Information note for Life HoAF's on the question of the Life Assurance Fund under Solvency II

Background

Following the transition to Solvency II, the concept of the 'Life Assurance Fund' still exists (for Irish life assurance undertakings only) – Articles 14 and 15 of the Insurance Act 1989 ("the 1989 Act"), which introduce this concept, were not repealed following the move to Solvency II.

Articles 14 and 15 of the 1989 Act are set out in the Appendix to this note. In summary, Article 15(2) states that assets may only be taken out of the Life Assurance Fund following an actuarial investigation. This restriction can, therefore, have implications for life assurance undertakings' ability to pay dividends in situations where undertakings wish to distribute an amount which exceeds the amount of the assets held outside the Life Assurance Fund.

In addition, the Companies Act 2014 references the 'Life Assurance Fund' in respect of realised profits of assurance companies. The relevant text is included in the Appendix to this note.

The "actuary" was, therefore, given a statutory role/responsibility in this area under Solvency I. The question is: what are actuaries/undertakings supposed to do in this regard in practice, following the transition to Solvency II?

Purpose/status of this note

As the 'Life Assurance Fund' is a uniquely Irish construct (although there are parallels with the old UK regime), there is no mention of this issue in any of the EU-wide Solvency II texts, guidance or Q&As.

However, somewhat strangely, there is also no mention of how it should be treated under Solvency II in Irish texts either – there is nothing in the Statutory Instrument that transposed the Solvency II Directive into Irish law, nor is there any reference to it in any CBI publication (including the CBI's paper setting out what it terms the 'Domestic Actuarial Regime' or "DAR").

The purpose of this note is twofold:

- to make actuaries aware of this issue; and
- to provide the Life Committee's views on it.

Depending on whether or not the CBI issues further guidance on this topic, it is possible that the Society may develop formal guidance for its members (noting, however, that Heads of Actuarial Function of Irish life assurance undertakings may not necessarily be members of the Society).

This note attempts to address the following questions:

- Who is ‘the actuary’ for the purposes of the relevant requirements in the 1989 Act?
- How should the actuary establish the surplus/deficit in the Life Assurance Fund under the Solvency II regime?
- What governance/documentation should be put in place around the process?
- What additional items should the actuary consider with respect to the Life Assurance Fund?

Who is ‘the actuary’?

Article 15(3) refers to an “actuarial investigation” and “the abstract of the actuary's report”, both of which referred to the Appointed Actuary under Solvency I.

Under Solvency II the position of the Appointed Actuary no longer exists. However, every life assurance undertaking must appoint a Head of Actuarial Function (“HoAF”).

The CBI’s Domestic Actuarial Regime is silent on this exact point, but it would seem reasonable to assume that the HoAF assumes the role of “the actuary” for this purpose under Solvency II.

How do you establish the surplus/deficit in the Fund under Solvency II?

Article 15(7) of the 1989 Act refers to determining the value of assets representing the fund and the solvency margin “in accordance with any applicable valuation regulations”. For life assurance undertakings subject to Solvency II, the applicable valuation regulations since 1 January 2016 are the valuation regulations set out in the Solvency II Directive and related texts. On that basis, it would appear consistent with legislation to apply Solvency II valuation requirements when tracking the Life Assurance Fund.

In practical terms, this generally means assessing the assets of the Life Assurance Fund on a market value basis (but noting the specifics of the Solvency II asset valuation rules). In relation to assessing the liabilities of the fund, this means valuing the technical provisions and other liabilities in accordance with the relevant Solvency II rules.

It is also worth noting that some undertakings may have more than one Life Assurance Fund. In a Solvency II context, the question arises as to whether it is necessary to look at the position separately at the level of any ring-fenced funds that are deemed to exist under Solvency II.

