



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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Solvency II Directors' update

As 1 January 2016 gets closer we have already reached several key milestones. The IMAP application process has started and the PRA has already received a number of applications for various Solvency II approvals. Firms are reminded that if approvals are needed for day one, or where interdependencies exist, applications need to be submitted as soon as possible. To prevent unnecessary delays, and to ensure the 'clock' does not need to be stopped for any reason, applications must be of a high quality and meet all the requirements of the Solvency II Directive. Firms should have liaised already with supervisory contacts to agree when applications are expected. However, firms are reminded that if these dates change they should inform their supervisor as soon as possible.

For in-scope firms, step one of the [balance sheet review](#) should be complete. The PRA will be looking to publish information on some issues arising from the stage-one process by end May. For internal model firms, step two should be completed by end June 2015; specific timelines should have already been agreed with supervisors. In-scope standard formula firms should also have discussed, and agreed, with their supervisors dates when step two should be completed.

The submission period for the first annual returns for the preparatory phase of the regulatory reporting process starts on 1 June, with submissions due by 30 June. More information on that process is included in this update.

Standard formula

In the [February Directors' letter](#) the PRA informed firms that it had identified a number of pilot firms which would be reviewed for standard formula appropriateness. All other standard formula firms will be reviewed as part of the normal supervisory process.

Although the PRA considers that the standard formula is the right option for a number of firms, there will be circumstances where the standard formula deviates from an individual firm's risk profile. Firms are reminded that it is their responsibility to identify these and that an assessment of their significance should be included in the ORSA report. As part of the ORSA review, the PRA will assess the appropriateness of the standard formula to ensure the SCR is, or remains, an adequate reflection of a firm's risks at the individual and aggregate level. This will include an assessment of supplementary information to explain any deviations.

We emphasise also the importance of rigorous quality assurance and governance underpinning the standard formula calculation and of Boards having a good understanding of the key drivers and material SCR components.

Ideally, the firm will already have recognised where the standard formula deviates from its risk profile. Where the PRA identifies that a firm's conclusion on this question is not appropriate, it will consider specific

interventions. These are detailed in [SS4/15](#). The PRA intends to inform all firms before the Solvency II Directive is implemented on 1st January 2016 where interventions are required. Where firms are intending to seek model approval post-January 2016 this will be taken into account when considering what interventions might be necessary.

Internal model

Feedback from internal model commitment panels

The [internal model commitment panel process](#), is now almost complete. Firms have been informed of the outcome of their commitment panel and of the specific areas where the PRA considers further progress is required. Annex A to this letter is designed to supplement this individual feedback by highlighting some of the general themes that the panels have observed

Internal model – model change policy

All internal model firms are required to have a model change policy. The policy needs to be developed as part of the internal model approval process. Following approval, the model change policy is expected to play a central role in the wider governance of a firm's internal model. For example, it should help ensure that the internal model continues to reflect the risks to which a firm is exposed and meet the requirements of Solvency II.

It is important that the model change policy is of a good standard. To date, however, the PRA has seen a wide variation in quality. On 7 May, the PRA [published](#) some good practice. This list is not, however, exhaustive and firms should consider all the relevant Solvency II requirements and Guidelines when developing their model change policy.

Regulatory reporting

BEEDS portal

Firms in scope for the preparatory phase of regulatory reporting must submit annual reporting information, using the Bank of England Electronic Data Submission (BEEDS) portal, by 1 July 2015 for solo firms, or 15 July 2015 for groups.

To ensure in-scope firms are fully prepared and in a position to use the BEEDS portal ahead of the submission deadline, the Bank of England will provide information and materials in an on-boarding pack. This will be sent, via email and post, to nominated principal users in late May 2015. Support to firms will also be provided from late May to the submission deadlines; details will be provided in the on-boarding pack.

Reporting currency

EIOPA is currently consulting on the Solvency II reporting currency requirement that firms will have to meet after Solvency II implementation. During the preparatory phase, the PRA envisages that UK firms will submit their quantitative reporting in sterling. Any firm that intends to submit their quantitative reporting in another currency should inform their supervisor as soon as possible. The PRA would also find it helpful if firms that submit quantitative reporting in the preparatory phase inform their supervisor of the source of exchange rate used for their submission.

Solvency II approvals

A [new webpage](#) has been added to the Bank of England website specifically for Solvency II approvals and waivers. The transactions that firms may apply for under Solvency II are listed on this page, together with information on the application types. To access information, forms, and guidance relating to each approval, firms should follow the appropriate links. The 'Solvency II waivers' link will take users to the waivers and

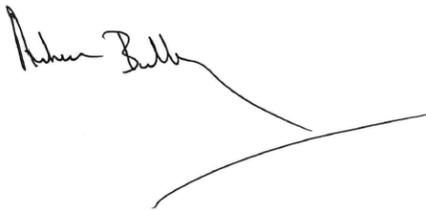
modifications home page where they can find information about the waivers process along with Solvency II-specific information and forms.

