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**Solvency II related approvals for Day 1 of the new regime**

In the final months before implementation of the Solvency II regime, we will be reviewing around 300 applications from firms for Solvency II-related approvals and communicating decisions ahead of 1 January 2016 ('Day 1'). This letter summarises our plans and approach to a number of key approvals following communications issued over the past year, and is relevant to all Solvency II-affected firms. I encourage firms to continue to liaise with their usual supervisory contact if they have any questions about any of the issues covered in this letter.

**Applications to use the matching adjustment (MA)**

We have received a number of applications from firms seeking supervisory approval to use the matching adjustment (MA) from 1 January 2016. As confirmed in an update on 24 July 2015, the PRA will be reaching decisions on applications at a formal panel of PRA senior management. In line with our commitment to a fair process that is consistent with orderly markets, we are intending to issue 'approve' or 'reject' decisions to each individual firm simultaneously around early November. A brief Solvency II update confirming that letters outlining these decisions have been sent will be included on the Solvency II news section of the Bank of England website.

**Applications to use an internal model**

We have been working with PRA-regulated firms on the internal model approval process since 2009. Over that time, we have seen a number of developments in policy, changes within firms and advances in our approach to supervision. As part of this, we introduced 'ICAS+' to bridge the transition from the Individual Capital Standards Regime (ICAS) to Solvency II as we, and firms, sought ways to benefit from the work done on internal model development during a time when the implementation date for Solvency II was being decided by the European Commission. We have received around 20 applications from firms seeking approval to use an internal model for Day 1.

In line with our approach to MA applications, we expect to communicate an 'approve' or 'reject' decision simultaneously to each individual firm in early December. Whilst the EU Implementing Technical Standard covering internal models prevents the PRA from disclosing that a firm's application to use an internal model has been either rejected or withdrawn, we will confirm which firms have gained model approval on the Solvency II section of the Bank of England website in an update in early December. This approach will ensure that our communications are fair and transparent to all firms and consistent with orderly markets.

In order to reach an 'approve' or 'reject' decision:

- we will hold a firm-specific "recommendation panel" to assess the individual internal model application and consider the recommendation of the reviewing team;
- the recommendation from this initial panel will be reviewed by an oversight panel of PRA senior management who will reach a "minded to" decision;
- all "minded to" decisions will be reviewed, and final decisions taken, in early December to ensure consistency in our approach.

We expect firms to be informed of the recommendation the supervision team will make on their internal model application before the initial panel. However, at further points in the decision-making process, PRA senior management may or may not support the recommendation made by the supervision team. Firms should therefore take no assurance from this recommendation, as it is subject to change. For this reason, firms should not expect to discuss their internal model application any further with their supervisory contact between the date of the initial recommendation panel and the final communication of the 'approve' or 'reject' decision in early December.

I would like to take this opportunity to remind firms that they should have in place robust contingency plans in the event their MA or internal model applications are not approved. Decisions on these applications are taken independently, so firms who have built models or have calculated the standard formula on the basis that they will gain MA approval should have mitigating actions in place should their MA application not be approved. I encourage firms to continue to liaise with their supervisor on these issues.

**Capital add-ons**

The Solvency II Directive allows supervisory authorities to apply a capital add-on in specified circumstances (see Articles 37 for solos and 232 for groups).

We are putting in place a process to consider, quantify and apply capital add-ons. There will be at least two formal communication points in setting a capital add-on:

- the firm will receive a letter informing them that we are considering applying a capital add-on and seek comments from the firm; and
- where this is applicable, and further to the consideration of the firm's comments, we will tell firms that we will apply an add-on.

The quantum and method for calculating the add-on may be proposed by the firm, but while we may take this into account, the PRA will ultimately determine the nature of the add-on. If an add-on is set, the PRA will monitor the continued need for it. When the PRA is satisfied that the firm has completed any remedial action to which the add-on relates, it will be removed at the earliest opportunity.

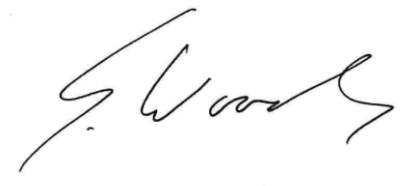
As set out above, those firms intending to use an internal model should have contingency plans in place should the PRA reject the model. If this plan includes using a standard formula, and there are deviations from the standard formula calculation, firms could also consider using a capital add-on as part of this contingency plan.

