By email to: Solvency2Review@bankofengland.co.uk

Prudential Regulatory Authority
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AFM Response to PRA Discussion Paper on potential reforms to the risk margin and matching adjustments within Solvency 2

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

   - Comment on the proposals, and their consequences for members of AFM.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of over £20 billion, and employ nearly 30,000 staff[1].

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses[2] and to take account of corporate diversity[3].

[1] ICMIF, https://www.icmif.org/publications/market-insights/market-insights-uk-2016 with updates from EY and AFM
[2] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted
[3] http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted

AFM comments on the proposals

4. We welcome the Government's and PRA's review of Solvency 2. Overhaul of the regime is overdue, and whilst the Solvency 2 Directive has provided a vital safeguard during uncertain times, and avoided any significant failures amongst UK insurers, it has come at a significant cost to the efficiency and capacity of the UK insurance sector.

5. We have responded to the Treasury consultation in full, and a copy of our response is attached. We are making only a limited response to this paper since, as we set out in our response to Treasury, the issues currently being debated have less impact on AFM members than for non-mutuals. The decision to defer issues that would produce a more proportionate regime for mutually owned businesses is very disappointing, as is the slow pace of reform in the UK compared to the EU. We note that the paper lists some of the other planned reforms, but makes no commitment on timescales.

6. In general terms, we support the arguments produced by the ABI in its previous assessment of the reforms[4]. Our additional comments are:

    a. The changes to the risk margin will offer a welcome change for many life insurers offering long-term products. In other cases, the raw proposals in the DP could be detrimental: we discussed this with PRA in April, who indicated it was not their intention to 'leave anyone behind'.
    b. OAC's analysis for AFM of the changes to the risk margin for AFM members estimate there might be up to £150m of capital released[5]. Whilst that is welcome, it is much more modest than the headline figure of 10% to 15% adopted by PRA. It is also, as we understand, some way short of the expected reduction in the risk margin proposed in the EU. It should not therefore be assumed that balancing amendments, either via the FS or otherwise, are a necessity.
    c. We note PRA indicates a 60% reduction in the risk margin, coupled with 'an FS with a CRP equivalent to at least 35% of credit spreads', would deliver a package 'within the potential ranges noted in HMT's consultation'. However, it is not clear what the source of this assessment is, and how tolerant it is to different sizes of business, and different products. We suggest PRA produces greater evidence to support its conclusions. In any event, as AFM members were unable to take advantage of

[4] https://www.abi.org.uk/news/blog-articles/2021/12/our-industrys-purpose-is-to-protect-people/
[5] https://financialmutuals.org/wp-content/uploads/2022/07/SFCR-Analysis_2021-1.pdf

matching adjustments, the level of the FS will have no direct bearing on our members.

7. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Martin Shaw
Chief Executive
Association of Financial Mutuals