REVIEW OF SOLVENCY II IN THE UK AND THE ACTUARIAL PROFESSION

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the authors wrote the article as members of the Solvency UK taskforce

Since the UK's departure from the European Union in 2020, the UK Government together with the Prudential Regulatory Authority (PRA) has sought to tailor the regulatory environment to better suit the UK's domestic market while maintaining high standards of financial stability and policyholder protection. At the time of writing, the review is at its final stage, and it is expected to be fully implemented by 31 December 2024. There is however the possibility of some disruption or change to this timescale as a result of the recently announced UK general election on 4 July 2024.

The review of the Solvency II in the UK (Solvency UK) covers a wide range of areas including:

- Risk Margin, with the Cost of Capital parameter reduced from 6% to 4% and the introduction of a risk tapering factor of 0.9 for life insurance and reinsurance obligations and 1.0 for non-life, subject to a floor of 0.25, in force from 31 December 2023.
- Recalculations simplifications to Transitional Measures of Technical Provisions (TMTP), in force from 31 December 2023. The changes are being phased in to minimise disruption and provide insurers and reinsurers with adequate time to adjust to the changes.
- Matching Adjustment, which allows insurers to adjust their liabilities to reflect the value of matching assets held to back long-term insurance products.
- Reporting and disclosure requirements, with policy statements now published (PS3/24 – Review of Solvency II: Reporting and disclosure phase 2 near-final) and expected to come in force on 31 December 2024. The review is aimed at simplifying reporting and disclosure requirements.
- Innovation and technology, with the review considering how the regulatory framework can support innovation, including the use of InsurTech solutions and data analytics to enhance risk management and customer service. >

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The proposed changes to Matching Adjustment are of particular importance to the bulk purchase annuity market, with changes aimed at relaxing some requirements to encourage investment in UK productive finance such as long-term investments in infrastructure and sustainable projects. Matching Adjustment benefit is a key benefit – the PRA estimates suggest it was circa £66bln[1] , whilst life insurers were holding circa £250bln[2] in assets to back their long-term liabilities at the end of 2022.

Under current rules, strict requirements apply to assets that are eligible for Matching Adjustment. Some long-term investments do not meet these requirements, in particular requirements for fixed cash flows. As a result, the proposed changes introduced a new asset category to be eligible – assets with highly-predictable cash flows. At the same time, the proposed changes also introduced additional requirements, some which are specifically designed for assets with highly predictable cash flows.

Solvency UK is expected to increase the competitiveness of UK based insurers (by tailoring the regulatory framework to better fit the UK market), enhance investment in long-term, productive assets (through changes to the Risk margin and Matching Adjustment), and streamlined improved regulatory framework.

The UK Government and the PRA conducted consultations with various stakeholders, including insurance companies and industry bodies. As part of these efforts, in 2023 several major life insurance companies and long-term saving firms set up the **Investment Delivery Forum**, with the aim of accelerating large-scale infrastructure investment.

With the Matching Adjustment one of the few areas still being consulted on, the Institute and Faculty of Actuaries (IFoA) has set up a **taskforce**, looking at the impacts of the Matching Adjustment reforms introduced through Solvency UK and the relative competitiveness of the UK regulations relative to other countries.

IFOA SOLVENCY UK TASKFORCE

The PRA intends to reform the regulations that apply to the calculation of the Matching Adjustment to introduce a more principle-based approach. The end outcome of the reforms is intended to enable broader and quicker investments by UK based insurers to encourage them to play a greater role in the UK economy while ensuring that insurers hold sufficient capital to protect their policyholders.

Within these new requirements, there are several areas where there is no established actuarial practice, and the Solvency UK taskforce was established by the IFoA Life Board in March 2024 with the intent of publishing several timely discussions and thought leadership pieces to help establish potential acceptable approaches to meeting the PRA's requirements. The proposed requirement for an attestation for firms using the Matching Adjustment is of particular interest to all stakeholders, with the attestation covering both the >

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[1] **CP19/23 – Review of Solvency II: Reform of the matching adjustment**, 28 September 2023.

[2] **What next? Bulk Annuity insurers – Regulatory developments – speech by Lisa Leaman**, 25 April 2024.

Matching Adjustment and the Fundamental Spread, which applies to the whole Matching Adjustment fund and all assets within it.

The taskforce has so far provided a strong foundation for careful and helpful considerations amongst its more than 20 members on some of the newly introduced areas, such the broadening of the asset universe eligible for Matching Adjustment alongside requirements for an attestation of the Fundamental Spread and Matching Adjustment. Related to this, some areas are being identified as potentially of greater importance for actuaries, such as a broadening and deepening of our understanding of new asset classes, asset specific risks including credit risk, credit rating assessment, asset restructuring and climate risk.

In recent weeks, the members of the task force authored and published five articles:

- **What is the definition of 'high degree of confidence'?** (17 April 2024)
- **Matching Adjustment attestation – how granular do you go?** (19 April 2024)
- **Strengthening Confidence in Matching Adjustment: The Role of the Attestation Report**, (29 April 2024)
- **Solvency UK Matching Adjustment Reforms: Highly Predictable cash flows and their implications for investment in UK productive finance** (6 May 2024)
- **Matching Adjustment Attestation Policy - A Key Piece of the Puzzle** (14 May 2024).

Five articles will be published in the next few weeks, covering:

- The Fundamental Spread sufficiency and add-on requirements
- How should climate risk be allowed for in the attestation
- International comparison of regulatory regimes
- What have we learnt from previous supervisory statements on Equity Release Mortgages and the Effective Value Test, and
- Environment and social impact bonds.

The taskforce has had initial discussions with the PRA, ahead of the publication of the final policy statement on Matching Adjustment, expected in June 2024, with an effective date 30 June 2024, subject to the comments noted above on the UK general election in July 2024. It is expected that the taskforce will support further IFoA/PRA discussions focussed on how practitioners are implementing the new regulations, given the wide range of potential solutions to meeting the new principle-based regulations.

The industry recognises the importance of these reforms, and in particular the opportunity to be at the forefront of sustainable investments in the wider economy, with circa £1,700bln of assets[3] available from Defined Benefit schemes which could transition to Bulk Purchase Annuity providers.

CONCLUSION

The Solvency II review in the UK represents a significant step towards creating a more tailored and effective regulatory framework for the insurance industry, by addressing key areas such as the Risk Margin, Matching Adjustment, and other requirements. The actuarial profession has reacted quickly and effectively in providing views from the profession on key issues surrounding the review.

The taskforce has a key role to play in assisting practitioners with adapting to the new rules and engaging with the PRA to help them identify where further guidance on implementation could be helpful. <

[3] **Options for Defined Benefit schemes: a call for evidence**, 22 November 2023.