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Response to CP 11/22: Transposition of Solvency II Part I

Dear Eleanor,

This letter and the appendix, set out our written comments on the Consultation Paper (CP) 11/22 published in November 2011 (the 'consultation').

We welcome your consultation on the rules to transpose the requirements of the Solvency II Directive ('the Directive') into UK law and broadly agree with your 'intelligent copy-out' approach to transposition. We respond to the specific consultation questions in the Appendix to this letter.

In particular, we welcome the fact that the FSA is consulting now, before the changes arising from Omnibus II have been finalised and before the publication of the Level 2 measures. Whilst this will necessitate further consultations, and possible amendments to the proposals in this consultation, we believe it is imperative that all stakeholders have as much clarity as possible as to how the requirements of Solvency II will be implemented. The ongoing delays in the finalisation of Omnibus II are unwelcome and we believe it would be beneficial if the expected content of Level 2 and Level 3 measures, and how they will be implemented by Member States, are made available to all stakeholders without waiting for the finalisation of Omnibus II.

One area where we would welcome clarification at an early stage is the potential for an audit requirement over Solvency II reporting (as referred to at paragraphs 12.2 and 12.6 of the CP). This is a matter that has previously been discussed in consultations by CEIOPS[1] and the European Commission[2] and it is regrettable that there is still no clarity of what, if any, requirements will exist in this area. If this is a matter that is to be left at the discretion of Member State supervisors then we encourage the FSA to bring forward its proposals at the earliest opportunity. As we set out in our response to the European Commission, we believe that audit is a valuable tool to provide confidence to the users of reported information, both for supervisors and for the public and other stakeholders, and

[1] Consultation Paper No. 58: Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Supervisory Reporting and Public Disclosure Requirements

[2] Consultation document on the Level 2 implementing measures for Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

we would therefore support a requirement for undertakings to obtain external assurance over a subset of the reported information.

Paragraph 2.3 of the CP notes that it is expected that Level 2 will apply directly to firms and therefore will not be subject to FSA consultation. As set out in paragraph 5.4 of the CP this will mean that the rules in the FSA Handbook transposing the Directive will need to be read alongside the Level 2 legislation. Arguably, it would aid clarity if all Solvency II's requirements were contained in a single source and so we believe FSA should consider whether it is possible to incorporate the Level 2 requirements applicable to firms into the FSA Handbook (without amendment or consultation). In any event we believe there should be a mechanism for the FSA to provide guidance, where necessary, on the application the Level 2 in the same way as it has in the 'intelligence copy-out' approach to the Directive. If it is not proposed to incorporate Level 2 into the FSA Handbook, it should be clarified how the rules will be interpreted and enforced in practice; in particular:

- How will any Member State options contained in Level 2 be dealt with?
- Where appropriate, will FSA give individual guidance on the interpretation of Level 2 in accordance with the provisions of SUP 9?
- Will the requirements of Level 2 be subject to the same enforcement regime that applies to the requirements of the FSA Handbook?

If you have any queries on the content of this response please contact Mike Vickery (0117 923 4222).

Yours sincerely

PricewaterhouseCoopers LLP

Appendix – responses to specific consultation questions

Chapter 3 – Approach to consultation

Q1: We welcome views on our approach to the overall consultation process proposed to transpose Solvency II: a first consultation (CP1) on the Directive requirements that have most certainty at this stage in the European process, followed by a second consultation in 2012 (CP2) once there is more certainty on Omnibus II, levels 2 and 3 and the UK legislation has been finalised.

We welcome your consultation on the rules to transpose the requirements of the Solvency II Directive ('the Directive') into UK law and broadly agree with your 'intelligent copy-out' approach to transposition.

In particular, we welcome the fact that the FSA is consulting now, before the changes arising from Omnibus II have been finalised and before the publication of the Level 2 measures. Whilst this will necessitate further consultations, and possible amendments to the proposals in this consultation, we believe it is imperative that all stakeholders have as much clarity as possible as to how the requirements of Solvency II will be implemented. The ongoing delays in the finalisation of Omnibus II are unwelcome and we believe it would be beneficial if the expected content of Level 2 and Level 3 measures and how they will be implemented by Member States are made available to all stakeholders without waiting for the finalisation of Omnibus II.

Chapter 4 – Approach to transposition

Q2: Do you have views regarding the clarity of our rules included in CP1, bearing in mind the limited scope for discretion?

We set out below our comments on the proposed transposal:

SOLPRU rule reference	Comment
N/A	The Articles detailed in Article 309 of the Directive are required to be transposed into UK law and regulation. Some of those Articles are dealt with in this CP, some are dealt with in the recent HM Treasury Consultation on Solvency II whereas others have not yet been consulted on. We note that paragraph 3.6 of the CP indicates that the transposition of some further Articles will be consulted on by FSA in CP2. However, to ensure there is clarity as to the completeness and location of transposition, it would be helpful if FSA (in conjunction with HM Treasury as appropriate) set out a full mapping of how it is proposed that all the Articles listed in Article 309 are to be transposed into UK law and regulation. In addition, whilst Article 168 is not itself required to be transposed, it does apply the requirements of certain other Articles to branches of non-EEA insurers which are not addressed in this CP. It should be confirmed that the application of these requirements will be dealt with in CP2.