In practical terms, assessing the value of the liabilities should be relatively straightforward – the insurance contracts that are within a particular Life Assurance Fund should be readily identifiable and can then be valued on Solvency II principles. Similarly, all other liabilities that fall within the Life Assurance Fund should be readily identifiable – undertakings generally only have a limited number of specific liabilities which are considered to be purely shareholder-related and therefore outside of the Life Assurance Fund.

Assessing the value of the assets of the Life Assurance Fund may be more problematic – it may not always be the case in practice following the transition to Solvency II (even if it is still required under Article 14(1) of the 1989 Act), that life assurance undertakings are recording a register of those assets that are deemed to be within the Life Assurance Fund. In particular, it should be noted that there is no formal/audited record of the Life Assurance Fund under Solvency II (i.e. no specific QRT entry that tracks this value). Therefore the last reference point for the Life Assurance Fund was probably the last reporting date to the CBI under Solvency I (so 31 December 2015 for most companies).

What governance/documentation should be put in place around the process?

Against that backdrop, what governance/documentation should be put in place around the process of the actuarial assessment of the surplus/deficit in the Life Assurance Fund?

As noted above, Article 15(3) of the 1989 Act refers to an "actuarial investigation" and to "the abstract of the actuary's report of the investigation". These were originally well-defined with reference to the Solvency I regime – being set out in Schedule 4 of the 1994 Life Framework Regulations – but those provisions have since been repealed (for undertakings subject to Solvency II).

Under Solvency II, there is no direct equivalent of the "abstract of the actuary's report": that document used to form part of the annual regulatory returns to the CBI, but there is no equivalent regulatory filing under Solvency II. Instead, under Solvency II, the HoAF prepares a report for the Board of Directors and, separately, the Directors file QRTs with the CBI which contain, amongst other things, information on the value of assets and liabilities on a Solvency II basis (but, crucially, for the balance sheet as a whole, rather than identifying the Life Assurance Fund separately).

As noted above, there is no guidance available from the CBI on this issue. In the absence of such guidance, it seems reasonable that the HoAF would address it in his or her annual Actuarial Report on Technical Provisions ("ARTPs"). This would probably require quantification of the assets in the Life Assurance Fund at the date of the valuation (or perhaps confirmation that the assets exceed the liabilities at the valuation date).

In addition, it would be good practice for the HoAF to recommend that the company maintains a formal record of the assets that are deemed to be within the Life Assurance Fund to meet the requirements of Article 14(1) of the 1989 Act and assist the HoAF in making a clear recommendation to the Board.

What additional items should the actuary consider with respect to the Life Assurance Fund?

In addition to the issues considered above, there are some other considerations that come into play with regard to the Life Assurance Fund and the distribution of any surplus in that fund.

The first is the question of profit sharing. The CBI's Domestic Actuarial Regime includes a requirement that *"[w]here any rights of life assurance policyholders entitle them to participate in*

profits related to a particular fund or part of a fund" the HoAF's ARTPs shall include *"a recommendation on any allocation of profits related to those policyholder rights"*. That report is addressed to an undertaking's Board of Directors, with a copy provided to the CBI on request.

Clearly, therefore, for those undertakings with policyholders with an entitlement to profit sharing, the DAR envisages a role for the HoAF in making a recommendation on such profit sharing. This implies that the HoAF will first need to quantify the surplus/deficit in the Life Assurance Fund before doing so (which in turn implies that the undertakings in question will be maintaining accounts at the level of the those funds to which profit sharing applies). It also provides a governance framework – the position needs to be documented in a report to the Board (although it is unclear as to whether this section of the ARTPs is within the scope of any Reviewing Actuary's review and/or external audit). However, the relevant section of the DAR does not address the situation where an undertaking does not have policyholders with rights to participate in profits (but is still required to assess the surplus/deficit in the Life Assurance Fund by virtue of Article 15 of the 1989 Act).

The second is the question of tax.

