ICAEW
REPRESENTATION 58/22

REVIEW OF SOLVENCY II

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ICAEW welcomes the opportunity to comment on the Review of Solvency II consultation published by HM Treasury on 28 April 2022, a copy of which is available from this link.

For questions on this response please contact John Boulton: representations@icaew.com quoting REP 58/22.

ICAEW supports HM Treasury's review of Solvency II. It is welcome to see government recognises that the UK has one of the most vibrant and innovative insurance sectors in the world and is committed to taking action that enables it to flourish within a robust regulatory regime that protects policy holders and manages systemic risk.

The Solvency II regime has been effective in developing more sophisticated mechanisms for managing prudential risk. The Government should not lose sight completely of what is happening within the European review of Solvency II , and in any case, the UK should continue to keep an eye on best practice internationally, including the International Capital Standard, and relative levels of prudential protection and the level playing field.

We think it is right that HM Treasury is taking an evolutionary rather than revolutionary approach to reforming Solvency II. Nevertheless, we welcome the ambition to develop 'a coherent, agile, and internationally respected approach to financial services regulation that is right for the UK'. In summary our views are:

1. we do not have a view on the optimum level of capital. In this submission we present evidence to help government assess how the proposals will help meet its objectives;
2. regulatory reporting can and should be made more efficient, we suggest some principles to inform the review;
3. robust governance and reporting reduces risk. These technical prudential changes should be viewed in the wider context of an improving UK system for reporting, audit and governance and considered alongside BEIS' proposals in this regard.

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KEY POINTS

1. Although we agree with HM Treasury's approach of seeking specific and targeted changes to the actuarial calculations to achieve rapid outcomes – informed by data gathered in the PRA's 2021 Quantitative Impact Study - the detailed nature of the measures proposed and the questions asked in the consultation paper risk losing sight of the bigger picture. A clear understanding of how the desired macro-outcomes are intended to be balanced is necessary in making final decisions on the package. This is pertinent because while changes to the risk margin are likely to lead to a reduction in the amount of capital held by insurers, these will be offset, to a greater or lesser extent for different insurers, by tightening the fundamental spread. It is appropriate for individual reforms to be considered in their own merit, in terms of the government's objectives for the review and not to be conflated.
2. That analysis should also look carefully at changes that might result in increased volatility, which could result in compensating changes in behaviour from firms to reduce such volatility. That might have the opposite effect to the policy outcome intended. For example, changes in calculation in the FS (by introducing a credit spread component) is likely to result in a MA benefit that would be too volatile for the appetite of some firms and therefore might actually incentivise less investment in certain asset classes.

Will the proposals achieve HM Treasury's objective for the review?

3. In his Forward to the consultation paper John Glen MP sets clear objectives for the review, including: 'to help maintain and grow the insurance sector whilst ensuring both a very high standard of policyholder protection and the safety and soundness of UK insurers'. The reforms aim to enable businesses to 'spend more of their money investing, innovating and creating jobs' while at the same time 'safeguarding policyholder protection'. These aims are not mutually exclusive, but they do require a balance to be struck.
4. Detailed evidence from the insurance industry will help HM Treasury gauge the precise impact of each of the changes. In our response we concentrate on the implications for the quality and reliability of information, to help government assess whether there are any specific unintended consequences from the changes it may wish to consider further. However, at a high level our impression of the four principal proposals is that:
    - The existing calculation of the Risk Margin ("RM") is too volatile and sensitive to interest rates and insurers believe has been too high in the low interest rate environment. This has been widely recognised by policymakers and supervisors both in the UK and Europe. The Government proposes to modify the cost of capital methodology to bring the Risk Margin in line with observed transfer values. The Government estimates that this will reduce the Risk Margin by 60-70% for long-term life assurers and by around 30% for general insurers. The success of this measure will therefore be judged on the extent to which it achieves this.
    - We expect that the capital benefits through the reduction of the risk margin will not be shared uniformly by different market participants due to the operation of the transitional measures on technical provisions for business written prior to 2016. Some insurers entered into reinsurance arrangements in relation to business written after 2016 thereby already reducing the amount of risk margin recognised by such firms. At the same time, with tightening now expected in interest rates, the reduction in the risk margin might not translate into capital releases of the magnitude anticipated.
    - Regulators are concerned that the fundamental spread ("FS") is too slow to respond to some material risks, notably credit risk, and are tightening the FS to address its perceived low sensitivity. Credit risk can be quite volatile, and this will therefore make