Firms are also reminded that they should have contingency plans in place should they identify through their Own Risk and Solvency Assessment, or we consider there to be, deviations from a firm’s system of governance from Solvency II standards (i.e. Pillar 2 requirements and standards) which warrant a capital add-on.

**Regulatory reporting – preparing for Pillar 3**

Annex 1 provides generic feedback on the preparatory phase submissions, which required a significant proportion of the UK market to submit a subset of the full Solvency II regulatory reporting package in July. This feedback is also applicable to those firms who were not part of the preparatory phase and, to that end, the PRA will now broaden its industry engagement to those firms who are due to submit regulatory reporting returns for the first time in 2016. We are holding a regulatory reporting seminar on 22 October for relevant Category 3 and all Category 4 and 5 firms, which will explain what firms should be doing to prepare for the Solvency II Pillar 3 requirements and the timetable to bring them into the Bank of England Electronic Data Submission (BEEDS) portal. Invitations have already been sent to the relevant firms.

Yours sincerely



Sam Woods
**Executive Director**

# Annex 1

# Solvency II regulatory reporting feedback

## Summary

EIOPA's Preparatory Guidelines required a significant proportion of the UK market to submit a subset of the full Solvency II regulatory reporting package in July. The submission of this information has allowed the PRA, and firms, to test systems and processes ahead of full implementation. This annex provides feedback to firms on the key issues resulting from this process and areas that firms should look to improve. Whilst only a subset of firms were required to report ahead of full implementation, the feedback will be relevant for all Directive firms as they finalise their work to implement the new Solvency II reporting requirements. Ensuring that we have high quality data is a key objective for the PRA. To assist in achieving this, we expect to issue further feedback on key issues identified.

The additional data required by the Solvency II regulatory reporting package represents a significant step-change in the amount, and granularity, of data submitted to regulatory authorities across Europe. Firms should not underestimate the amount of work required to effectively implement these new reporting standards. The Insurance Directorate has taken this major change as an opportunity to undertake a fundamental review of the way it collects and utilises data. We have designed, built and implemented a new web-based data collections system, known as the BEEDS portal (Bank of England Electronic Data Submission), and we have also now released the first set of Solvency II data analytic tools to our supervisors. Significant internal focus is being given to the quality of the data received and on building our analytical capability to enable supervisors, and other members of the Bank, to make efficient and effective use of the data received.

## Overview

Overall, we feel that the submission of information required during the preparatory phase has gone well. We know from our engagement through the industry working group that firms have been preparing for the submission for some time and this preparation seems to have helped in ensuring the process ran smoothly.  We thank all those who took part.

Preparatory phase returns were received from 103 solo entities and 34 groups, with the submissions meeting the EIOPA requirement of 80% of the UK insurance market.  The data submissions received were of a reasonable standard, and whilst there are themes for improvement, no significant trends or persistent material errors have been identified at this stage. However, it should be noted that during this phase of our work we have only implemented a limited number of checks on the data. We expect to carry out considerably more validation and plausibility checks in the future and this is very likely to identify further issues.

There are three phases to the way we work with the regulatory data and further feedback on each area is provided below, with more specific detailed feedback on each area later in this annex.

## Submission of information

The BEEDS portal was launched on time and firms were all successfully 'on-boarded' enabling them to submit data. The key issue was the quality of the XBRL. We put considerable resource into working with the interim reporters to improve the quality of the XBRL ahead of the submission deadline. Without this work, the majority of firms may not have been able to submit their return.

All firms must work with their vendors to ensure their XBRL files meet the requirements, including the EIOPA filing rules. If the XBRL does not meet the correct standard then our portal will reject the file. More detailed feedback on the XBRL issues can be found later in this annex. We hope to be able to offer a test environment in the New Year that firms can use to test the quality of their XBRL files ahead of day one reporting deadline in May 2016.

## Quality of the data

The data goes through a three-stage process to assess its quality. Firstly, the data must meet the EIOPA validation checks. This did not present any significant issues for the interim reporters. However, it should be noted that EIOPA had 'turned off' a significant number of their validation checks ahead of the interim reporting. We therefore expect this to be a more significant issue in the future and we expect firms to check compliance with the EIOPA validation checks ahead of submission through the BEEDS portal. Returns will not be formally accepted until the validation checks are passed.

