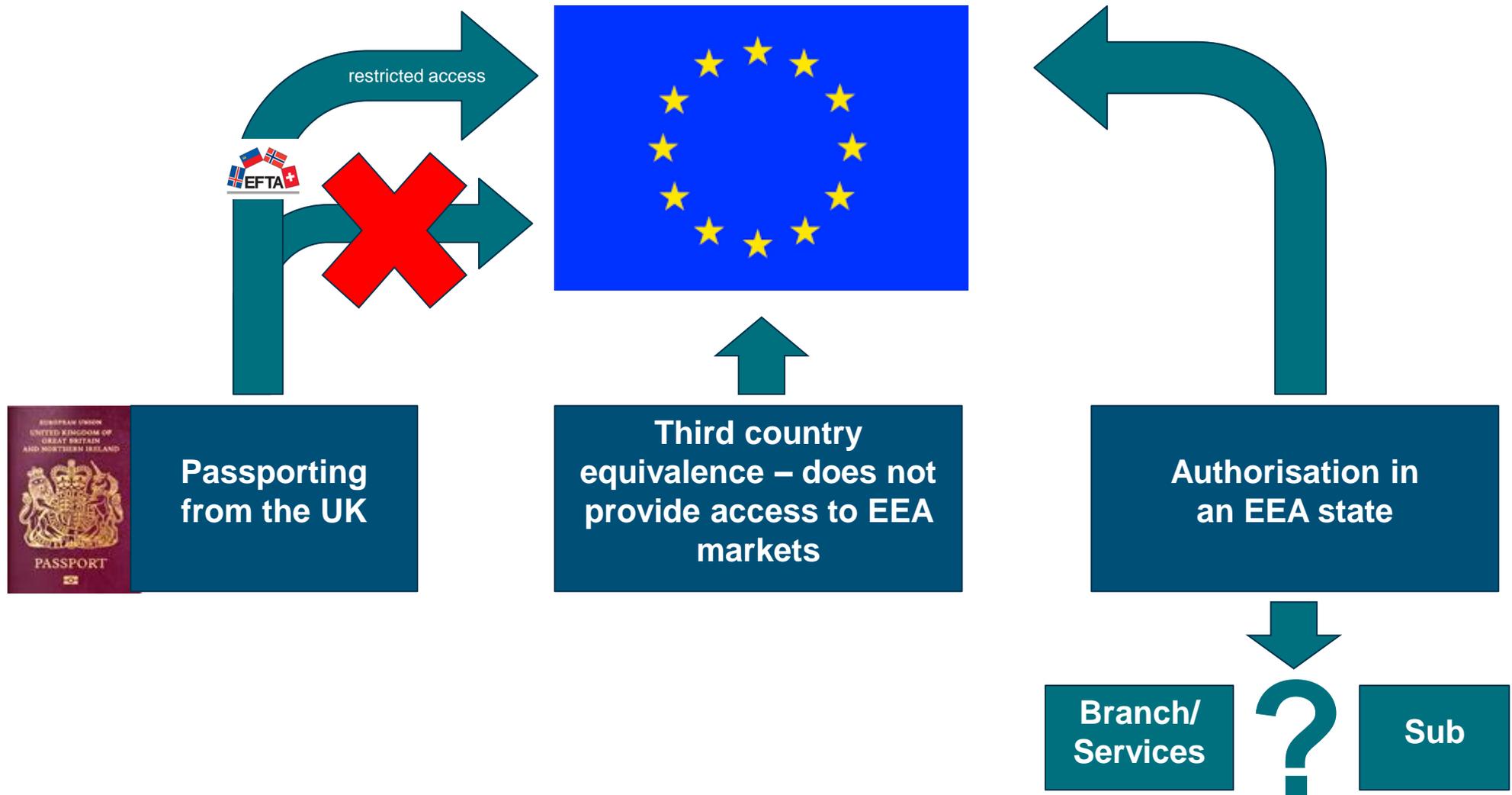
- Not binding; “comply or explain”
- No application in UK post-Brexit
- PRA to decide whether to incorporate guidance into the UK regulatory regime, with appropriate amendments to reflect post-Brexit structure