balance sheets less stable, particularly as it is pro-cyclical in nature. Such volatility may be appropriate to recognise for assets intended to be held in the shorter term – as changes in credit risk will affect the current transfer value. But for assets intended to be held to maturity as part of a matched portfolio, insurers are only affected by credit risk in the event of default. The changes will therefore reduce incentives for insurers with long-term liability portfolios to match them with long-term assets – particularly those such as infrastructure assets where spreads are typically higher relative to sovereign and corporate bonds. If the government's intention is to further incentivise investment in long-term assets, this change may have the opposite effect to that desired.

- Weighing up these two factors; government could analyse the expected beneficial effect of the Risk Margin reduction alongside the potentially punitive effect of the fundamental spread changes to determine the overall impact and the extent to which it meets its objectives.
- Reforms to encourage greater investment in long-term assets such as infrastructure have the potential to benefit the economy and support sustainable development. In principle this is desirable and could in itself justify the review. We welcome the increased flexibility in investments by broadening the range of assets that are eligible for the matching adjustment portfolio to include assets with prepayment risk, callable bonds, commercial real estate lending, housing association bonds and loans, infrastructure asset and local authority loan portfolios. We note however that insurers already invest in all of the asset classes mentioned. We also observe some ambiguity around the mitigating actions expected from firms for the extra risk taken when they include assets with these characteristics – if this needs to be achieved, for example, through holding hedges, that could reduce the incentive to firms of holding these assets. Though greater flexibility is welcome, it is not clear how relaxing the RM but increasing the FS especially for illiquid assets services will encourage greater investment in long-term assets. It could well have the opposite effect.
- A major reduction in the EU-derived regulations which make up the current reporting and administrative burden is to be welcomed, but the paper gives little details about it. We await further consultations on this topic.

ICAEW does not have a view on the optimum level of capital

5. ICAEW recognises that decisions about the optimum and preferred level of capital are for individual firms, within the parameters set by prudential regulation. We support the three objectives set for the review, but in each case there is a balance to be struck which is a matter of government policy. Behind the objectives there are also further balances that need to be weighed-up, for example:
    - policy holder protection v affordability of insurance/assurance and the acceptable level of the 'protection gap' in society. The protection gap remains high for life products and there is a clear public interest case in seeking to reduce it. Regulation plays a part in pricing and it is welcome that government is seeking to address this in the review;
    - attractiveness of UK insurers to equity investors and creditors – perhaps in particular to foreign investors - which is linked to the return on equity and balance sheet performance/strength;
    - returns from the sector to UK investors, including pension schemes – again return on equity v balance sheet risk/strength; and
    - effect of capital requirements on availability of balance sheet to enable growth.
6. We do not have a view on where the balance should be struck on these factors, and are pleased to see government considering these issues in the round. Nevertheless, it is clear

that each of these balances has a public interest dimension, and as a professional body working in the public interest we offer our observations to help government assess how effectively the proposed measures deliver its policy objectives.

Regulatory reporting can be made more efficient

7. We welcome government's efforts to make regulatory reporting more efficient. There are simple measures that could be taken to remove duplication and ensure that: an insurer is only required to submit regulatory reporting where it relates to a specific information need of the regulator in order to perform its supervision of the entity involved; that the regulator cannot otherwise form a view of the solvency or financial condition of an entity by reference to other reported information; and, that the regulator requests the information only as frequently as necessary. We await further details of the measures proposed in the PRA's phase two consultation. In the answer to question 5.1 below we suggest some principles that HM Treasury could apply in working with the regulator to design these simplifications.