The data then passes to the Bank of England's regulatory data specialists where a series of further checks have been developed. These are known as plausibility checks. These checks have significantly more human intervention. The team works with supervisors to provide feedback to firms on those areas where issues are identified. Currently, there are only a limited number of plausibility checks in place, and due to this being the first formal submission of data, we have only limited ability to carry out comparative checks. To date, 50% of failures investigated have been raised with firms, giving them an opportunity to provide a suitable reason for the plausibility failure or to resubmit data where errors need to be corrected.

Currently, only one significant trend has been identified and this relates to the quality of the asset data. Significant issues have been identified with this data and we expect insurance firms to address these. In many cases this will require insurers to work with third party providers, including asset managers, to ensure gaps are filled and the data quality is acceptable.

Post-plausibility checking, the data passes into the analytics systems where it will be used by a range of users across the Bank. At this stage, it is likely that further issues with the data will be identified and supervisors, working alongside our regulatory data specialists, will provide feedback to firms on these areas. Once again, firms are expected to provide an explanation to show why the data is not as we might expect, or re-submit where errors need to be corrected.

## Use of the data

The Insurance Directorate is using Solvency II changes to transform the way we use regulatory data. Significant investment is being made in both personnel and technology to understand and analyse the new data, providing both reports and analytical tools to supervisors and other teams who may have a need for the data across the Bank.

This team has released the first Solvency II database and related analytics tools allowing Bank of England users to gain insight into the interim reporting submissions. A three year strategy is being developed focused on the evolution of the PRA's analytics capability, aligned to the expected increases in quality and volume of data.

## Detailed feedback

**Submission of information - XBRL filing**

The vast majority of firms (96%) submitted a successful return by the deadline for annual solo submissions.  Of these, 44% of firms successfully submitted on the first attempt, increasing to 75% by the third attempt; after which errors shifted from XBRL technical errors to data validation issues.

The filing process was assisted by 48% of preparatory phase firms submitting test XBRL files ahead of the formal submission. This resulted in a greater proportion of firms successfully meeting the deadline, a reduction in the number of filing submission attempts and a reduction in both the number of technical issues identified and the time taken to correct them. This demonstrates the importance of firms testing the quality of the XBRL files before submission.

**Application of EIOPA filing rules**

Encouragingly, analysis of the annual submissions showed most submissions were compliant with the filing rules with the exception of the rules related to financial instruments, firm identification, issuer codes and counterparty codes.

Firms are reminded that EIOPA filing rules will be applied to all submissions from the end of October. Further detail is provided in the Solvency II XBRL filing manual. After Solvency II is implemented, firms will be required to resubmit the submission if any validation data check fails.

**XBRL quality**

Analysis of the annual submissions for both solo firms and groups revealed three main issues that firms should address. These are detailed below. Other common issues are detailed in the Bank of England Solvency II XBRL filing manual.

**Financial instrument codes**

For templates S.6.02 and S.08.01 the value entered in the 'ID code' column identifying the financial instrument must use one of the following prefixes listed in the EIOPA filing rules:

- ISIN/{code} for ISO 6166 for ISIN code;
- CUSIP/{code} for The Committee on Uniform Securities Identification Procedures number assigned by the CUSIP Service Bureau for U.S. and Canadian companies;

- SEDOL/{code} for Stock Exchange Daily Official List for the London Stock Exchange;
- WRT/{code} for Wertpapier Kenn-Number;
- BT/{code} for Bloomberg Ticker;
- BBGID/{code} for Bloomberg Global ID;
- RIC/{code} for Reuters instrument code;
- OCANNA/{code} for other code by members of the Association of National Numbering Agencies; and
- CAU/{code} for code attributed by the undertaking for items not covered by any of the above.

Approximately 40% of submissions did not use a prefix for financial instruments as specified in the EIOPA filing rules and approximately 40% of submissions used an incorrect prefix for financial instruments. It is important that these prefixes are observed, as it provides the ability to analyse data in a consistent manner as well as ensuring that data can be submitted to EIOPA successfully without the need for re-submission. Further detail can be found in sections 4.2 and 5.3.2 in the Bank of England's Solvency II XBRL filing manual.

