



**BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY**

Director Life/General Insurance
Prudential Regulation Authority

19 December 2014

Solvency II Directors' update

Our focus in the first quarter of 2015 will be the end of the internal model approval process (IMAP) pre-application phase and the start of the formal application process. IMAP commitment panels are now scheduled and following these, inform firms whether, based on the current progress, we judge them suitably advanced to be able to submit a viable formal application after 1 April 2015.

The matching adjustment (MA) pre-application process closes on 6 January 2015. The PRA will then evaluate the submissions to allow supervisors to give firms feedback in March 2015.

This final Directors' update of 2014 includes the usual look forward to communications planned for the next few months but, by request, also includes a list of information that has been added to the Solvency II pages of the Bank's website since the last update; this will be a regular addition to future updates.

Internal model common application template (CAP)

Firms who are preparing to apply for an internal model should be aware that EIOPA has recently published the CAP which will replace the PRA's Self-Assessment Template (SAT). EIOPA is currently revising its website so firms wishing to review the CAP are encouraged to go directly to the [EIOPA website](#) once the update is complete.

The CAP consists of a template and an accompanying explanatory note which outlines how to complete the template. All firms are expected to complete the spreadsheet titled 'S.A.T', but each National Supervisory Authority has been asked by EIOPA to clarify whether firms are expected to complete the spreadsheet titled 'background information'. The PRA is currently reviewing the content of the 'background information' spreadsheet and intends to issue guidance to firms early in the New Year. All firms wishing to apply for internal model approval are reminded that they are required to submit the template in the CAP (not the PRA SAT) as part of their formal application.

Role of non-executive directors

At our recent conference, and in some firm meetings, supervisors have been asked for further clarification on the PRA's expectation of the non-executive directors when considering the internal model.

The use test is one of the tests and standards firms need to meet to gain internal model approval. As part of the use test, firms must ensure that members of the Board and others involved in running the firm have an understanding of the model. One of the methods the PRA might use to assess whether firms are meeting the use test is to speak to non-executive directors (either individually or collectively) to gauge their understanding. The PRA does not believe that it is necessary for Board members to be technical experts in

modelling techniques in order to meet the use test requirements. Rather, the PRA would expect Board members to understand and be able to explain areas such as the:

- key strengths, limitations, and judgements within the model;
- assumptions and judgements that have the most material impact on the model output; and
- key sources of information and advice the Board has relied upon in order to satisfy itself about the appropriateness of both the model design and the model output.

Board members should expect support from executive management to ensure that these key features of models are explained in a way that the Board can properly understand and engage with. Boards should also draw on a wide range of sources to help them obtain the comfort they need. For example, independent validation can play an important role in helping Boards gain an overall understanding of a model and its strengths and limitations, as long as the validation work is focused appropriately on a critical appraisal of the most material aspects of the model, and if its conclusions are summarised and presented appropriately for a Board-level audience.

MA pre-application

The pre-application process for the MA approval has identified that firms may be using internal ratings methodologies to assign a rating to some of the assets included in their MA portfolio(s). In CP 23/14: Solvency II approvals, the PRA stated that:

“The MA calculation requires a fundamental spread to be assigned to each asset based on the credit quality, duration and asset class. Where firms have unrated assets, and have rated these assets using an internal rating system, the PRA may consider undertaking a review of the process followed to produce the internal rating to determine its appropriateness.”

If a firm uses internal ratings, suitable documentation should be provided with the pre-application to allow the PRA to review the process followed in order to determine its appropriateness. The PRA would anticipate this should include details of the ratings methodologies; the calibration and back testing of the ratings; the governance around the ratings process; and the processes in place for the review of internally assigned ratings.

The PRA acknowledges that some firms may have already submitted, or are about to submit, pre-applications for MA that do not contain information on the internal ratings process. In such instances, firms should agree with their usual supervisory contact a date by which the relevant information on internal ratings will be delivered to the PRA. The absence of internal ratings documentation should not delay the submission of the MA pre-application to the PRA.

Standard formula risk classification for income protection claims in payment

The PRA is aware that firms are taking different approaches to the classification of recovery/termination risk on income protection claims that are in payment by instalment. The PRA considers that in the case of the risk that claims persist for longer than expected, this risk falls under the disability-morbidity sub-module of the health underwriting risk (as defined in the Solvency II Directive) and not the revision risk sub-module for the purpose of calculating the solvency capital requirement using the standard formula approach.