Robust governance and reporting reduces risk

8. It is welcome that the consultation, at least implicitly invites views on the trade-off between the level of prudential protection and the economic consequences of regulation. The risk of an institution failing is not derived solely from the magnitude of its capital – it is also affected by the robustness of its governance and the reliability of its reporting. Where businesses fail without due warning (which is what the prudential regime is intended to guard against) it is typically because either their reporting fails to give a fair indication of the resilience or that it has been undermined by fraud. Both are protected against by a robust system of internal control and the centrepiece of governance should be to give assurance that controls are effective.
9. Without reliable reporting it is difficult to make sound judgments on capital adequacy. We therefore suggest a broader focus on robust and high-quality corporate reporting – and the governance necessary to achieve that – will also serve to reduce risk by enabling more timely action against mounting tensions. We welcome the role that the new corporate reporting regulator ARGA can play in this regard and hope it can be brought into operation as soon as possible. In weighing up the overall risk environment we believe that government should take this into account alongside the technical modifications to prudential capital proposed.

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ANSWERS TO SPECIFIC QUESTIONS

RISK MARGIN

Question 2.1: How would a reduction in the risk margin for long-term life insurers toward the bottom or top of the 60%-70% range impact on:

- ***policyholders and their level of protection; and***
- ***insurers and their reinsurance, investment and product pricing decisions.***

10. Some observers have noted that the current design and calibration of the risk margin leads to a disproportionately large and volatile risk margin. This is widely accepted by policymakers and supervisors in both UK and Europe. In the current low-rate environment this leads to providers of long-term insurance, particularly annuities, holding an inappropriately large buffer. ICAEW recognises both the need for change and the policy objective to reduce the size and volatility of the risk margin.
11. In theory, reducing the capital buffer could be seen as reducing the protection to policy holders from the risk of firm failure, but that is not the case if the current level of risk margin is excessive for its intended purpose. It should also be noted that the solvency capital requirement already provides protection against a 1-in-200 year event and it could be questioned whether the role of the Risk Margin is intended to provide a buffer on top of a buffer. The paper suggests that the current methodology results in measuring liabilities at a value significantly in excess of what they could be transferred for in the market – if correct, that suggests the risk margin is overly prudent. Certainly, the Institute and Faculty of Actuaries (IFoA) have said there is 'consensus in the UK that the risk margin is flawed[1]'. We understand this is largely due to the low interest rate environment which has negated the discounting effect which would otherwise significantly reduce the present value of liabilities that are very long-term in nature. It makes sense to look at this again.
12. In terms of reinsurance, firms use this not just to manage regulatory capital; there are a number of other factors involved. Therefore, it is difficult to conclude that the reform will necessarily result in firms reducing significantly their reinsurance programmes – factors like overall capacity, governance, risk appetite, etc will play a role. We understand some firms believe that for consistent on-shoring of longevity risk to be achieved, the reduction might have to be bigger than that proposed, others consider the level of reinsurance will continue regardless for the reasons outlined above.

Question 2.2: How would a reduction in the risk margin for general insurers of 30% impact on:

- ***policyholders and their level of protection; and***
- ***insurers and their reinsurance, investment and product pricing decisions.***

13. General insurers are less affected by discounting due to the shorter-term nature of their liabilities, so the capital effect from adjusting the risk margin will naturally be less for them.

Question 2.3: Do you agree that a modified cost of capital methodology should be used to calculate the risk margin?

14. The consultation paper says that 'the size and volatility of the risk margin could be reduced using a modified cost of capital methodology'; the BoE paper DP2/22 suggests that the modifications comprise: amending the cost of capital rate; and, introducing a new 'tapering parameter'. This approach therefore appears to have the benefit of consistency with the existing methodology and, presumably, the modifications are intended to have a predictable

[1] Institute and Faculty of Actuaries, A review of the risk margin– Solvency II and beyond, September 2019, p8.

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outcome. Indeed, it appears from DP2/22 that the modifications are calibrated to achieve a reduction in the risk margin of around 60% for long-term life business. We observe there are similar discussions on the risk margin in the context of their Solvency II review.

15. We appreciate that the policy objective is to achieve a size and volatility reduction – which the IFoA have called ‘primarily a political choice’ – and that the modifications are intended to achieve this. This being the case, the effectiveness of the changes will presumably be judged by the extent to which this is achieved. In the current rising interest rate environment the measures may have less of an effect than originally modelled.

Question 2.4: Is there any further information about actual transfer values of insurance risk that should be taken into account when finalising the calibration of the risk margin reforms?