2015 general insurance stress test

Firms are reminded that the PRA has issued a draft questionnaire for firms' comment regarding the forthcoming general insurance stress test exercise. If your firm is interested in participating in this exercise, please let us know via your usual supervisory contact or Stefan Claus (Stefan.Claus@bankofengland.co.uk). Feedback on the draft questionnaire will be accepted until the end of this month.

As mentioned in the last [Directors' update](#) this exercise will be similar to the IMAF stress test exercise carried out in 2011, except that the PRA intends to broaden the scope to include all Category 1 & 2 general insurers. As in 2011, the PRA will ask firms to provide the impact of specific stress tests both before and after mitigation.

Yours sincerely



Andrew Bulley
Director, Life Insurance



Chris Moulder
Director, General Insurance

Annex A

Feedback from internal model commitment panels

Impact of late changes to internal models on the model application

The PRA was encouraged to see that, in a number of cases, firms have made changes to their models to address weaknesses identified in previous feedback. However, decisions by firms to make late changes to models means that further work is now required in order to demonstrate that these changes have been properly incorporated into the model. Firms are reminded that before formal applications are submitted they need to ensure any revised approaches are technically sound, have been reviewed and agreed by appropriate internal governance fora, and are documented and validated as set out in the tests and standards. Where firms are still seeking model approval for 1 January 2016, the PRA is unlikely to have the opportunity to review any of these late changes, or give further feedback, before a formal application. As a result, firms must be confident that any changes made at this stage are likely to be sufficient to address satisfactorily any previous feedback given by the PRA.

Changes to internal models during the application period

Firms are also reminded that once a formal internal model application has been submitted to the PRA, there is very limited opportunity for firms to make any substantive changes. Firms should therefore make sure their applications are stable and approved by the internal governance process prior to formal application. Where firms become aware that they may need to make changes during the application period, these should be discussed with their usual supervisory contact as soon as possible. Where changes are material, a new formal application may be required. Alternatively, firms themselves have an option to 'stop the clock' on the current application. Neither of these options should be approached lightly. If firms believe that model changes are likely to continue into the formal application phase, they are encouraged to consider delaying the formal application and discuss options with their usual supervisory contact.

Validation

Validation of models is critical. It requires a combination of detailed 'bottom up' testing and 'top down' ownership by Boards. The PRA has made clear for some time that it expects firms to be able to produce clear evidence showing how Boards are overseeing and influencing the design of the validation process, how the findings from validation work are summarised and reported to them and how Boards are then involved in tracking validation issues through to resolution. The PRA is still seeing examples where it is not clear that Boards are using validation as a tool to enable them to gain a good understanding of a model and its strengths and weaknesses. The PRA outlined its high-level expectations on Board involvement in validation in the [Directors' letter of 13 March 2015](#) and firms are encouraged to revisit this guidance.

Importance of meeting the Solvency II tests and standards for model approval

The PRA can approve an internal model application only where it is satisfied that the model has met all the Solvency II tests and standards. Approval must be based on this requirement and not an 'on-balance' judgement. Some firms have proposed applying internal management loadings to models to help deal with known areas of weakness which cannot be fixed fully ahead of the formal application. In some cases, such adjustments might help firms to demonstrate that specific areas of the model meet the relevant tests and standards (for example, the Solvency II calibration standard of 99.5% over one year). However, all areas of the model must meet the Solvency II requirements and the use of more generic management loadings cannot be used by firms as a mitigant where the model does not meet the required tests and standards.

Contingency planning

The PRA has observed that many firms still have a considerable amount of work to submit a viable formal application to order to gain model approval for 1 January 2016. It is important that firms take a realistic approach to their chances of completing any outstanding work prior to formal application. If firms have concerns they should speak to their usual supervisory contact.

Irrespective of internal model progress, all firms should have a viable contingency plan in the event that they either do not gain model approval, or a dependant Solvency II approval is rejected. In the commitment panel process the PRA has observed differing levels of contingency planning. Firms need to ensure they have a clear understanding of the actions they would take if they do not secure model approval.

