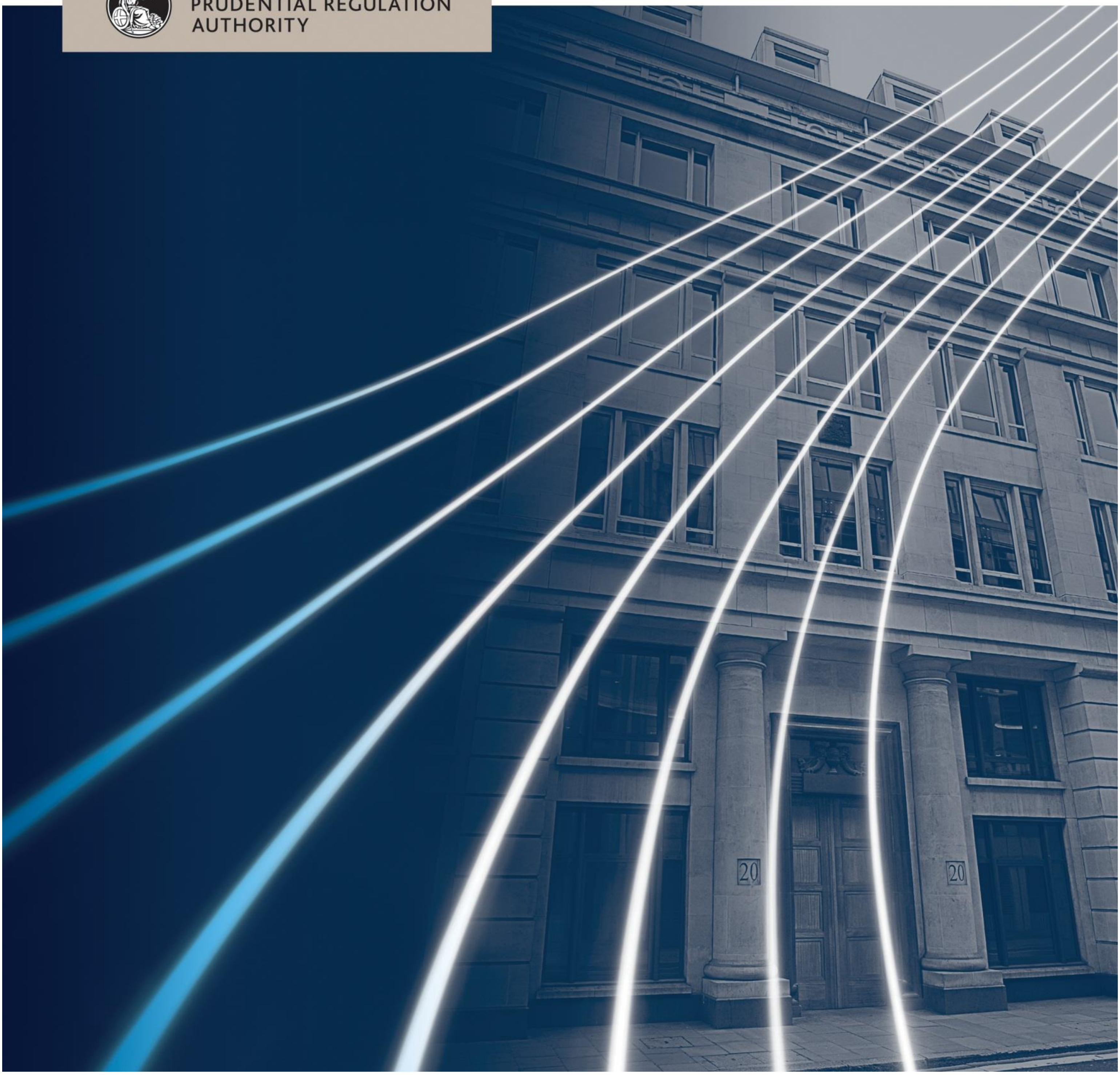
Policy Statement | PS16/17

Dealing with a market turning event in the general insurance sector

July 2017

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses, and the final Supervisory Statement (SS) 5/17 'Dealing with a market turning event in the general insurance sector' (see Appendix), for Consultation Paper (CP) 32/16 'Dealing with a market turning event in the general insurance sector'.[1]

1.2 This PS also provides responses, in the context of the CP proposals and policy on a market turning event (MTE), to recommendations made to the PRA set out in an industry White Paper published in January 2017.[2] This follows an industry-sponsored dry run exercise simulating a $200 billion catastrophic loss event that took place in November 2016 (see Chapter 3).

