Review of Solvency 2

PRA is taking forward its review of Solvency 2. This draws on the review undertaken by EIOPA over recent years, and the more recent post-Brexit review by HM Treasury. The consultation issued by Treasury and an accompanying discussion paper from PRA on 28 April take the review forward, and Treasury has suggested that the reforms could result in a release of 10 to 15% of life insurers' capital.

The proposals are reported to reduce the Risk Margin by 60% or more for life offices, and 30% for non-life insurers. This will be partly offset by making the Fundamental Spreads more sensitive, thereby reducing the Matching Adjustments. There are also changes to Internal Model approval, and reporting requirements.

The Treasury consultation has only limited coverage of proportionality: there is no proposal to review the standard formula, and it is proposed that the threshold for Solvency 2 is increased, to £10M, compared to the current £5M. However, the increase in threshold compares to EIOPA's proposal to increase the threshold to £25M, and Treasury proposes the higher threshold only applies to new insurers and those below the current threshold. This would offer little prospect of the improvement in competition that Treasury suggests will emerge: only one AFM member is at danger of exceeding the Solvency 2 threshold, and other rules stand in the way of new insurers seeking authorisation.

The PRA's stated ambition, in its 2022/23 Business Plan, is to ensure the regime better reflects the 'products supplied and the risks faced by the UK insurance sector'. As well as the activities described above, with regards to simplification of the regime, Business Plan states:

> *"the PRA will pursue initiatives to enhance competition by simplifying and expediting the authorisations process, consulting on a mobilisation regime that will reduce barriers to entry for new retail firms, and raising thresholds for the application of Solvency II requirements. After the completion of the government's current review of Solvency II, the PRA will also consider the case for a simpler regime for smaller insurers and friendly societies."*

In our responses to past Treasury and PRA consultations, we have called for a significantly higher threshold for Solvency 2, but to retain the value invested in meeting Solvency 2 standards for those that fall below any new threshold. We have highlighted how the current regime has acted as a barrier to entry. The final sentence of the extract above offers hope that PRA will explore these issues further, but the indication that this will wait until after the current review leaves uncertainty as to how quickly this will happen.

PRA held an online meeting with AFM members in March, to better understand their priorities for reform. The regulator also issued a qualitative and quantitative survey to insurers in April, designed to better understand the costs of regulatory reporting, and to inform a future cost-benefit case. AFM is writing to members to encourage their participation.

In 2016, AFM undertook work with a group of fund managers, members, and the largest rating agencies, to explore how members could most effectively use rating agency data to inform their regulatory returns. We have recently reviewed the resulting note, and the latest version is attached.