2.3.1 Technical provisions	The rule refers to "adequate" technical provisions, this adjective is not in the Directive. It is not clear why the FSA considered including this addition necessary or how it should be interpreted by users. We suggest deletion of this word.
2.4.11 R (1)	SOLPRU 2.4.1.R should read SOLPRU 2.3.1 R to ensure that the requirements transposed from Article 76 are within the scope of this rule (as required by Article 81)
3.2.2 R (1)	Consistent with the wording of Article 88, it should be stated that the excess of assets over liabilities should be valued in accordance with SOLPRU 2.2 – 2.4.
4.3.3 R (1)	It is unclear why the following requirement of Article 101(3) has not been transposed in respect of the standard formula: (3): *"It shall cover existing business, as well as the new business expected to be written over the following 12 months. ...."*. When dealing with internal model, SOLPRU 4.12.1 R(2) transposes this passage but its application is not limited to the internal model.
4.7.1 R	The requirements of Articles 106(2) and 106(3) have not been transposed. Whilst it is expected that detailed requirements will be set out at Level 2, it would appear appropriate to transpose those requirements that are set out in the Directive.
4.16.1R	SOLPRU states: *"A firm with internal model approval must not change its internal model otherwise than in accordance with the firm's internal model change policy."* Directive Article 115 states: "*...undertakings may change their internal model in accordance with that policy ..."* but does not strictly preclude changes that are not in accordance with the policy, although it is explicit that such changes require prior supervisory approval. As such we suggest the words, "Absent prior supervisory approval ..." are added to the start of this rule.
4.21.3R	SOLPRU states that a *firm* must ... However the obligation in the Directive (Article 120 last paragraph) is placed on "*The administrative, management or supervisory body ..."* and it would appear appropriate for

	the transposition to reflect this.
6.4.1R	This rule should be disapplied to any insurer falling within 6.6.1R (as Article 131, on which 6.6.1R is based contains a derogation from Article 139, on which 6.4.1R is based).
6.6.2R and 6.6.3R	These requirements do not stem from the Directive. It should be clarified that these requirement are consistent with the maximum harmonisation requirements.
11.9.5G	It is assumed that the actual requirements of Article 257 (which require Member States to impose requirements on those effectively running insurance holding companies) will be separately transposed.

Chapter 7 – The Solvency Capital Requirement (SOLPRU4)

Q3: Do you agree with our approach to the Member State option outlined in Article 304?

We believe that the fact that there is currently little or no UK business that meets the criteria to apply the 'equity dampener' is not, in itself, a reason to justify the preclusion of its use, as such types of business could be written in the UK in the future.

The FSA also notes their view that the treatment permitted under this discretion does not fully reflect the equity risks to which UK life insurance business is exposed. However, it is possible that the nature of UK life insurance business may develop over time. An absolute preclusion of the option provided in Article 304 of the Directive could be detrimental to UK business in future and put it at a disadvantage in the European market.

Given that the use of the equity dampener under Article 304 requires supervisory approval, we believe it would be more appropriate for the FSA to consider applications for its use on a case-by-case basis, balancing the need for regulatory prudence with the desirability of achieving a 'level playing field'.

Chapter 8 – The Minimum Capital Requirement (SOLPRU5)

Q4: Do you agree that we should exercise the case-by-case option in Article 129(3), for example when the internal model result has temporarily deviated from the risk profile for the firm and the standard formula is a better fit? Do you have views on any other situations where it would be appropriate to use this option?

We believe it is acceptable for the FSA to give itself the option allowed for under Article 129(3). We have not identified any circumstances for its use other than the one set out in the consultation.

Chapter 11 – Composites (SOLPRU8)

Q5: Do you agree with the approach suggested in this Chapter in relation to separate management of life and non-life business for composite firms?

We believe the disapplication of the concept of the long-term fund is appropriate for the reasons set out. We note that this concept is used in the definition of distributable profits of a long-term insurer in the Companies Act 2006. Whilst the definition of distributable profits is not a matter for the FSA, we

would encourage FSA to raise this matter with the government to ensure that proposed amendments to company law are developed alongside the FSA's proposals rather than waiting until the FSA finalises its rule changes.

Q6: Do you have any further comments on our proposals for the Handbook rules relating to composite firms?
Our comments on the drafting of the rules are set out in our response to Q2. We have no further comments on the rules relating to composites.

Chapter 12 – Conditions governing business (SOLPRU9)

Q7: Do you consider that the APR is the appropriate method for us to implement the Article 42 requirements regarding receiving notifications and making assessments on personnel?
Yes.

Q8: Do you agree with our approach to assessing third party providers where a key function has been outsourced?
It appears reasonable to exclude such assessments from the APR for the reasons set out. It is not possible to comment further on the approach as no further details are set out.

Chapter 14 – Groups (SOLPRU11)

Q9: Do you agree with the way we are proposing to exercise the Member State option in Article 227?
Yes. If third countries have been assessed as equivalent, we believe it is appropriate for local rules to be used when calculating the SCR under the deduction and aggregation method ('method 2').

Q10: Do you agree with the way we are proposing to exercise the Member State option in Article 225?
Where the deduction and aggregation method ('method 2') is applied we believe it is appropriate for home Member State rules to be used in the calculation of the SCR and own funds.

However, when an accounting-consolidation based approach ('method 1') is adopted, it is unclear how this Member State option would be applied in practice. The accounting-consolidation based approach is based on consolidated accounts and so it would appear natural to apply a single set of requirements to these consolidated accounts. It is unclear how, in practice, individual Member State rules would be applied to the individual undertakings in varying Member States under an approach that is based on a consolidation as opposed to an aggregation.

Chapter 16 – SUP 10

Q11: Do you agree with our proposed approach to those currently approved for CF28 because of their finance responsibilities? Or do you think one of the alternative options discussed above would be preferable?
We have no comments on this question.

Annex 1: Diversity Impact Assessment

Q12. Do stakeholders agree with our findings of this Diversity Impact Assessment?
We have no comments on this question.