



Director Life/General Insurance
Prudential Regulation Authority

12 February 2015

Solvency II Directors' update

The volume of Solvency II work remained high in January with the PRA receiving a number of matching adjustment pre-approval applications. The assessment process is ongoing and an internal PRA panel has been scheduled for March to review recommendations. The PRA will provide individual firm feedback on 28 March 2015 and general feedback to all firms by the end of April 2015. A number of internal model commitment panels were also held in January. Firms who are part of this process will receive feedback from their usual supervisory contact as soon as possible after the panel. Feedback on common areas identified by the commitment panels where firms are not meeting the tests and standards required by Solvency II will be provided in April. More information on the commitment panels is provided in this update.

The European regulatory agenda has also progressed with the issue of the Delegated Act and publication of the Set 1 Guidelines

Solvency II Delegated Act

The text of the Solvency II Delegated Act was published in the Official Journal on 17 January 2015 and the regulation entered into force on the following day. The official title is the Commission Delegated Regulation (EU) 2015/35.

The entry into force of these regulations is the cut-off date for the own-funds transitional provisions. As this date has now passed, any firm issuing capital instruments between now and 1 January 2016 will need to ensure that the instrument is Solvency II compliant so it is eligible for transitional treatment. For UK firms this should not have a major effect as the PRA has already encouraged firms to anticipate the enhanced quality of capital Solvency II will bring. However, firms should ensure that any capital issued will meet the relevant Solvency II criteria.

Regulatory reporting

The PRA's regulatory reporting industry working group met on 26 January 2015. The PRA gave an update on regulatory reporting preparations and also highlighted changes to some of the templates for the preparatory phase and the templates for Solvency II implementation. Firms should review the draft ITS on supervisory reporting, [EIOPA-CP-14/052](#), to familiarise themselves with the differences.

The PRA gave a demonstration of the portal that firms will use to submit their returns and requested the submission of test XBRL files ahead of the preparatory phase. The PRA will provide high-level feedback to inform firms about the quality of the XBRL files received. This will help the PRA and firms identify and resolve potential problem areas early ahead of the 1 July deadline. To take this opportunity please send partial or full XBRL files by secure email to PRASIIregulatoryreporting@bankofengland.co.uk by Thursday 2 April. The data provided will not be used for supervisory purposes, but for planning and testing only. Firms not

submitting the reporting templates required by EIOPA's preparatory guidelines in July 2015 are also welcome to submit test XBRL files.

The PRA would like to thank firms that have submitted their principal user details and completed the Pillar 3 firm readiness survey mentioned in the last [Directors' update](#). If you have not provided principal user details please email them to solvencyinquiries@bankofengland.co.uk and your usual supervisory contact soon as possible. The details are necessary to provide firms with accounts on the PRA's portal as part of the registration and onboarding processes.

The Pillar 3 firm readiness survey indicates that the majority of firms due to submit preparatory reporting are on-track. The PRA is also encouraged to see a high level of industry confidence with their preparations to date; 80% of respondents are not reporting any issues.

Solvency II approvals

Firms who are planning to submit applications for multiple Solvency II approvals are expected to consider actively the dependencies between these applications and prepare contingency plans, in case approval is not obtained for one or more of the applications where dependencies exist. Please refer to paragraphs 2.9 and 2.10 of [CP23/14: Solvency II approvals](#) for further information.

To ensure a smooth application process, and avoid unnecessary delays in the review of those applications targeting a Day 1 decision, it is vital that firms submit credible and realistic applications which consider and allow for any dependencies. In particular, for matching adjustment and internal model applications, firms will have had the opportunity to participate in the pre-application processes, and therefore the PRA would expect such firms to submit applications that address the feedback provided.

The PRA also encourages firms to devise an overall plan setting out the approvals they are planning to submit for Day 1 decision, identifying the dependencies between these approvals. Given that timings will vary by firm, firms should discuss their plans with their usual supervisory contacts prior to submitting their applications.

Balance sheet reviews

In advance of Solvency II and any EIOPA guidelines on this subject, the PRA needs to be satisfied that solo and group Solvency II balance sheets, own funds and technical provisions are calculated in accordance with the Solvency II regulatory framework. To achieve this in a proportionate way, in October 2014 the PRA proposed a [two-step approach](#) to be commissioned by firms that would provide assurance to the PRA. This process suggested that the 'review and recommend' report required for step 1 could be carried out by the firm's external auditor, a suitably qualified external professional services or consultancy firm, or the firm's internal audit function. For the 'reasonable assurance' review required for step 2 the firm should engage an external audit firm.

The PRA asked firms to discuss the review with their usual supervisory contacts prior to it commencing to agree the approach. The PRA has now had a number of these discussions and has produced further clarification for individual firms to consider, which can be found on the [PRA website](#).