1.3 This PS is relevant to all PRA-regulated general insurance firms in scope of the Solvency II Directive (the Directive), and to the Society of Lloyd's (Lloyd's) and managing agents ('Solvency II firms').

1.4 In the CP the PRA set out its proposed expectations of how general insurers, particularly those operating in the global specialty insurance and reinsurance market known as the London Market, might plan for and respond to a market turning event (MTE). The PRA also proposed some areas that it would expect firms to consider in the medium- and long-term after an event, to assess the lessons which might be learned from the experience, and to assess the potential consequences for their business model and risk profile.

1.5 Following consideration of respondents' comments to the CP and the recommendations following the industry-sponsored dry-run exercise, the PRA has made several changes to the SS consulted on. These changes and feedback to responses are set out in Chapter 2. The changes include:

- further consideration of the characteristics of a MTE and its impact on firms' model change policies;
- addressing concerns over the speed of a regulatory response following a MTE (including the PRA's interaction with Lloyd's and other regulators);
- amendments made to the example loss return template;
- clarification of the application of proportionality and firms' use of existing documentation such as Own Risk & Solvency Assessments (ORSAs); and
- amendments to more explicitly draw out the importance of liquidity management following a MTE.

1.6 Chapter 2 also confirms that no changes have been made to the SS regarding a breach of minimum capital requirement (MCR) or solvency capital requirement (SCR).

1.7 The PRA does not consider that the changes made to the proposals contained in the CP are significant enough to have any additional material impact on firms, including mutuals, and so

1 September 2016: www.bankofengland.co.uk/pra/Pages/publications/cp/2016/cp3216.aspx.
2 Published by an industry steering group comprised of insurers and brokers from across the market, as well as Lloyd's 'London Market looks ahead: Preparing for the next big insurance event', available at www.hiscoxgroup.com/news/press-releases/2017/31-01-2017.aspx.

has not provided an updated cost benefit analysis. The PRA also considers that the impact of the changes on mutuals will be no different from the impact on other PRA-authorised firms.

2 Feedback to responses

2.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to consider representations that are made to it when consulting on its general policies and practices.[1] The PRA received seven responses to CP32/16. All respondents were supportive of the intentions behind the proposals. The sections below summarise the responses, and provide the PRA's feedback and final decisions.

Definition of a market turning event

2.2 Some respondents to the CP asked for greater clarity on any distinction between a MTE and a 'significant general insurance event'. The SS notes that a MTE is an event triggered by a significant insurance loss which then causes a number of other consequences for firms, regulators, and the market, possibly including material changes in premium rates (the SS does not, however, attempt to define the nature of such an event – see paragraph 2.3 below). It is possible that a significant general insurance event might occur which causes large losses to firms but which does not necessarily result in some of the other changes contemplated in the SS (eg changes in premium rates). Nevertheless, many of the expectations set out in the SS would still be relevant in such circumstances, for example, what steps firms might take in advance to help assess the impact of such an event on their financial position, and the expectations the PRA might have of firms to provide it with data on the impact of the loss on the market. Some minor changes in wording have been made throughout the final SS to use the term 'MTE' more consistently.

2.3 More generally, the CP did not attempt to forecast the cause, likelihood, or impact of such an event due to the impossibility of capturing all possible future circumstances. Instead it listed certain characteristics that might be present in a MTE. The SS continues this approach, however, to the aforementioned list, the PRA has added the possibility that a MTE may also have characteristics such as being unusual, unexpected, un-modelled or hard to price.

Model change policy

2.4 Several respondents asked for greater clarity on the process for model change approval following a MTE. The PRA has set out its expectations on this process in SS12/16 'Solvency II: Changes to internal models by UK insurance firms'.[2] However, additional clarity has been provided in the final SS regarding purely rate-driven triggering of model change policies.

Speed of regulatory response

2.5 A number of respondents raised concerns about whether there would be sufficient flexibility and speed in the PRA's regulatory response to requests from firms to allow them to take advantage of the so-called 'hard market' conditions that might follow a MTE.

2.6 The PRA recognises that firms would prefer a quicker response. The PRA's ability to deliver this, however, depends to a large extent on the quality and timeliness of the information and data provided by firms following a MTE. Firms should therefore consider the expectations set out in the final SS to help identify in advance the type of issues on which they might seek the PRA's response, look to engage with the PRA at an early stage, and respond to any requests for information on a best endeavours basis.

1 Sections 2N and 2L, FSMA.
2 September 2016: www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1216.aspx.

2.7 A number of respondents asked whether it would be possible for applications that might be necessary in the event on a MTE, to be processed by the PRA quicker than the timescales set out in its rules or in statute, for example, expediting reviews of capital instruments or model change requests. The PRA notes that these timescales are maximum periods available and that it often processes applications significantly quicker than the statutory timetable available. Firms are reminded that they can help shorten this period by considering in advance what applications they might need, and ensuring they provide good-quality information as part of an application.

