Review of Solvency II update: Policy Statements 2/24 and 3/24

Summary of key aspects

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In February 2024, the Prudential Regulation Authority (PRA) published the first two sets of rules expected to be published during 2024 as part of its ongoing Solvency II review[1].

The rules include Policy Statement 2/24 Review of Solvency II: Adapting to the UK insurance market (PS2/24), and Policy Statement 3/24 Review of Solvency II: Reporting and disclosure phase 2 near-final[2] (PS3/24). The PSs will come into effect on 31 December 2024.

The second set of rules is expected to be published in June 2024.

The reforms under the Solvency II review are being delivered through a combination of the Financial Services and Markets Bill (FSM Bill), HMT's Statutory Instruments (SIs) and changes to the PRA's rules and policy.

Reforms to the Risk Margin have been in force since 31 December 2023, through the HM Treasury's reforms to Solvency II.

The proposed changes to the PRA's rules and policy were published during 2023, as the following consultation papers (CPs):

- CP12/23 Review of Solvency II: Adapting to the UK insurance market, published in June 2023, which set out the majority of PRA's reform proposals, focused on simplification, improving flexibility and encouraging market entry;
- CP19/23 Review of Solvency II: Reform of the Matching Adjustment, published in September 2023, covered the second set of proposed reforms to Solvency II in the UK relating to the matching adjustment (MA).

Milliman has previously produced summary papers on the proposals set out in CP12/23 and CP19/23.

In 2022, the PRA also published CP14/22, which set out the proposed changes to the reporting and disclosure requirements.

PS2/24

Like CP12/23, PS2/24 is relevant to UK Solvency II firms, the Society of Lloyd's and its members and managing agents, insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings), and UK holding companies with insurance or reinsurance subsidiaries.

PS2/24 contains the PRA's final policy in the form of near-final rules and updated near-final policy materials, including supervisory statements (SSs) and statements of policy (SoPs) - a full list is show in Appendix 1 of PS2/24.

PS2/24 provides the PRA's feedback to responses received to the following chapters of CP12/23:

- Chapter 1 – Overview
- Chapter 2 – Transitional measures on technical provisions (TMTP) and the risk-free interest rate
- Chapter 3 – Internal Models (IMs)
- **Chapter 4 – Capital Add-Ons (CAOs)**
- **Chapter 5 – Flexibility in calculating the Group SCR**
- Chapter 6 – Third-country branches
- **Chapter 8 – Mobilisation**
- Chapter 9 – Thresholds
- Chapter 10 – Currency redenomination.

Note: Chapters for which PS2/24 introduced material changes compared with CP12/23 are shown in bold.

A summary of key proposals included in CP12/23 in relevant chapters is below:

- Chapter 2 – TMTP and the risk-free rate introduced simplifications and process improvements to the calculation of TMTP.
- Chapters 3 – Internal Models and Chapter 4 – Capital Add-Ons introduced a new, streamlined set of rules for IMs,

[1] In oral evidence given on 7 February 2024 to the House of Commons, the PRA announced that the first two sets of Solvency II rules will be published by end of February, with the remaining set of rules (related to Matching Adjustment) expected to be published in June.

[2] As explained in Paragraph 1.35 of PS3/24, while PS3/24 contains the PRA's final policy, the related rules and policy materials are considered near final due to the potential for further changes. The PRA expects such changes to be limited.

where they are used by insurers to calculate their capital requirements.

- Chapter 4 – Capital Add-Ons introduced a Residual Model Limitation capital add-on (RML CAO) which addresses an IM residual deviation in the risk profile of a firm from the assumption underlying the Solvency Capital Requirements, where the deviation is not considered significant.

  The requirements in CP12/23 meant firms were required to disclose any CAOs set by the PRA and any RML CAO. The requirements also proposed that PRA would publish regular reports at an aggregate industry level summarizing its use of CAOs.
- Chapter 5 proposed additional flexibility in the calculation of the minimum solvency requirements for insurance groups.
- Chapter 6 removed certain requirements for branches of international insurers operating in the UK.
- Chapter 8 introduced a new 'mobilisation' regime to facilitate entry and expansion for new insurers and to facilitate competition.
- Chapter 9 introduced an increase in the size of thresholds beyond which small insurers are subject to the Solvency II regime.
- In Chapter 10 it was proposed to redenominate monetary values within the Solvency II firms section of the PRA Rulebook from EUR to GBP, using the average daily GBP/EUR spot exchange rate covering the 12-month period prior to 31 December 2020.