Internal models

The end of the formal internal model pre-application period (31 March 2015) is currently a focus for both firms and the PRA. From the PRA perspective, the conclusion of this process is the commitment panel which is an opportunity for a panel of senior personnel from the PRA Insurance Division to take stock of the firm's work to date and to assess whether the firm is likely to be able to make a credible model application after 1 April 2015. The panels include the Insurance Executive Director for the Category 1 firms and the GI or Life

Directors – or an appropriate head of department - for the remainder of the sector. In addition all panels are also attended by a senior advisor with relevant market experience, an independent head of department, an independent actuary and policy representatives. Feedback from the panel will be discussed with firms as soon as possible after the panel to allow them to consider it and decide next steps. To ensure the position of the firm is accurately presented at the panel it is important that the supervisory team has a clear summary from the firm on the status of the model development, including strengths and weaknesses. For clarification, these panels will not be making decisions on whether to approve an internal model. This is the responsibility of the decision panel which will take place later in the year once firms have submitted formal applications.

Initial feedback from the commitment panels and from firm-facing work has identified areas where some firms are not meeting the standards expected. These include contingency plans, expert judgement documentation and validation; more information on these areas is in the Appendix.

Standard formula

In October's '[Solvency II: countdown to implementation](#)' conference the PRA said that it had identified a number of pilot firms which it would review in more detail for standard formula appropriateness. Two internal panels have been held to ensure there has been consistency of approach and that any supervisory interventions are applied in line with the PRA's statutory objectives and the requirements of the Solvency II Directive. Supervisors will contact those firms where interventions are considered necessary in Q2 to allow firms to take appropriate action.

If the outputs of the two panels and further review work highlight thematic issues, the PRA will provide general guidance to all firms by Q2 2015.

Update on consultation papers

On 23 January 2015 the PRA issued [CP3/15 - Solvency II: transitional measures and treatment of participations](#). Firms should be aware that the outputs of the draft supervisory statement included as part of this consultation paper are required for transposition; therefore, it has been necessary to reduce the consultation period from the usual 3 months to 4 weeks. This will allow the PRA to consider firms' responses and include the final supervisory statement in the policy statement planned for 20 March 2015.

Data collection exercise

Before the end of February the PRA will be issuing the templates and guidance for the 2015 data collection exercises to all life and general insurance firms in scope of Solvency II. The exercise will be similar to that conducted in previous years and the information gathered will be used to inform the preparation for, and transition to, Solvency II. As the information also supports PRA decision making, this year's exercise will require firms to provide high quality submissions with increased level of sign-off; further details will be provided in the data collection exercise guidance.

PRA regulatory digest

The PRA Regulatory Digest is produced for anyone interested in the UK financial services industry and highlights key regulatory news and publications delivered in the previous month. The January digest is available here:


<http://www.bankofengland.co.uk/pradocuments/publications/regdigest/2015/praregulatorydigestjanuary2015.pdf>.

The next issue will be published on 2 March 2015. Firms can subscribe to receive the digest automatically. To do this please:

- Visit the [Subscribe to alerts](#) page and follow the instructions.
- When you reach the 'Subscription updates' page select the 'Prudential Regulation Authority (PRA) and Credit Unions' option.

- You will then receive automated updates for all PRA-related news and publications, including the PRA Regulatory Digest.

Yours sincerely

A handwritten signature in black ink that reads "Andrew Bulley". The signature is written in a cursive style and is positioned above a long, thin horizontal line that extends to the right.

Andrew Bulley
Director, Life Insurance

A handwritten signature in blue ink that reads "Chris Moulder". The signature is written in a cursive style.

Chris Moulder
Director, General Insurance

Appendix: Feedback on internal models

Firms need to develop contingency plans to detail what they will do if an application to use an internal model is not approved (either due to the firm failing to meet the regulatory timetable, or because the PRA considers the tests and standards have not been met). When developing these plans firms should consider:

- the dependencies between all approval applications being made under the Solvency II regime;
- the capital requirements that would be needed for the alternative approach;
- management or mitigation actions, including an indication of the time and resource requirements, that would be required for these to be implemented. This could include capital raising or other risk mitigation such as purchase of additional reinsurance, and
- key dates when decisions will be needed and the critical path, including key risk indicators, that indicate further action is required. This may include trigger points when resource would be committed to taking plans to the next level of detail.

