

PRA Solvency II Insurance Directors' update - November 2015

The Prudential Regulation Authority (PRA) published a [Solvency II Insurance Directors' update letter on 6 November 2015](#) for all Solvency II affected firms, to discuss the updates. With the implementation of Solvency less than two months away, reviewing applications for Solvency II approvals is the PRA's main priority.

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The balance sheet review (BSR) by external auditors of firms' risk margin methodologies showed much variation in the projection of future, non-hedgeable Solvency Capital Requirements (SCR).

We have outlined further Solvency II updates below:

Equity Release Mortgages (ERM)

- Some firms are increasing their investments in alternative assets, such as ERMs (these assets are marked-to-model).
- More specific requirements are required under Solvency II than the current Individual Capital Adequacy Standards (ICAS) regime in the UK. These include:
 1. how to update valuations over time and in response to new information
 2. how to value embedded options and guarantees when assessing the appropriate value for asset
 3. the appropriate capital treatment
- During 2016, the PRA intend to undertake an industry-wide review of ERM valuations and capital treatment to assess compliance with Solvency II requirements.

Risk margin methodologies

- The balance sheet review (BSR) by external auditors of firms' risk margin methodologies showed much variation in the projection of future, non-hedgeable Solvency Capital Requirements (SCR).
- The main findings can be found in the annex to the November update, which covers:
 1. risks included in projected SCRs
 2. projection of future SCRs
 3. granularity of risks in SCR projections and diversification assumptions
 4. volatility adjustment and matching adjustment approvals in risk margin calculations
 5. actuarial function and documentation

Calculation of the transitional deduction for technical provisions (TDTP)

The calculation of the TDTP and the resulting quantum of the deduction is expected to be overseen by the audit committee of the firm, with the chair providing the PRA with evidence of suitability and ensuring that requirements are met. This should be done for the opening Solvency II balance sheet and repeated on an annual basis, and again after any recalculation is performed.

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Most of the current waivers and modifications still in force will expire on 31 December 2015.

Reinsurance counterparty credit risk

- Firms could be exposed to a significant concentration of counterparty default risk, if it reinsures to a single or only a few counterparties and it is expected that this will be managed and mitigated under Solvency II.
- The PRA continues to expect firms to manage and mitigate reinsurance counterparty default risk and the risk management system should cover risks, both included and excluded from the calculation of the SCR. The risk management system should also demonstrate prudence and compliance with the PRA rules.
- The implementation of Solvency II doesn't make it appropriate for firms to unwind mitigation currently in place, unless other suitable actions are taken to ensure effective risk management systems are in place.

Solvency II waivers and modifications

- Most of the current waivers and modifications still in force will expire on 31 December 2015.
- Rules transposed from EU directives or those directly from Solvency II regulations won't be granted waivers by the PRA.

Information on how to apply for specific supervisory approvals set out in the Solvency II Directive can be found on the PRA website.

Solvency II national specific templates (NSTs)

- NSTs are eligible for waivers but the PRA does not expect many instances where this would be appropriate.
- NSTs are not expected to impose material one-off, or ongoing, incremental costs on firms but any additional costs are likely to be minimal.

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PRA timetable of activity November to December 2015:

Date	Description
November	Letter: communication of matching adjustment approvals, to relevant firms.
November	Publication: final supervisory statement on third-country insurance and pure reinsurance branches.
November	Publication: consultation paper on internal model approval process data review findings.
November	Publication: consultation paper on external audit of public disclosure requirements.
December	Letter: communication of internal model approvals, to relevant firms.

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