Regulatory reporting preparatory phase

This week, the PRA will send a letter to the CEOs of all firms in-scope for the preparatory phase of regulatory reporting asking them to nominate an appropriate person to act as a principal user. The principal user will have full access to the PRA's data collection system and will upload, edit and submit data on behalf of the firm. The principal user will be the point of contact in the firm to prepare for on-boarding firms onto the PRA Solvency II data collection system.

The letter also includes a readiness survey which firms are requested to complete. The results of the survey will provide the PRA with a better understanding of the progress firms are making towards regulatory reporting readiness and to understand any practical problems in advance.

Firms are requested to provide the principal user details and complete the readiness survey by Friday 16 January 2015.

In our last Directors' update we informed firms that the PRA was preparing to publish information on reporting dates for firms who did not have a 31 December year end. This information will be on the [regulatory reporting page](#) of the website this week and will provide affected firms with reporting requirements for day 1 returns, quarterly and annual reporting and their final Solvency I annual return dates.

Standardised risk information – feedback for general insurance firms

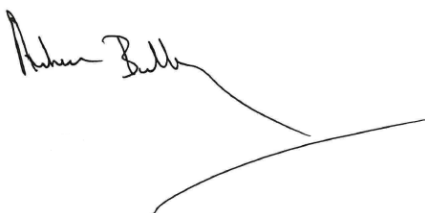
In May 2014, the PRA issued various data requests to [life and general insurance firms](#). As part of this, the PRA carried out standardised risk information (SRI) data collection exercise for general insurance firms to support preparations for, and the transition to, Solvency II. General insurance firms and Lloyd's managing agents contributed information and responded to the PRA's subsequent questions. The information provided was very helpful. The PRA has analysed the information and has now provided [feedback](#).

The PRA would like also like to thank life firms for their responses to our SRI request. As in previous years, the PRA is using this information to prioritise the areas for the IMAP pre-application and application phases. Supervisors will discuss particular areas of focus identified during reviews with individual firms.

PRA Updates

The last Directors' update noted that the PRA hoped to provide firms with more information on the transitional arrangements this month. Unfortunately, this update will be delayed and the PRA now intends to issue a CP on transitional arrangements in January 2015. Similarly, the PRA had hoped to issue the CP on volatility adjustment this month. HM Treasury is still considering replies to consultation paper [Solvency II: resolving the remaining policy issues for UK transposition](#). Dependent on the outcome, the PRA will issue a consultation paper on the volatility adjustment once HM Treasury has published the results.

Yours sincerely



Andrew Bulley
Director, Life Insurance



Chris Moulder
Director, General Insurance

Timetable of activity December 2014 to 2015 Q2

Date	Description	Information or Action	Dependency on policy certainty
1 Dec 2014-6 Jan 2015	Submit matching adjustment pre-application approval process submissions	Action	No
December	Reporting information for firms without a 31 December year end	Action	No
December	Letter to CEOs of firms in scope for regulatory reporting preparatory guidelines – principal user and readiness survey	Action	No
9 January 2015	Deadline for responses to CP23/14: Solvency II approvals	Action	No
16 January	Provide information on principal users and complete regulatory reporting readiness survey	Action	No
30 January	Deadline for responses CP24/14: Solvency II further measures for implementation	Action	No
January	Consultation paper on transitional arrangements	Action	No
January	Consultation paper on volatility adjustment (depending on HMT decision)	Action	No
February 2015	Consultation paper on EIOPA guidelines	Action	Yes
March 2015	Individual firm feedback following MA submissions	Information	No
March 2015	Policy Statement on Solvency II	Information and action	No
31 March 2015	Transposition of Solvency II into the PRA Rulebook	Information and action	No
2015 Q2	Feedback for firms on the Preparatory Guidelines	Information and action	No
2015 Q2	Feedback on the MA pre-application process	Information and action	No
2015 Q2	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
---------	---	------------------------	----

Web updates since last Directors' letter

2 December 2014 [EIOPA consultation papers](#)

12 December 2014 [Feedback for general insurance firms on the standardised risk information data collection exercise](#)