For undertakings with "old basis business" taxed on the so-called "I-E" basis, the starting point for one of the components of the overall tax computation (specifically the Notional Case I ("NCI") computation) was the surplus transferred out to shareholders (from the Life Assurance Fund) as evidenced on Form 28 of the (Solvency I) annual regulatory returns to the CBI.

However, the transition to Solvency II gives rise to a practical issue in that Form 28 is no longer prepared by life assurance undertakings subject to Solvency II. Therefore it is important for actuaries with "old basis business" to ensure that the Life Assurance Fund is clearly identified and a suitable audit trail exists in relation to the use of the Life Assurance Fund value in the tax computation for the entity.

The Irish Revenue Commissioners (following consultation with industry via Insurance Ireland) issued an eBrief in February 2017 (http://www.revenue.ie/en/practitioner/ebrief/2017/no-202017.html) which sets out the expectations of the Revenue Commissioners in relation to the NCI calculation and the reliance on the Life Assurance Fund. This eBrief makes reference to the Head of Actuarial Function and in particular notes that "it is expected that the Head of Actuarial Function will make a recommendation to the Board of Directors in relation to the amount of the surplus to be transferred to shareholders and this will be considered by the Board for its approval".

The eBrief notes that the Revenue Commissioners may request a copy of the ARTPs and also details a number of pieces of information which should be submitted by life assurance companies as part of their corporation tax computations:

- a formal statement of amount of the surplus transferred to shareholders;
- the recommendation of the amount of the surplus transfer to shareholders by the Head of Actuarial Function, and
- full details of any alterations, amendment and departures (if any) from the surplus transfer figure as initially recommended by the Head of Actuarial Function.

Finally, the HoAF should consider the extent of any surplus in the Life Assurance Fund which should be transferred to the shareholder. Under Solvency I, the Appointed Actuary could (and in some cases was expected to) use the transfer from the Life Assurance Fund to control the amount of surplus assets available for distribution as a dividend to the shareholder. Market practice appears to have differed in terms of the extent of the surplus maintained in the Life Assurance Fund across companies and depended on the other elements of governance surrounding dividend payment, target capital buffers and companies' stated risk appetite.

Under Solvency II, there should be adequate governance in place surrounding dividend payments to ensure that the transfer to / from the Life Assurance Fund is not required as an additional control on dividend payment. However, in deciding what level of transfer from the Life Assurance Fund to the shareholder is appropriate, the HoAF may wish to consider the adequacy of the entity's governance surrounding dividend payments and include appropriate caveats to his / her recommended transfer if appropriate.

Conclusions and next steps

Key conclusions:

- The HoAF for an Irish Life Assurance entity has responsibilities relating to transfers to/from the Life Assurance Fund.
- The HoAF's responsibilities may vary depending on the nature of the company's business (e.g. presence of profit-sharing, extent of I-E funds).
- There is no obvious way to track the Life Assurance Fund under Solvency II, so companies should consider what additional record keeping is appropriate.
- Good practice would be for the HoAF to document the responsibilities for their company, document these as part of the responsibilities of the Actuarial Function in Ireland in the ARTPs, and maintain clear evidence on how they have derived their recommendation and complied with these responsibilities.

Next steps:

- The Society's Life Committee will share this note with:
    - The Life HoAF community within the Society of Actuaries in Ireland;
    - the Central Bank of Ireland and encourage them to engage with the Department of Finance to amend the relevant legislation to either remove the concept of the Life Assurance Fund completely (for non-"I-E" business) or formally include updated requirements which are consistent with Solvency II; and
    - Insurance Ireland, who have worked in this area also, mainly concerning domestic life assurance entities with "I-E" taxed business.

SAI Life Committee
March 2017

Appendix – Extracts from Insurance Act 1989 and Companies Act 2014

Extracts from Insurance Act 1989

Article 14: Separation of assets and liabilities attributable to life assurance business

14.— (1) Every undertaking authorised to carry on life assurance business—

(a) shall maintain an account in respect of that business and the receipts of that business shall be entered in the account maintained for that purpose and shall be carried to and form the life assurance fund, and

(b) shall maintain such accounting and other records as are necessary for identifying—

(i) the assets representing the fund maintained by the undertaking under paragraph (a) of this subsection, and

(ii) the liabilities attributable to that business.