**Firm identification, issuer and counterparty codes**

<u>Firm identification</u>

- For templates S.01.02, S.32.01, S.33.01, S.34.01 and S.35.01 the value entered in the 'identification code' should be the firm's LEI (or PRE-LEI) code, or if an LEI is not available, an FRN.
- Approximately 30% of submissions did not use the prefix for 'identification code' in these templates as specified in the EIOPA filing rules.
- A 20 character LEI or PRE-LEI code e.g. '123LEI4567890CODE321' must be entered into the 'identification code' column using the prefix 'LEI/' or 'PRE-LEI' e.g. 'LEI/123LEI4567890CODE321' or 'PRE-LEI/123LEI4567890CODE321'.
- If an LEI (or PRE-LEI) code is not available and a FRN e.g. 123456 is used, this must be must be entered into the 'identification code' column using the prefix 'SC/' e.g. 'SC/123456'.

<u>Issuer code and issuer group code</u>

- For template S.06.02 the value entered in the 'issuer code' or 'issuer group code' columns' should be the issuer's LEI (or PRE-LEI) code, or if an LEI is not available, a specific code;
- Approximately 30% of submissions that had this template marked as complete did not use the prefix for 'issuer code' or 'issuer group code' in these templates as specified in the EIOPA filing rules;

- A 20 character LEI or PRE-LEI code e.g. ‘123LEI4567890CODE321’ must be entered into the ‘issuer code’ or ‘issuer group code’ column using the prefix ‘LEI/’ or ‘PRE-LEI’ e.g. ‘LEI/123LEI4567890CODE321’ or ‘PRE-LEI/123LEI4567890CODE321’; and
- If an LEI (or PRE-LEI) code is not available and a specific code e.g. 123456 is used, this must be must be entered into the ‘issuer code’ or ‘issuer group code’ columns using the prefix ‘SC/’ e.g. ‘SC/123456’.

Counterparty code and counterparty group code

- For template S.08.01 the value entered in the ‘counterparty code’ or ‘counterparty group code’ columns’ should be the counterparty’s LEI (or PRE-LEI) code, or if an LEI is not available, a specific code.
- Approximately 50% of submissions that had this template marked as complete did not use the prefix for ‘issuer code’ or ‘issuer group code’ in these templates as specified in the EIOPA filing rules.
- A 20 character LEI or PRE-LEI code e.g. ‘123LEI4567890CODE321’ must be entered into the ‘counterparty code’ or ‘counterparty group code’ column using the prefix ‘LEI/’ or ‘PRE-LEI’ e.g. ‘LEI/123LEI4567890CODE321’ or ‘PRE-LEI/123LEI4567890CODE321’.
- If an LEI (or PRE-LEI) code is not available and a specific code e.g. 123456 is used, this must be must be entered into the ‘counterparty code’ or ‘counterparty group code’ columns using the prefix ‘SC/’ e.g. ‘SC/123456’.
- firms are expected to only use the prefixes detailed above. Further detail can be found in sections 4.1 and 5.3.1 in the Bank of England Solvency II XBRL filing manual.

**Usage of NACE codes as identified in the DPM dictionary**

XBRL technical issues accounted for 31% of issues with submissions uploaded on the first attempt and almost one third of these were due to NACE codes marked as ‘unusable’ in the DPM dictionary being used for reporting. Further detail on what to look for and how to resolve this can be found in the section 7.3.1 of the Bank of England Solvency II XBRL filing manual.

**Quality of the Information – plausibility checks**

It is not possible for the Bank to assess every data element for plausibility, therefore data checks target the data items and forms that are of most interest to the supervisors and risk specialists supporting them.

Due to the infancy of the returns, which have many new data elements within entirely new data items, there will be an inevitable learning and development process of defining, assessing and refining of these data checks. As the Bank becomes more familiar with the data, it may identify particular areas of greater importance, or serve as better indicators of data quality and thus it may be necessary to change, add or remove data checks over time.

The data itself is also in its infancy and therefore the calibration of the data checks and tolerances around data elements will be refined as the Bank becomes more familiar with the data and is able to compare the data either on an individual or aggregated basis. As the number of submissions increase over time and the process matures, those checks relating to trend analysis will become more robust and those checks relying on an expected figure will also become more accurate, potentially allowing tolerances to be tightened.