## Issues

- Role of EIOPA will need to be taken on by another body, presumably the PRA
- Integration with current PRA rulebook, Supervisory Statements and other materials
  - Creation of full body of rules and guidance along the lines of the old FSA Handbook?
  - Perhaps unlikely in the short term – wholesale adoption of current regime is more likely
- In longer term, what direction will regulation take? Possible return of “gold plating”? Relaxation will likely be constrained by desire for “equivalence”
  - Some rules may become more onerous e.g. wider jurisdiction to apply capital add-ons; use of early warning indicators; changes to risk modules e.g. sovereign risk
  - Some areas may be simplified e.g. reporting; risk margin; long term products
- Questions about interaction of UK and EU principles of interpretation
  - Purposive vs literal approach
  - Continued relevance of CJEU decisions?

# ACCESSING THE SINGLE MARKET



# ACCESSING THE SINGLE MARKET

	Pre-Brexit	Post-Brexit
Services business	<p>UK (re)insurer can passport into rest of EEA</p> <ul style="list-style-type: none"> <li>• Single home state authorisation</li> </ul>	<p>Position unclear; may require authorisation of branch</p> <ul style="list-style-type: none"> <li>• Not only an issue for new business</li> <li>• May affect ability to service existing business</li> </ul>
Branch business	<p>UK (re)insurer can passport into rest of EEA</p> <ul style="list-style-type: none"> <li>• Single home state authorisation</li> </ul>	<p>Solvency II rules apply to UK insurers (but not pure reinsurers) absent a deal allowing them to passport</p> <ul style="list-style-type: none"> <li>• Branches (nb require “permanent presence”) must be authorised in each EEA state and will have no passporting rights</li> <li>• Rules on localisation of assets and capital requirements</li> </ul> <p>Pure reinsurers</p>
EEA subsidiary	<p>EEA (re)insurer is authorised in home EEA state</p> <ul style="list-style-type: none"> <li>• Full passporting rights</li> </ul>	<p>Groups may prefer to access EEA markets through EEA subsidiaries</p> <ul style="list-style-type: none"> <li>• Additional cost likely</li> <li>• How much of the activities must be carried on in the new “home” state?</li> </ul>

# EQUIVALENCE UNDER SOLVENCY II

“Equivalence” of third country supervisory regimes is relevant in 3 contexts under Solvency II (Arts 172, 227, 260)

- Level 2 Regulation contains criteria by reference to which an assessment of equivalence should be carried out (Arts 378-380)

**Article 172:** reinsurance with reinsurer subject to equivalent regime must be treated in same way as reinsurance with EEA reinsurer

**Article 260:** a group headed by an insurance holding company based in a jurisdiction with an equivalent group supervision regime will be group regulated only by the supervisor in that jurisdiction

**Article 227:** subsidiary in equivalent country may, with supervisory approval, be valued on basis of local, not Solvency II, rules when using the “deduction and aggregation” method