16. We do not have any further evidence on this point.

Question 2.5: How could the Government be assured that resource that becomes available following a reduction in the risk margin would not be distributed to shareholders or used to increase remuneration to parties within the insurance firm?

17. Implicit in this question appears to be an assumption that the measure is intended to support growth in insurers’ balance sheets. The government has stated the benefits of regulatory freedom is to allow businesses to ‘spend more of their money investing, innovating and creating jobs’ and to ‘use long-term capital to unlock growth’. Reducing capital requirements should certainly provide additional capacity for growth. But it does not necessarily follow that it is desirable for all such capacity to be used for growth rather than being returned to shareholders as dividends. Dividend streams also benefit the UK economy – not least by enabling investment by other businesses who may have more productive opportunities. Provided that the capital is reinvested into the UK economy, and that there are appropriate and attractive investment opportunities in the UK, if an insurer does not have sufficiently remunerative growth opportunities within its risk appetite it may be optimal for it to return capital to shareholders.

18. We believe it is healthy and desirable for stakeholders to consider the optimum level of capitalisation and ICAEW is encouraging BEIS to move ahead with its planned incremental disclosures of distributable reserves. These are intended to enable investors to examine and compare capitalisation policies and take them into account in investment decisions. In the case of insurers, minimum levels of capital are already ensured through the prudential regime and incremental disclosures enable investors to assess headroom above this. We are therefore unsure what is implied by this question, as with the existing prudential and disclosure regimes already operating effectively, we cannot see what incremental measures could be desirable.

19. Nevertheless, it should also be noted that a reduction in regulatory capital requirements will not necessarily translate directly into additional reserves available for distribution. UK company law caps insurers’ distributions at the lower of a) a formula based on prudential requirements and b) the accumulated accounting profits. The risk margin does not affect the measurement of liabilities for accounting purposes and therefore changes to it will not affect accounting profits. The changes therefore will not necessarily increase the amount of distributable profits; what they may do is to increase the amount under part (a) of the lower-of test.

20. We would expect employee remuneration to be linked to performance and therefore productive growth opportunities should give rise to incremental remuneration within the

business. However, we are also conscious that executive remuneration linked to equity prices will benefit from actions that increase dividend capacity.

MATCHING ADJUSTMENT

21. The matching adjustment (MA) was designed such as to limit its use to a narrow range of long-term products with suitable characteristics within Europe, particularly annuities in the UK and Spanish insurance markets. For this reason, it was designed with a number of rigid constraints both on asset eligibility and calculation approach. As a result, although the MA is an important feature of Solvency II it does not provide the flexibility within the UK insurance market for insurers to invest in a broader range of suitable assets. ICAEW therefore supports the need to introduce greater flexibility in the MA.
22. We suggest that regulators continue to consult with industry participants regarding the initial complexities of restructuring portfolios and ongoing portfolio maintenance necessary to meet MA thresholds. This can be challenging for smaller and/or more specialised firms which are a critical component of the UK insurance market.
23. For insurers providing annuity products small changes in the fundamental spread can have significant impacts.

Question 3.1: Taking into account the fundamental spread methodology needing to be sufficiently responsive to changes in investment decisions and reflect long-term exposure to credit risks, do you agree with the above assessment that the current methodology does not:

- ***sufficiently address the risks associated with assets with the same credit rating but different market measures of retained risks; or take account of all the risks associated with holding internally rated or illiquid assets?***