The most material changes made in PS2/24 include:

- Chapter 4 – Capital Add-Ons
  - The removal of the proposed requirement for firms to disclose RML CAOs and removal of safeguards (including RML CAOs) from the PRA's regular aggregate report on CAOs;
  - Allowing explicitly for the possibility of setting a CAO which moves dynamically in line with certain outputs calculated by a firm, in order to reflect how the underlying risk deviation varies over time (e.g. due to changes in the business and economic conditions). This may benefit firms in mitigating the need for as frequent reviews of CAOs.
- Chapter 5 – Flexibility in calculating the group SCR
  - Allowing an insurance group up to six months after an acquisition to create a clear and realistic plan to integrate any internal models, amending the proposal that required this plan at the point of acquisition, and a two-year period thereafter to implement this plan.
- Chapter 8 – Thresholds
  - Increasing the threshold for gross written premiums above which a firm enters Solvency II to £25 million, a further increase of £10 million compared with the CP12/23 proposals.

Other changes introduced in PS2/24 are clarifications related to internal models, such as regarding negative model limitation adjustments (MLAs) and confirmation that MLAs are not expert judgments, and that splitting or combining risks already within firms' internal model scope or adding risks which fall within the sub-modules of risks already within the scope of internal models may not necessarily amount to including new risks in internal models.

PS3/24

The PRA also published its Policy Statement 3/24 (PS3/24) which covers the changes to the reporting and disclosure requirements under Solvency II. This policy statement provides feedback to responses to consultation paper CP14/22 and Chapter 7 of CP12/23, and sets out the PRA's final reporting and disclosure policy. PS3/24 builds on PS29/21 – Review of Solvency II; Reporting (Phase 1); Milliman has previously produced a summary of this policy statement.

Proposals set out in CP14/22 aimed to streamline the reporting requirements, where the current disclosures have limited prudential value, or the PRA can use information reported through other templates or disclosures. The proposals in the consultation included the following:

- Removal of the requirements to complete a number of Solvency II Quantitative Reporting Templates (QRTs), the directly associated disclosure templates, and the relevant PRA's National Specific Templates (NSTs);
- Reduction of the reporting frequency of certain templates from quarterly to either semi-annually or annually;
- Consolidation of a number of reporting templates covering the same reporting topics into new templates;
- Introduction and amendments to reporting proportionality thresholds for certain reporting and disclosure templates;
- Amendments to existing reporting and disclosure templates;
- Introduction of three templates covering new reporting topics – excess capital generation, cyber underwriting risk, and non-life obligation analysis; and
- Amendments to the expectations set out in certain PRA SSs to:
  - reflect the above proposed reporting changes;
  - transfer some expectations contained in a SS to the reporting instructions; and
  - clarify references to EU provisions following the UK's withdrawal from the EU.

Further PRA proposals to amend reporting and disclosure requirements were set out in Chapter 7 of CP12/23; those were summarised in the Milliman briefing note on CP12/23.

To briefly recap, the consultation set out changes to the way firms report and disclose the information required by the PRA. The Regular Supervisory Report (RSR) would no longer be required; the view of the PRA being that other proposed changes set out in the consultation paper would make the RSR less important when it comes to the supervision of insurers.

The PRA aimed to set out clearly what would be required to be submitted for different types of entities (for example separating out pure reinsurance branches and other third-country branches). The intention was to have an overall net reduction in the templates submitted.

Other proposed changes to reporting and disclosures include the below:

- Changes to the methods used to determine the group SCR;
- Simplifying reporting to allow for the changes to the calculation of the TMTP;
- Replacing templates to improve the way BEL subject to the Volatility Adjustment is reported;
- Changing the way IM and partial IM changes are reported;
- New template to report on the quantitative impact of the SCR between each financial year-end;
- Changing the templates on IM output reporting to include more granular data;
- Minor amendments to existing asset reporting templates;
- Changes to the Solvency II balance sheet reporting including details of the Matching Adjustment portfolios;
- Limiting the requirement to report on best estimate assumptions for life insurance risks; and
- Minor changes to the reporting requirements on business model analysis for financial guarantee insurers.

The PRA collected the feedback on the proposals, and the summary of the feedback is included in PS3/24. It states that most respondents were supportive of the PRA's aims to review the stock of EU-derived and PRA insurance reporting.

The final policy largely includes the proposals outlined in the consultation, with some amendments. The changes mainly include not introducing some of the proposed templates, introducing simplified versions of others and simplifying versions of some existing templates.

Appendix 6 to the statement provides a mapping of reporting and disclosure template names with the description of whether it is amended (27 templates), has amended instructions (12), is deleted (36), is a new template (17), or there is no change (34).

Appendix 7 includes a more detailed commentary on the changes to templates.

In addition to the proposals set out in consultations, the PRA has also made a few presentational changes to the near-final rules to enhance the readability of the reporting and disclosure requirements; these do not impact the substance of the rules.

How Milliman can help

Milliman consultants have extensive experience with Solvency II and its operation in the UK and are well placed to understand the proposals and the implications for insurers.

Milliman can provide tailored assistance and advice on how these proposals can impact individual firms, navigate the proposed changes and provide modelling assistance if required.

Milliman is also able to assist in formulating responses to the policy statements, considering the specific need of a firm.

Please get in contact with your usual Milliman consultant if you wish to discuss further.

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