“Temporary” equivalence

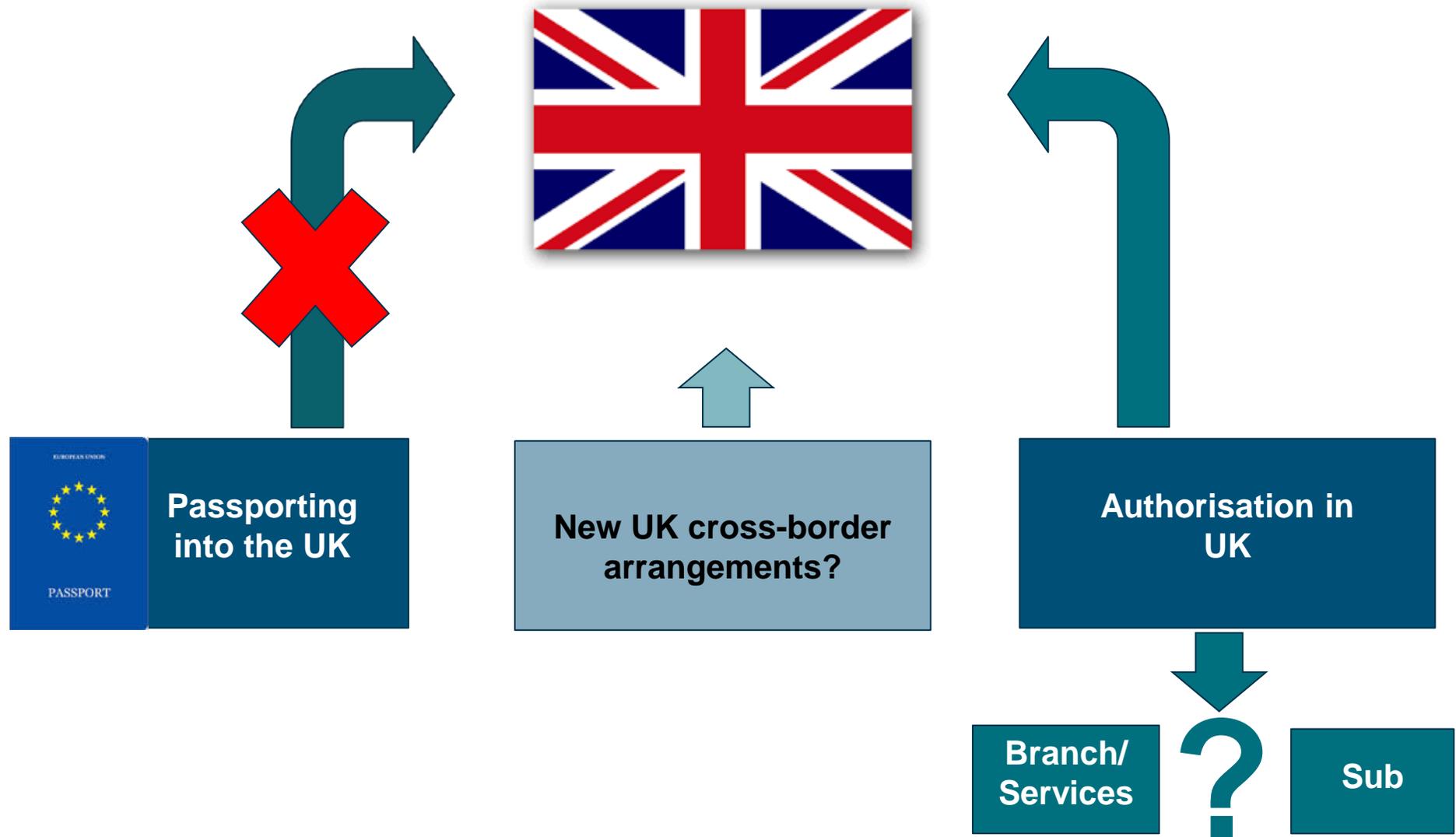
- Available up to December 2020
- Subject to meeting various criteria (more limited than full equivalence)

“Provisional” equivalence

- Available for 10 years (and renewable thereafter)
- Even more limited criteria

- Full equivalence is likely to be available to the UK for all 3 purposes assuming no significant relaxation of the UK regime
- Timing is a problem: political considerations; assessment cannot be commenced unless UK has already become a “third country”
  - Lobby for equivalence from date of Brexit; EEA reinsurers’ wish for reciprocity may help negotiations