The PRA appreciates that firms need to make expert judgements to implement Solvency II. Firms are already aware that documentation is required to evidence these judgements, but this documentation is not always of the standard to give the PRA the confidence it needs to accept the expert judgements the firm has made. To help the PRA understand the rationale behind expert judgements, documentation should demonstrate that:

- there is a mechanism to ensure that key judgements are identified;
- there is a process that will ensure that decision making and approval on key judgements is taken at the appropriate level;
- the level of documentation and validation of the judgement is proportionate to the importance of the decision; and
- the definition of expert judgement is appropriately broad, in that as well as identifying critical individual parameters, it may incorporate:
 - fundamental methodology decisions on how a firm will quantify a particular issue; and
 - the design of a process, or an implicit assumption, that will influence a wide range of other decisions/judgements.

There is a perception by some firms that validation should be carried out by someone external to the firm. This is not a requirement of Solvency II Directive or the PRA. It is appreciated that, in some cases, in-house validation is the more effective solution as there is greater insight into the dynamics of the business and associated risks but if firms use this option they need to demonstrate that there is robust challenge from individuals who are suitably qualified, independent from the decisions they are validating, and are senior enough within the organisation to provide an effective challenge.

The PRA has identified some instances where validation is still not meeting the required standards including:

- insufficient evidence to show why the probability distribution forecast calculated by the model is considered to be a good fit to the firm's risk profile;
- failing to identify areas of the model that require further development or the limitations of model; and
- a validation report that shows that every test has been passed as this may indicate insufficient challenge or that the tests are too weak to be useful.

Timetable of activity January 2015 to 2015 Q2

Date	Description	Information or Action	Dependency on policy certainty
2015-Q1	Consultation paper on volatility adjustment (depending on HMT decision)	Action	No
February 2015	Consultation paper on EIOPA guidelines	Action	Yes
February 2015	Data collection exercise	Action	No
28 March 2015	Individual firm feedback following MA submissions	Information	No
31 March 2015	Transposition of Solvency II into the PRA Rulebook	Action	No
March 2015	Policy Statement on Solvency II	Action	No
March 2015	Communication on equity release mortgages	Information and action	No
March 2015	Communication on sovereign debt	Information and action	No
March 2015	Communication on other aspects of matching adjustment	Information and action	No
March 2015	Briefing for non-executive directors – details to be confirmed	Information and action	No
April 2015	Feedback on the preparatory guidelines – ORSA and system of governance	Information and action	No
April 2015	Feedback on the MA pre-application process	Information and action	No
April 2015	Feedback on the internal model pre-application process	Information and action	No
2015 Q2	PRA to provide information on GI stress testing questionnaire	Information and action	No
2015 Q2	Communication on standard formula appropriateness and interventions	Information and action	No

Solvency II web updates since the last Directors' update

www.bankofengland.co.uk/solvency2

February 2015

On 10 February 2015, the PRA published further clarification on its approach to the review of the Solvency II balance sheet, technical provisions and own funds. This followed a publication on the same topics on 16 October 2014. Both updates are available on the page dedicated to 'Other Pillar 1' aspects of Solvency II.

 **PRA Solvency II: Further clarification on balance sheet, technical provisions and own funds review, February 2015**

 **Other Pillar 1 aspects**

January 2015

On 30 January 2015, the PRA published information on its internal model page to assist firms in their preparations to submit a formal internal model application from 1 April 2015. This included links to the European Insurance and Occupational Pensions Authority's (EIOPA) Common Application Package for Internal Models (CAP), which includes instructions firms should follow when submitting a formal internal model application.

 **Internal model**

On 23 January 2015, the PRA published a consultation paper that sets out draft rules on transitional measures for risk-free interest rates and for technical provisions, necessary to implement the Solvency II Directive. CP3/15 also includes two draft supervisory statements: the first on the PRA's expectations regarding the calculation and application process for these transitional measures; and the second on the internal model treatment of participations.

 **CP3/15 - Solvency II: transitional measures and the treatment of participations**

On 16 January the PRA re-published Solvency II reporting schedules for firms with non-December year ends to correct a number of inaccuracies, primarily related to submission dates in 2017 and 2018. The updated schedules are available on the regulatory reporting page.

 **Regulatory reporting**

December 2014

On 19 December the PRA published reporting schedules for firms with non-December year ends. This has been made available on the regulatory reporting page.

 **Regulatory reporting**

On 19 December 2014 the PRA published an update letter from the PRA's Insurance Directors for all Solvency II-affected firms.

 **PRA Solvency II: Insurance Directors' update letter, 19 December 2014**

On 12 December 2014 the PRA published feedback for general insurance firms on the standardised risk information data collection exercise issued in May 2014. This has been made available on the Other Pillar 1 aspects page.

 **Other Pillar 1 aspects**

On 2 December 2014, the European Insurance and Occupational Pensions Authority (EIOPA) published its Public Consultation CP-14-062 on Set 2 of the Solvency II Implementing Technical Standards and Guidelines. The consultation papers, accompanied by a cover note and templates for comments, can be found on the EIOPA consultation papers page.

 **EIOPA consultation papers**