24. We agree that the current methodology is intentionally designed to mute these effects. But the key policy question here is whether that is desirable or not; in other words, to what extent government believes the fundamental spread needs to be 'responsive'. As the fundamental spread is currently based on long-term averages that means it is relatively constant over time. That has benefits in terms of balance sheet stability, particularly in times of high stress when measures could otherwise be highly volatile. Indeed, in DP2/22 the PRA recognises that 'significant smoothing is desirable to prevent unwarranted balance sheet volatility'. That has a particular benefit for annuity product providers, where small changes in the fundamental spread can have a large impact. The trade-off, of course, is that it is not fully responsive to short-term changes in credit spreads.
25. We can see why regulators might prefer a model that was more responsive to credit risk. Such a model could increase capital buffers; to the extent that capital would rapidly need to be rebuilt as credit conditions changed. As portfolio level credit events may be systemic, that should provide a rapid response to economy or sector-level events. But is this consistent with the objective of the matching adjustment? The MA is focused on long term well cashflow matched assets and liabilities where the exposure is to defaults rather than short-term credit fluctuations.
26. Nevertheless, DP2/22 says that the fundamental Spread 'does not capture all retained risks' and 'as such is generally too low'. In making a final decision in this area, government will need to consider whether they agree that all retained risks should be captured. The proposal already recognises that the MA should include the part of the assets' value that represents the 'liquidity premium', as where assets and liabilities are matched this risk has a natural hedge. The question is whether the FS should include both expected loss due to default and the 'credit risk premium' as is proposed. The credit risk premium is a measure of current

credit conditions, and while it would be reflected in current asset values – may not directly affect cashflows, unless and until the asset is sold. For assets held to maturity, the holder may never be affected by the credit risk premium – being exposed only to the risk of default. Indeed, DP2/22 recognises that for annuity business it may be difficult to trade out of relatively illiquid assets – with exit on distress being achieved by 'transfer of the business to another insurer'.

Question 3.2: What is the impact of the fundamental spread including a credit risk premium of 25, 35 or 45% of spreads on life insurers':

- ***key balance sheet metrics including best estimate liabilities, own funds and the solvency capital requirements;***

27. All other things being equal, increasing the fundamental spread will mean that insurers will either need to hold more assets, to be able to meet their SCR (thereby reducing profitability), or will need to reduce liabilities (ie, shrink their business). It will also change the incentives for individual asset and liability decisions – for example incentivising away from assets with a higher credit risk premium. With the scope of the MA being extended to include additional assets, those considerations will apply to those too – eg. there will be a natural disincentive to hold assets that increase portfolio volatility. There will be benefits arising from managing actions if the two month timeframe for rectification is removed or lengthened as proposed.
28. With volatility being increased, insurers may feel they need to increase headroom above regulatory minimums, amplifying the effect of the measures.

- ***incentives to provide annuities;***

29. This depends on the approach in the round, including the level of longevity reinsurance as well as FS in particular and also whether the changes increase volatility to a level that might make annuities less attractive (for example if your MA benefit would rapidly decline in a crisis due to a sensitive FS / CRP that would not be attractive to management).

- ***annuity prices;***

30. Overall, an MA benefit reduction will result in increased annuity prices – all else being equal.

- ***investment in economic infrastructure, such as clean energy, transport, digital, water and waste;***
- ***investment to support the transition to net zero, either allocation of capital to support the development of new green technologies or to support adoption of green solutions; and***
- ***relative incentives to invest in different types of assets, including assets of different credit ratings and different risks, assets with different liquidity, assets that are internally or externally rated, and assets in different sectors?***

31. There are many factors that come into play when deciding what products to invest in and capital requirements are only one – the issue of availability of investments (supply side), knowledge, data, yields, expertise, matching potential, risk appetite, etc. While we might expect the industry to evolve to create products that can fit well with the MA, there may well be a reduction in investment opportunities due to the considerations above.

Question 3.3: What is the threshold for any increase in the fundamental spread above which adverse effects become significant, such as excessive balance sheet volatility or increased reinsurance of risks off-shore?

32. We do not have any evidence on this point.

Question 3.4: What is the impact on policyholder protection of a credit risk premium of 25, 35 and 45% of spreads, when accompanied by a risk margin reduction for long-term life insurers of 60-70%?

33. We do not have any evidence on this point.

Question 3.5: What is the impact of selecting an averaging period (n) of 0.5, 1, 2, 5, 10 and 30 years?

34. We do not have any evidence on this point.

Question 3.6: Are there other ways to achieve the same impact that changes to the fundamental spread would have?