(2) The provisions of subsection (1) are without prejudice to the obligations of an undertaking to maintain such records as are necessary for the preparation and submission to the Minister of separate accounts and statements for any class or part of a class of business as required from time to time by the Insurance Acts.

Article 15: Application of assets of undertaking transacting life assurance business

15.— (1) The assets representing the fund maintained by an undertaking in accordance with section 14 (1)—

(a) shall be applied for the purposes of that business, and

(b) shall not be transferred so as to be available for other purposes of the undertaking except where the transfer constitutes reimbursement of expenditure borne by other assets (in the same or the last preceding financial year) in discharging liabilities wholly or partly attributable to life assurance business.

(2) Where the value of the assets mentioned in subsection (1) is shown, by an investigation to which Article 5 of the European Communities (Life Assurance Accounts, Statements and Valuations) Regulations, 1986 (S.I. No. 437 of 1986) applies or which is made in pursuance of a requirement imposed under section 16 or 17 to exceed the amount of the liability attributable to the undertaking's life assurance business the restriction imposed by that subsection shall not apply to so much of those assets as represents the excess.

(3) Subsection (2) shall not authorise a transfer or other application of assets by reference to an actuarial investigation at any time after the date when the abstract

of the actuary's report of the investigation has been deposited with the Minister in accordance with Article 9 (1) of the said Regulations of 1986.

(4) Nothing in subsection (1) shall preclude an undertaking from exchanging, at fair market value, assets representing the fund maintained by the undertaking in respect of its life assurance business for other assets of the undertaking.

(5) A mortgage or charge shall be void to the extent to which it contravenes subsection (1).

(6) Money from the fund maintained by an undertaking in respect of its life assurance business shall not be used for the purposes of any business of the undertaking which is not life assurance business notwithstanding any arrangement for its subsequent repayment out of the receipts of that other business.

(7) No undertaking to which this section applies shall declare a dividend at any time when the value of the assets representing the fund or the solvency margin, as determined in accordance with any applicable valuation regulations, is—

(a) in the case of the fund, less than the amount of the liabilities attributable to that business as so determined, or

(b) in the case of the solvency margin, less than the amount required by the Regulations of 1984.

(8) In this section a reference to “the fund” is to the total fund of assets maintained by an undertaking in respect of its life assurance business, not being shareholders' assets.

Extracts from Companies Act 2014

Realised profits of assurance companies

1444. (1) In the case of—

(a) a designated activity company,
(b) a public limited company, or
(c) a company limited by guarantee,

carrying on life assurance business, or industrial assurance business or both, any amount properly transferred to the profit and loss account of the company from a surplus in the fund or funds maintained by it in respect of that business and any deficit in that fund or those funds shall be respectively treated for the purposes of Chapter 7 of Part 3 as a realised profit and a realised loss, and, subject to the foregoing, any profit or loss arising on the fund or funds maintained by it in respect of that business shall be left out of account for those purposes.

(2) In subsection (1)—

(a) the reference to a surplus in any fund or funds of a company is a reference to an excess of the assets representing that fund or those funds over the liabilities of the company attributable to its life assurance or industrial assurance business, as shown by an actuarial investigation, and

(b) the reference to a deficit in any such fund or funds is a reference to the excess of those liabilities over those assets, as so shown.

(3) In this section—

"actuarial investigation" means an investigation to which section 5 of the Assurance Companies Act 1909 applies or provision in respect of which is made by regulations under section 3 of the European Communities Act 1972 ;

"life assurance business" and "industrial assurance business" have the same meaning they have as in section 3 of the Insurance Act 1936 .