# EEA (RE)INSURERS ACCESSING THE UK



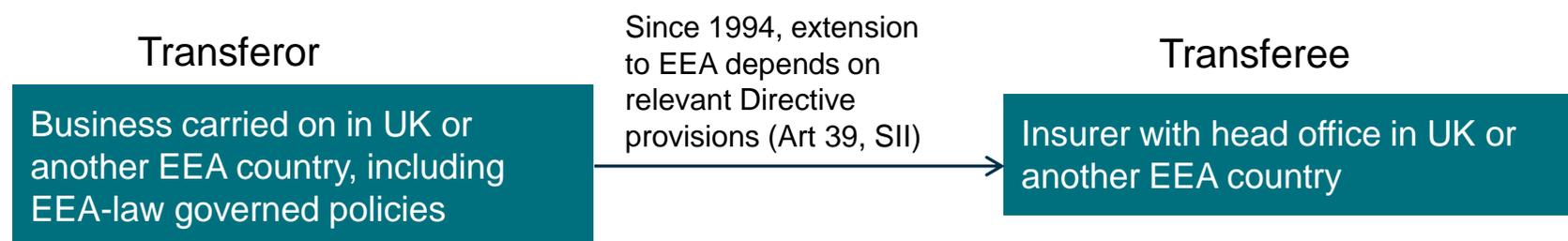
# LIKELY INDUSTRY RESPONSE

<p>UK (re)insurers need to plan for loss of passport</p> <ul style="list-style-type: none"> <li>• EEA option would leave UK without control of borders it seeks</li> <li>• Restructuring options (see below) require planning and will take time to implement</li> </ul> <p>For now, at least, (re)insurers should assume that current timetable for Insurance Distribution Directive and PRIIPS Regulation will proceed</p>		<p>Accessing EEA markets through EEA subsidiaries is an option</p> <ul style="list-style-type: none"> <li>• Likely to introduce additional cost</li> <li>• How much of activities must be carried on in new “home” state?</li> <li>• How much can be outsourced back to UK?</li> </ul>
<p>EEA (re)insurers also need to plan for loss of passport</p> <ul style="list-style-type: none"> <li>• PRA to decide whether to “grandfather” existing branches or take a light touch approach to branch applications</li> </ul>		<p>EEA reinsurers may wish to lobby for reciprocal “equivalence” finding under Article 172, SII from exit</p> <ul style="list-style-type: none"> <li>• Preserve their competitive position when it comes to providing protection to the UK insurance market</li> </ul>
<p>For groups headquartered outside the EEA, loss of passport may make UK less attractive as a hub for European operations</p>		<p>Where operations already exist in the UK, firm may prefer to retain the bulk of those operations in the UK on an outsourced basis</p>

# RESTRUCTURING TOOLS – A BRIEF REMINDER

Two tools available to UK firms which need to reorganise business to operate in a post-Brexit Europe: Part VII transfer (whole of part of business) or SE (European company) (whole business only)

## Part VII transfers



- Typical 12-18 month timeframe for Part VII transfer means firms cannot wait for outcome of negotiations before starting work – consider whether existing blocks of business should be held within EEA group entity post-Brexit even if UK business is retained; perhaps EEA business within a UK company should be sold pre-Brexit if of limited ongoing strategic importance, which will also require Part VII transfer
- Separately, almost any transfer even of UK-sold business to another UK entity has some EEA resident policyholders whose transfer is conveniently addressed under Part VII at present – if a transfer is contemplated at some stage in any event; consider accelerating it to ensure completion before Brexit takes effect
- Cross-border transfers will raise issues regarding ongoing FSCS coverage post-Brexit – clarity on future form of FSCS rules needed from PRA/FCA
- As with lead-in to Solvency II, likely capacity issues at PRA/FCA suggest it's sensible to begin process sooner rather than later

# RESTRUCTURING TOOLS – A BRIEF REMINDER (CONT'D)

Unique feature of an SE (Societas Europaea) is ability to migrate to another EU member state. In other respects, behaves like public company incorporated in home state

Amongst other means, can be formed with court approval but without need for portfolio transfer:

- Merger of two public companies formed in different EU member states
- UK plc can transform itself into SE if has owned for two years a company established in another EU member state

## SE (European company)

Process for establishment and then ongoing operation of SE involve requirements for formal employee engagement

Process of migration to another member state includes requirement for publicity (and in practice, customer notification) but (at present) no UK court hearing

Note however need for fresh authorisation in destination state – not automatic



# DISCUSSION