The data checks currently in place have several purposes including to:

- ensure cells add up to the correct totals;
- ensure that where a firm reports the same data element in two different forms, it has done so consistently;
- look for computational errors by measuring difference between 'reported' and 'expected' values; and
- identify significant changes in the firm's profile by measuring changes over time.

The data checking process generated a total of 2430 failed data checks with an average of 22 failed data checks per firm (10%) with an average of 15 failed data checks per firm requiring investigation. Many failed data checks (1219) related to differences between the Solvency II template and the comparison data being used. Given the current lack of time series data this was not surprising as the comparative data used in this test was not ideal. However, it still provides a useful benchmark for us to test against.

Over time we expect more of our plausibility checks to be included into the formal validation phase.

**Issues identified**

Some of the most notable failure areas are detailed below:

- around half of the overall failures were driven by checks that relied on comparison with historic data sets. As the data is in its infancy, it is possible that the comparison data may not be optimal, but as we gain consisted time series data these checks will be key to our assessment of quality;
    - as an example, a large number of firms failed data checks relating to standard formula SCR (form S.25.01). However, this involved a check against comparison

data which has been submitted for different purposes and therefore may not be an ideal comparator;

- in total there were 45 cross-form data checks which generated 263 failures. Most of these failures came from checks involving
  - form S.26.06 (Operational Risk) against S.02.01 (Balance Sheet); and
  - form S.28.01 (MCR Non Composite) against S.17.01 (Non-Life technical provisions;
- forms S.25 and S.25.02 had the most related failures when measured on a proportion of data checks per data item basis. These data items cover the SCR and the failures raised relate to inconsistencies in the way firms have approached completing forms for Partial Internal Model methodology approach and Standard Formula versus the comparison data used for the check; and
- some data checks will be modified to make them appropriate; an example of this is where data item '02.01' Assets Match SII SA compares the asset totals between Solvency II and IFRS. Similarly some checks failed due to application error (an example being a check not taking into account the requirement for firms to complete both partial internal model and standard formula templates).

**Focus on assets**

The 'List of Assets' template (S.06.02), provides a much more detailed analysis of assets than that provided in the Solvency I return, which resulted in larger firms submitting up to 100k rows of asset data across 30 columns, with over half a million rows of data collected across all prep phase submissions. This presents the possibility of numerous data errors such as incorrect units, spelling errors and mis-identification.

Due to the open-ended nature of the assets form, it was decided that automated data checks would not be performed on the assets data received in the preparatory phase. However, it is intended that in future submissions automated data checks will be developed. In the absence of automated checks, we have carried out a considerable amount of manual assessment of these returns. This manual review has identified a number of significant issues and data gaps which all firms must address:

- the assets data item required firms to complete a number of fields which provide information on the asset issuer (e.g. asset ISIN code, NACE code, issuer name, issuer LEI). Firms have taken a mixed approach to filling in these columns, prioritising different columns; for instance 16% of total assets reported do not have a NACE code reported and 34 firms have reported a combined £50bn of assets without an issuer name**;**
- firms have also taken different approaches to specifying the asset 'category'. For example it was noted that holdings of Network Rail bonds have been reported as both government bonds and corporate bonds, with the sector being described as either *'transporting and storage', 'freight rail transport', 'activity of a financial holding company' , 'trade of electricity' or 'trusts and funds'*. Whilst the Bank was able to identify all of these assets as Network Rail exposure, there remain issues e.g.15 firms have reported a single ISIN code relevant to Network Rail differently;

- firms' use of the *'Other'* category when compiling, in particular CIC codes, does not seem to be justified with some firms reporting over 50% of assets in *'Other'.* The issue is exacerbated when the remaining fields have not been adequately completed. From the data obtained it was possible to conclude that:
    - a significant number of firms have not been able to submit a value figure for all reported assets;
    - our analysis to date shows that a significant proportion of assets have been reported without information identifying the specific type; and
- another area specifically identified was the completeness of corporate bond credit rating and sector information which showed that less than 50% of firms submitted both categorisations in totality and often firms submitted data with one categorisation missing in totality.