Timetable of activity March 2015 to 2015 Q2

Date	Description
End May 2015	Communication on regulatory reporting 'on-boarding'
End May 2015	Feedback on step-one of the balance sheet review
June 2015	ED letter on the MA
June 2015	ED letter on the ORSA
1 June – 1 July (solos)/10 July (groups) 2015	Submission period for regulatory reporting returns (for in-scope firms)
June 2015	Supervisory statement: Solvency II: internal model reporting codes
June 2015	Supervisory statement: Solvency II: ORSA and the ultimate time horizon — non-life firms
June 2015	Supervisory statement: supervisory approach on volatility adjustment
June 2015	Consultation paper: Solvency II: internal model reporting codes and Solvency II: life product reporting codes
17 June 2015	ILAG briefing on ORSA
21 June 2015	AFM briefing on ORSA
1 July 2015	Data collection exercise for life firms – responses due
10 July 2015	Consultation closes - CP16/15: consistency of UK generally accepted accounting principles with Solvency II
July 2015	Smaller firms briefing (Cat 5 firms)
2015 Q2	Consultation paper – non directive firms
2015 Q2	Consultation paper – consequential instruments
2015 Q2	Supervisory Statement on treatment of sovereign debt in the internal model
2015 Q2	PRA to provide information on GI stress testing questionnaire

25 November 2016: This letter has been archived. Appendix 8 of Policy Statement 33/16 lists the supervisory statements in which the PRA's expectations, where relevant, are available.
See <http://www.bankofengland.co.uk/prs/Pages/publications/ps/2016/ps3316.aspx>

2015 Q2	Supervisory Statement on consistency of UK generally accepted accounting principles with Solvency II Directive
2015 Q2	Regulatory reporting preparatory phase feedback

[Solvency II web updates](#) since the last Directors' update

April 2015

On 22 April 2015, the PRA published a supervisory statement that sets out its expectation of firms in relation to EIOPA's Solvency II Set 1 Guidelines which were published on 2 February 2015. The statement follows consultation paper CP5/15, Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorized firms, issued on 19 February 2015.

 [SS22/15: Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorized firms](#)

On 10 April 2015, the PRA published a consultation paper that seeks feedback on a draft supervisory statement (SS). This SS sets out the PRA's expectation of firms which are considering applying the derogation within Article 9 of the Solvency II Regulation (EU) 2015/35. This derogation permits firms to value some assets and liabilities using local generally accepted accounting principles (GAAP) if certain criteria are fulfilled.

 [CP16/15: Solvency II: consistency of UK generally accepted accounting principles with the Solvency II Directive](#)

On 10 April 2015, the PRA released a briefing session on the role of non-executive directors in an internal model firm in Solvency II. A recording of the event and the delegate pack are available on the following links.

 [Non-executive directors in Solvency II](#)

 [Non-executive directors in Solvency II briefing slides, March 2015](#)

March 2015

On 31 March 2015, the PRA published a consultation paper that contained a draft supervisory statement (SS) setting out the PRA's position on treatment of sovereign debt in internal models. The consultation paper expands on the PRA's general approach as set out in its insurance approach document and reminds firms of a particular basis risk that arises when sovereign bonds are used to back Solvency II liabilities.

 [CP14/15: Solvency II: treatment of sovereign debt in internal models](#)

On Saturday, 28 March 2015, the PRA published a letter from Paul Fisher, Executive Director of Insurance Supervision, on the matching adjustment. Following the PRA's review of firms' matching adjustment pre-application submissions, the letter provides general feedback to the industry and should be particularly helpful to firms wishing to make a formal application from 1 April 2015. It should be read alongside earlier industry feedback letters published on [15 October 2014](#), [20 February 2015](#) and [9 March 2015](#).

 [Solvency II: feedback on firms' matching adjustment pre-application submissions, 28 March 2015](#)

 [Other Solvency II approvals](#)

On 25 March 2015, the PRA and Association of British Insurers (ABI) published a webcast ahead of Solvency II coming into force on 1 January 2016. The webcast features Paul Fisher, Executive Director at the PRA, discussing the Solvency II framework with Huw Evans, the ABI's Director General.

 [In conversation with the PRA - ABI webcast with Paul Fisher](#)

On 20 March 2015, the PRA published the following:

Policy statement 2/15 Solvency II: A new regime for insurers which sets out the rules and accompanying supervisory statements required for the PRA's implementation of the Solvency II Directive.

 [PS2/15 - Solvency II: A new regime for insurers](#)

Information regarding the approvals and waivers firms should use to make a formal application under the Solvency II Directive from 1 April 2015, ahead of the PRA rules that transpose the Solvency II Directive requirements coming into effect on 1 January 2016. This includes additional information to support firms applying for approval to use the transitional measure on technical provisions.

 **Approvals and waivers under the Solvency II Directive**

 **Additional information on the transitional measure on technical provisions**

Consultation paper CP11/15 Solvency II: supervisory approval for the volatility adjustment

 **CP11/15 - Solvency II: supervisory approval for the volatility adjustment**

On 13 March 2015, 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, 13 March 2015**