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CP12/23 - Review of Solvency II: Adapting to the UK insurance market

LCP's response

We are pleased to respond to this consultation. Our response is based on our experience providing actuarial support services to a wide range of UK general insurers, including to the Lloyd's market, and to personal / commercial lines providers of all sizes.

Overall, we agree with the PRA's objective of streamlining aspects of the Solvency II regime, and with the specific measures set out in CP12/23. We believe that the proposed measures are well thought through and provide some clear and tangible benefits to market participants, without any material change to the level of policyholder protection that general insurers provide to customers. We believe that the implementation timeline is appropriate.

In addition, our view is that these proposals strike a good balance between maintaining broad regulatory equivalence with the EU and tailoring the regulatory regime to the UK specific market. Bringing the existing Solvency II rules into the PRA rulebook will allow the UK regulatory framework to be more flexible in future.

Whilst we regard the overall proposals as a positive development for the UK general insurance market, we have identified a number of minor improvements we believe would be beneficial. These are set out below. In addition, the table overleaf sets out a summary of our specific response to each area of the consultation.

Considerations for improvement

The following are recommendations for you to consider when finalising the proposed Solvency UK rules:

1. We recommend that you index the thresholds at which Solvency UK will apply, so that they increase annually in line with an appropriate inflationary index (eg CPI).

2. We recommend that you provide further guidance about how you expect to apply the new principles-based internal model regime, in order to ensure that your expectations and those of market participants are aligned.

3. We note that, under the current Solvency II regime, there is a significant increase in the regulatory burden of implementing a partial internal model, compared to using USPs. Within the principles-based framework you propose, we recommend reducing this gap by either:
   - allowing firms to apply for waivers to use USPs in a wider range of circumstances (for example to replace standard catastrophe risk parameters); or
   - ensuring that the principles-based regime is applied proportionately to partial internal models that are limited in scope or relatively simple, noting that any PIM is likely to represent an enhancement of a firm's modelling capability compared to the Standard Formula.

4. We recommend that you continue to maintain broad alignment between SFCR reporting under Solvency UK and Solvency II, especially given that many groups will have entities reporting under both regimes.

5. We recommend that you consider increasing the flexibility of the mobilisation regime, particularly in respect of the strict 1-year time limit and the restrictions on business that can be written during mobilisation.

Response by consultation area

Reference	Consultation area	Comments
Chapter 2	**Transitional measures**	We have no comment on Chapter 2. These provisions are unlikely to be relevant to general insurers.
Chapters 3 and 4	**Internal models and capital add-ons**	Chapters 3 and 4 propose significant changes to the way in which you regulate firms with internal models. We support the move to a principles-based regime. We think that this has the potential to simplify compliance for firms, in particular when applying for permission to use an internal model, or when making major changes. In particular, we support your desire to remove the "cliff edge" around internal model approvals, and we think that a combination of principles-based oversight and safeguards against residual model limitations (RMLs) will be effective in doing so. The key risk of a principles-based regime is that it can lead to different views between firms and the PRA as to how the principles should be applied in practice. This can, in turn lead to additional work to address differences of interpretation, especially when the principles are new. In order to ensure the new regime achieves your simplification aims, we recommend that you provide clear guidance and examples of how firms can demonstrate compliance with the new principles-based standards. We note that, under the current Solvency II regime, there is a significant increase in the regulatory burden of implementing a partial internal model, compared to using USPs. Within the principles-based framework you propose, we recommend reducing this gap by either: • allowing firms to apply for waivers to use USPs in a wider range of circumstances (for example to replace standard catastrophe risk parameters); or • ensuring that the principles-based regime is applied proportionately to partial internal models that are limited in scope or relatively simple, noting that any PIM is likely to represent an enhancement of a firm's modelling capability compared to the Standard Formula.
Chapter 5	**Group SCRs**	We support the proposed easements, which provide more flexibility for the calculation of Group SCRs.
Chapter 6	**Third country branches**	We support the simplification of the third country branch regime. We believe it is proportionate to place more reliance on the regulation of parent-entities in Solvency UK equivalent jurisdictions, rather than requiring SCR calculations (and associated reporting) for entities that have no separate legal status in the UK. We note that the easements may create a risk of regulatory arbitrage, where it is preferable for firms to domicile overseas with a branch in the UK, rather than domicile in the UK with an overseas branch. Whilst we recommend you monitor this risk, we think it is unlikely to be significant. We note that the consultation removes requirements for branch SCRs and MCRs, but Chapter 10 still requires a branch security deposit. We recommend you consider whether it is necessary to retain this requirement in the absence of branch capital requirements.

Reference	Consultation area	Comments
Chapter 7	**Reporting and disclosure**	We support the overall intention of simplifying regulatory reporting and disclosure requirements. We believe the individual changes proposed by the PRA will provide some simplifications, although these will be mainly targeted at branches and groups, rather than solo entities. In addition to scrapping many of the reporting templates, you propose changes to a significant number of the remaining reporting templates. This is likely to pose a one-off compliance cost for most regulated firms, and an ongoing administrative challenge for firms that are regulated in both the UK and EU. In addition, firms regulated in both jurisdictions may not benefit from the scrapping of reporting templates in the UK as they will continue to submit those templates on the continent. On balance we agree that it is important for the PRA to efficiently obtain the data that is required for market monitoring; however, we would discourage you from making any further material changes for the foreseeable future. We note that this consultation does not include changes to the SFCR report, but that you note this may be an area you review in the future. We recommend that you continue to maintain broad alignment between SFCR reporting under Solvency UK and Solvency II.
Chapter 8	**Mobilisation**	We support your ambition to reduce barriers to market entry, which we recognise have been high. We also recognise that it is extremely challenging to balance this against the need to ensure that any policyholders of a new start-up are appropriately protected. In our opinion there is a risk that the mobilisation regime you propose may be too restrictive to be attractive. In particular, we recommend that you consider: • Flexibility for mobilisation to last longer than 1 year, where new entrants are making demonstrable progress towards full compliance, but are not in a position to achieve this within the existing hard deadline. • In conjunction with a longer mobilisation period, more flexibility to authorise firms to write a wider range of products and greater volume of business as their maturity increases. In particular, we note that the rules regarding claims-made basis would exclude mobilising firms from writing the majority of traditional personal lines products.
Chapter 9	**Thresholds**	We support the proposal to raise the premium and technical provisions thresholds at which Solvency UK will apply. We recommend indexing these thresholds annually in line with an appropriate inflation index (eg CPI). This will reduce the risk of firms being brought back into scope simply by the effect of inflation year-on year.
Chapter 10	**Currency redenomination**	We support your currency re-denomination plans.

Next steps

We would be delighted to discuss any aspect of our response further with you, should this be of interest.

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