July 2023

Dive into pensions de-risking

The insurance regulator issues its latest consultation on Solvency UK

On 29 June 2023 the Prudential Regulatory Authority (PRA) published its latest consultation paper on the operational aspects of the Solvency II review

Background

Recap of proposals to date

In November 2022, the Government published its response to a consultation regarding UK insurance reforms following Brexit. It announced a new “Solvency UK” regime, the key changes being:

- A reduction in the **risk margin**, a component of insurance capital that was introduced with Solvency II and is prominent for annuity business.
- Reform of the **matching adjustment** requirements, in particular increase flexibility for eligible assets.
- Simplifications and **reduced reporting requirements** to ease cost and burden on insurers.

What’s in this consultation?

This consultation focuses on the aspects of Solvency II that the Government is not proposing to legislate directly. It is primarily aimed at making processes and approvals simpler and more efficient for insurers, reducing reporting burdens and costs without impacting regulatory standards. As expected, this consultation does not focus on the more quantitative elements of Solvency II reform – a further consultation is anticipated in September covering these aspects. The key areas of simplification outlined in this consultation are:

- **Streamlined rules for Internal Models** – the current regime set a high bar for approval or updates to Internal Models (essentially the models which govern each insurer’s capital requirements), which creates significant work for both insurers and the PRA. The consultation introduces more flexibility and streamlines the tests and standards required. It also introduces a range of safeguards such as permitting the PRA to increase capital requirements on a case by case basis where they view insurer models as being limited.
- **A new ‘mobilisation’ regime** – aimed at facilitating competition in the insurance sector by allowing new insurers additional time to establish themselves whilst operating with more proportionate regulatory requirements during mobilisation.
- **Streamlining and removal of reporting requirements** – these changes should come with reduced costs and reporting burdens for firms. The proposals include a simplified calculation for transitional protection (a grandfathering of the previous solvency regime that has been running off since 2016), which has until now required insurers to maintain pre-2016 capital models at significant cost.

Next steps

The consultation sets out a clear timeline for the reforms:

Risk Margin – A draft Statutory Instrument was published by Treasury in late June re-confirming the proposals outlined in November 2022 that a reduction of around 65% to the risk margin would apply (for annuity writers). The final Statutory Instrument and necessary changes to bring PRA rules into line are expected in Q4 2023.

Matching Adjustment – the PRA is expected to issue an additional consultation in September this year setting out more granularity on the approach to asset eligibility and associated capital requirements. Any outcomes from the consultation are expected to come into force by the middle of 2024.

Reduced reporting requirements – responses to this consultation are expected ahead of 1 September 2023, with the final policy being published in early 2024 and updated reporting being in effect for the 2024 year end.

In summary

The consultation paper contained few surprises. There's plenty of detail to be worked through but the industry has been keen to see reform to many of the areas covered, so we expect these proposals to be generally well received. For pension schemes, the consultation in September is likely to be of greater consequence, but there could be some marginal benefits from this particular consultation, including:

- Supporting additional competition in the bulk annuity market by making it easier for new market entrants – although we note that the proposed mobilisation regime appears to be of greater value to general insurers rather than life insurers, somewhat curbing the potential;
- Facilitating the speed of innovation in the buy-in and buy-out market through simplification of Internal Model approvals, which can be required when new products or product features are introduced;
- Increased market efficiency as a result of streamlined rules and reduced reporting requirements .

Should the changes to the risk margin pass through to legislation and into the PRA rulebook as expected this year, some insurers will see a capital release at year end 2023, which will increase their solvency capital requirement coverage ratios (often used as a key indicator of financial strength). However, these proposals are not expected to impact insurers' requirements to use longevity reinsurance for new business and therefore bulk annuity pricing is not expected to be affected.

Get in touch

If you have any questions about anything covered, please don't hesitate to get in touch.

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