35. We are not presenting any additional evidence in this section.

INCREASING INVESTMENT FLEXIBILITY

36. We welcome the Government's aim to create a prudential regime that would help the insurance sector to support the Government's objectives in relation to climate change and investment in infrastructure. We agree this needs to be balanced with the objective of a sound risk based prudential regime to sustain a high degree of policyholder protection.
37. There is certainly scope to review the asset eligibility rules for the matching adjustment to provide greater incentive to life insurers to invest in longer-duration ESG assets. We believe that more clarity from regulators regarding investment management expectations is necessary to facilitate the development of an optimal framework for investment in infrastructure and green assets.
38. We also urge the Government to develop an UK specific sustainable finance taxonomy that is linked to the prudential regime for insurers to support greater allocation of capital towards sustainable economic activities.

Question 4.1: What would be the impact of these reforms on insurers' use of the matching adjustment and investment:

- ***in economic infrastructure, such as clean energy, transport, digital, water and waste;***
- ***to support the transition to net zero, either allocation of capital to support the development of new green technologies or to support adoption of green solutions; and***
- ***in any other asset classes.***

39. The insurance industry could potentially make a significant contribution to the growing investment needs in these areas. The proposed changes ease regulatory barriers to investing in long-term assets where there is repayment risk and as such have the potential to support investment in infrastructure and the green transition. All other things being equal, including these assets within the Matching Adjustment would incentivise insurers to invest in them – however, we note that the proposals are that other things will not be held equal and therefore these decisions will be influenced by the effect of the changes to the fundamental spread.
40. It is increasingly being recognised that in itself natural capital has an insurance value as it can mitigate the effects of uncertainty on human well-being – for example the contribution of forestation to reducing flood risk. There is therefore a natural affinity between the insurance

industry and investment in some of these areas – although some have more direct impact than others.

Question 4.2: What are the additional risks that these reforms may pose to policyholder protection?

41. Allowing or encouraging investment in longer-term illiquid assets does by definition increase some risks, this balance is inherent in the policy objective. But such a balance is a natural part of balance sheet management and indeed also what a prudential regime is for. Indeed Solvency II itself and the Prudent Person Principle incentives for appropriate strong risk management.
42. Risk depends on whether safeguards and robust governance on MA remain – the reality is that some new asset classes might lack reliable data and therefore there will be more risk as a result, but the impact on policy holder protection will depend on how firms manage it.

Question 4.3: What safeguards are appropriate to protect policyholders from the risks posed by allowing a wider range of assets into matching adjustment portfolios?

43. Robust risk management and transparent governance and reporting are key safeguards against these risks.

Question 4.4: What impact will these reforms have on insurers providing a greater range and more affordable pricing of products?

44. Annuities and Life products are long-term in nature and therefore intuitively facilitating greater matching with long-term assets should be beneficial to the sector. Analysis by the ABI and KPMG[2] suggests that measures to enable the inclusion of a wider profile of assets in the matching adjustment would have a positive impact on annuity pricing. These changes therefore potentially have the dual public benefit of providing better value for annuity holders while at the same time enabling investment in infrastructure and the green transition. However, as noted above, if the MA benefit is reduced due to FS changes then it would not have the effect desired.

Question 4.5: What changes to the matching adjustment approval process are necessary to ensure that applications to use the matching adjustment are approved more quickly?

45. Where an asset is approved for one firm's MA, the PRA could capture assumptions to make the process easier for others planning to add the same asset to their portfolios. At present the admin burden is high, so simplifying the process and making it more proportionate to the risks would be welcome.

REDUCING REPORTING AND ADMINISTRATIVE BURDENS

46. The introduction of Solvency II led to a significant incremental increase in the level of reporting compared to the previous UK regime. The present suite of Solvency II reporting requirements is onerous and requires a lot of time and effort to complete and the extent to which it is fully utilised by the regulators is uncertain.
47. The HMT review of Solvency II provides an opportunity to reduce the size and frequency of the reporting burden to focus on those requirements most important to the regulator. The opportunity should be taken to carefully consider whether over the last four years the data supervisors have been receiving (as required by Solvency II) had provided the relevant

[2] KPMG report for the ABI; Report on economic impacts of potential changes to insurance regulatory framework in response to HM Treasury Review of Solvency II:Call for evidence; https://www.abi.org.uk/globalassets/files/publications/public/regulation/kpmg-report-on-macro-economic-impacts-of-potential-regulatory-changes-from-solvency-ii.pdf

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information and whether the same supervisory determinations could be reached in the absence of such data. The auditability of data should also be considered.

