Solvency II Review – considerations for year-end 2023

This statement relates to HM Treasury (HMT) and the Prudential Regulation Authority's (PRA) reforms to Solvency II to be implemented at year-end 2023, in advance of the PRA's final decisions on its recent Solvency II reform proposals. The changes are informed by:

- Relevant Solvency II reform proposals set out in the following PRA consultation papers (CP), and the PRA's consideration of responses to those CPs:
  - CP14/22 – **Review of Solvency II: Reporting phase 2**, published in November 2022. The consultation period for CP14/22 ended on 8 May 2023.
  - CP12/23 – **Review of Solvency II: Adapting to the UK insurance market**, published in June 2023. The consultation period for CP12/23 ended on 1 September 2023.
- HMT's reforms to certain aspects of Solvency II through the **Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023**, made on 7 December 2023, laid before Parliament on 8 December 2023, and coming into force on 31 December 2023.

Specifically, this statement contains information about the PRA's changes to regulatory reporting requirements and the transitional measure on technical provisions (TMTP), which are facilitated by provisions in HMT's Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023. This statement also contains information to assist firms with implementation of the risk margin calculation, in light of HMT's regulations.

Early implementation of reporting measures

Regular Supervisory Report

The PRA proposed in CP12/23 to cease collecting the Regular Supervisory Report (RSR), including both the full triennial report and the annual summary of material changes (the material change report). The PRA's proposal in CP12/23 was to implement this change by not restating the RSR requirements in the PRA Rulebook once HMT revokes the relevant articles in onshored Commission Delegated Regulation 2015/35.

The PRA received feedback in response to CP12/23 calling for the earlier implementation of the removal of the RSR. The PRA has worked with HMT to facilitate the removal of Articles 312(1a) and 312(3) of the onshored Commission Delegated Regulation in HMT's SI; this reflects the PRA's consideration of feedback received, and the PRA's proposal to retire the RSR. This deletion has the effect of removing the requirement for insurers to submit both the full triennial RSR and the material change report. The requirement on firms to submit the RSR will be removed with effect from 31 December 2023.

Solvency II Quantitative Reporting Templates

In CP14/22 and CP12/23, the PRA also consulted on the deletion of the following templates:

Table 1: Proposed outright template deletion

Solvency II regulatory returns
S.07.01 Structured products
S.08.02 Derivatives transactions
S.21.01 Loss distribution risk profile
S.21.03 Non-life distribution of underwriting risks – by sum-insured
S.31.02 Information on special purpose vehicles
NS.06 Business Model Analysis (Life)

The PRA received feedback to both consultation papers calling for the earlier implementation of these template deletions to ease the burden on insurers' reporting processes.

The PRA has considered the intended supervisory use of the templates set out in Table 1 in the short term. While the work to finalise and implement the policy consulted upon in CP14/22 and CP12/23 is ongoing, the PRA is content not to receive the templates set out in Table 1 for a period prior to implementation of the final policy.

This approach covers the submission of the templates in Table 1 from all insurers and for all reporting reference dates falling on or between 31 December 2023 and 30 December 2024, ahead of the proposed implementation of final policy on 31 December 2024.

The PRA's final decision on whether or not to delete these templates will be taken together with the other proposals in CP14/22 and CP12/23 in light of the responses received and will be published in due course.

The PRA will issue further guidance on how firms that do not wish to file the templates set out in Table 1 should report templates S.01.01 and NS.00.01.01 on the contents of submission.

Recalculation of TMTP and changes to the FRR test

The PRA has recently invited firms to **apply for permission** to recalculate the TMTP as at year-end 2023. The PRA expects the recalculations will take account of the effect of the government's reform of the risk margin set out in the **Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023**.

The PRA proposed in CP12/23 to remove the financial resource requirement (FRR) test at year-end 2024. The PRA received feedback from respondents asking the PRA to use its discretion to remove the test at year-end 2023 to coincide with the Government's reform of the risk margin.

While the work to finalise and implement the PRA's proposed TMTP reforms in CP12/23 is ongoing, the PRA will have the following expectations for the FRR test, notwithstanding the policy set out in policy statement 25/19 – **Solvency II: Maintenance of the transitional measure on technical provisions**, supervisory statement (SS)6/16 – **Maintenance of the**

'transitional measure on technical provisions' under Solvency II and SS17/15 – **Solvency II: transitional measures on risk-free interest rates and technical provisions**:

- If firms were required to limit the TMTP due to the FRR test in their last recalculation before 31 December 2023, the PRA will consider removing the test. This will be subject to a case-by-case assessment by the firm's supervisors.
- Otherwise, the PRA no longer expects firms to carry out the FRR test when recalculating the TMTP.[1]

> **These expectations will apply to TMTP recalculations at year-end 2023, as well as any recalculations required between 31 December 2023 and 30 December 2024.**

The PRA considers that removing the requirement to carry out the FRR test a year earlier than proposed in CP12/23 will reduce resource costs for firms and the PRA, while the case-by-case assessment will limit risks to PRA objectives by ensuring the TMTP remains appropriate for each firm.

Firms required to limit the TMTP in their last recalculation due to the FRR test can contact their supervisors to request the removal of the FRR test at year-end 2023. Supervision teams will be able to support the requests and discuss the information required for the PRA to complete its assessments.

Calculating risk margin for Periodical Payment Orders (PPOs)

The Government's reforms to the risk margin are set out in the **Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023**, and will come into force on 31 December 2023. Specifically, HMT's SI makes an amendment to the Commission Delegated Regulation (EU) 2015/35 to:

- reduce the cost of capital rate from 6% to 4% for life and non-life insurance and reinsurance obligations; and
- amend the risk margin formula and introduce a risk tapering factor of 0.9 for life insurance and reinsurance obligations, subject to a floor of 0.25.

This part of this statement sets out how firms may interpret HMT's reforms to the risk margin in respect of Periodical Payment Orders (PPOs).

- The PRA notes PPOs are eligible for the 0.9 risk tapering factor given they are treated as life insurance obligations within the existing regime.[2]

- Insurance firms may have a pipeline of claims which could become PPOs, of which a proportion will be settled as a cash lump-sum and the rest as PPOs. Firms' best-

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[1] The PRA has discretion under **Regulation 54** of the Solvency 2 Regulations 2015 not to apply deductions to TMTP following the FRR test, as long as a firm's financial resource requirements are lower under Solvency I than Solvency II before the TMTP is applied. **HMT's regulations** will remove sub-paragraph (b) from paragraph (9) of Regulation 54, which will give the PRA discretion not to limit the TMTP even when a firm's financial resource requirements are higher under Solvency I than under Solvency II. This change in legislation provides the PRA full discretion over whether to apply deductions to TMTP following the FRR test, as well as whether to require firms to carry out the FRR calculation.

[2] See Annex I of Commission Delegated Regulation (EU) 2015/35, where PPOs are categorised as life insurance obligations (item 34 within D. Life insurance obligations).

estimate liability calculations are based on a probabilistic expectation of how these claims will settle. The PRA does not object to firms adopting a similar approach in the risk margin calculation, where the 0.9 risk tapering factor is applied to potential PPO obligations on a probabilistic basis.

- Some firms may not have systems in place to project capital requirements on PPO obligations only, ie separate from all other non-life lines of business, for the purpose of applying the 0.9 risk tapering factor. The PRA encourages such firms to propose potential simplifications to their risk margin calculation to their relevant supervisory contacts.