48. The trade-off between flexibility and comparability might allow for more alignment of regulatory reporting with firms' own management information. Following proportionality, the regulator could reduce reporting frequency and granting waivers and help with challenges around deadlines.

49. While designing the overall regulatory approach it would also be beneficial to take the following areas into account:
    - IFRS 17 implementation and interaction
    - EIOPA's review of Solvency II
    - Integration of climate change risk information

Question 5.1: What is the impact of these reforms on regulatory costs incurred by insurers?

50. We welcome efforts to reduce the regulatory reporting burden on insurers. The consultation paper does not set out the detail of the reporting changes envisaged and we await further consultations including the second phase of a PRA consultation on reporting. At this stage we would like to suggest some principles that HM Treasury may apply in taking forward the reforms:
    - Start small first – ideally templates would start from universal requirements and build up from there to supplementary information for more complex firms.
    - The PRA should review and analyse which information they are using, why and for what outcome - to enable a proper consideration of what can be removed;
    - Any information that is not frequently used by the regulator should be discontinued;
    - For data that has been frequently accessed it should be asked what purpose it serves;
    - International regulatory cooperation should help optimise reporting requirements – if other regulators are not requiring a particular disclosure, what can be learnt from this?
    - Reforms should consider not only the number of templates to be submitted, but also their frequency – the review should go beyond the templates. Duplication should be identified and removed;
    - Individual columns and fields within templates should also be reviewed. There is a concern that the regulator might introduce additional data fields to some templates;
    - While individual requirements may not add much, government needs to look at the whole cost of reporting in the round;
    - Timing of quarterly and annual reporting should be sensitive to pressures on reporting teams (e.g. Q1 reporting is due within 4 weeks of annual reporting);
    - Changes should be limited to those that are necessary or which provide a recognisable simplification as adjusting to change also comes at a cost.

51. Implications for auditing should also be considered. Under Solvency II, there are thresholds which apply to the UK audit requirements for the SFCR. However, there are no equivalent audit thresholds for regulatory reporting for firms reporting under the UK non-Solvency II regime on thresholds for application of Solvency II.

52. We also make these recommendations regarding specific reporting requirements:
    - Reporting requirements around the internal model have potential to be the biggest source of efficiency savings. However, introducing additional safeguards to the framework may increase reporting requirements – for example in relation to approval conditions, capital add-ons and exposure limits. There should be appropriate controls surrounding the use of any additional safeguards to ensure that they are only used where it is demonstrably necessary. The changes need to be looked at in the round,

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applying the principles above, with the additional prudential benefit achieved weighed against the cost of compliance.

- SFCR / RSR Update – as these documents largely repeat or reference information provided in the annual ORSA report and other documentation already provided to the PRA, the PRA could perhaps consider removing this reporting requirement for UK companies thereby reducing the cost and other burdens associated with these documents.

Question 5.2: What would be the impact of removing capital requirements for branches of foreign insurers operating in the UK, both on existing branches and on the decision to establish new branches?

53. We can see why government wishes to take steps to ease requirements for third country insurers to establish branches in the UK. Access to London markets is important for European insurers and it can be expected to be attractive to establish a branch in the UK now that passporting rights no longer apply. Measures to encourage the establishment of branches can be mutually beneficial to London markets and to the European insurers accessing them. However, there is the potential for this to lead to regulatory arbitrage and therefore safeguards are necessary to ensure appropriate policyholder protection and a level playing field. Comparability of home supervisory regimes should also be taken in consideration.

54. Moreover, foreign insurers would still need to meet home state capital requirements for their worldwide operations and therefore this may not have significant implications for foreign insurers from a capital perspective. In order to maintain the same level of UK policyholder protection the PRA might need to increase the level of supervision of UK branches where home state capital requirements are considered less onerous than UK ones.

Question 5.3: What would be the impact of a new mobilisation regime for insurers and changes to thresholds at which Solvency II applies on:

- ***businesses currently considering whether to become an authorised insurer; and***
- ***small insurers' ability to expand before Solvency II applies?***

55. It appears inefficient to have three different UK regulatory regimes for insurers (small insurers, friendly societies and Solvency II). It may be more effective to have one regime and apply proportionality in its application.

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