2.8 Some firms noted the potential value in discussions being held with the PRA ahead of an event to clarify mutual expectations, and for firms to explain their plans. The PRA has noted in the final SS that it is open to holding discussions with individual firms who would like to discuss their potential plans to respond to a MTE.

Interaction with Lloyd's

2.9 One respondent asked for greater clarity on how the PRA would interact with Lloyd's and how the PRA and Lloyd's would co-ordinate to interact with the market. The PRA has worked with Lloyd's to refine post-event data requests in an effort to reduce duplication and promote standardisation. The PRA is aware that Lloyd's is also intending to publish its own 'Guiding principles for a MTE' which are intended to be broadly consistent with the PRA's expectations.

Loss return template

2.10 Most respondents were supportive of the proposed use of a standardised loss return template by the PRA to gather information after an event, although one suggested it would be more efficient to align the information requested more closely with firms' own Management Information. The PRA considers that collecting this information in a standardised format allows quicker comparison, identification of outliers, and aggregation of information.

2.11 Some respondents asked for further clarity on the approach taken by the PRA to defining the alternative scenarios set out in the loss return template. The loss return template has been amended to simply request a firm's best estimate of industry and individual losses.

2.12 Respondents also noticed a discrepancy on proposed response times between the template and the main text. This has now been corrected to state that the PRA considers that in most cases it is most likely to look to issue its initial data request template within a week of a significant general insurance loss event, and request initial submissions from firms a week thereafter. Some respondents noted that these timelines might be ambitious and that estimates would be likely to be subject to change at that point. SS5/17 recognises this potential uncertainty, and confirms that the timescales will remain subject to an assessment by the PRA at the time, to ensure sufficient flexibility to respond to the circumstances.

SCR/MCR breach

2.13 Some respondents sought clarification on the PRA's treatment of an SCR/MCR breach, for example how the plan referred to in the SS as consulted on interacted with the requirements in Rules 3.1 and 4.1 of the Undertakings in Difficulty Part of the PRA Rulebook. The PRA considers that, where an SCR/MCR breach or potential breach has occurred as a result of a MTE, the statement identifies a number of relevant factors which the PRA would expect firms to consider when submitting the realistic recovery plan or finance schedule required under these rules. No changes have been made to the statement in this regard.

Co-ordination of information requests with other authorities

2.14 A number of respondents asked for confirmation that the PRA would look to manage its information requests with other regulatory stakeholders to avoid unnecessary duplication of submissions by firms. As well as creating greater alignment between the PRA's and Lloyd's likely data requests, the SS has been updated to reflect the fact that, where possible, the PRA will look to utilise existing mechanisms such as the general co-ordination agreement with Lloyd's and/or a global college of supervisors to gather information. It also makes clear, however, that the PRA reserves the right to request information from managing agents directly if this is considered necessary.

Interaction with other processes such as ORSA and stress testing

2.15 Some respondents noted it would be helpful if the statement could explain how the PRA's expectations on MTEs interacted with existing processes such as firms' ORSAs and stress testing. The PRA has updated the SS as consulted on to note that it recognises some elements of firms' planning for MTEs might already be (or could be) incorporated into existing processes, and conversely that these existing processes might provide useful insights for firms thinking more specifically about how to respond to a MTE. Paragraph 3.4 in the final SS makes clear that firms are not expected to duplicate work already undertaken elsewhere when considering the possible impacts of a MTE.

Liquidity

2.16 Several respondents stressed the importance of liquidity following a MTE, in particular given the size of potential reinsurance recoveries. The PRA agrees that this could be an important consideration and this has been more explicitly drawn out in the final SS in paragraph 8.10.

Proportionality

2.17 One respondent also noted that the scope of CP32/16 appeared focused on the London Market and queried whether proportionality would be applied to non-London Market firms. As stated in the overview, the SS is relevant to all general insurance firms as well as Lloyd's and managing agents, but is aimed particularly at those firms operating in the global specialty insurance and reinsurance market known as the London Market, whose business models are exposed to low probability, high severity catastrophe risks. The SS consulted on already contained a statement in paragraph 3.1 confirming that "the PRA expects the level of consideration given to these issues by firms to be proportionate to the nature and scale of their business, and the impact that a MTE is likely to have on its operations". For clarity, this sentence has been moved to the introduction in the final SS.

3 Recommendations from industry dry-run exercise

3.1 The PRA also received more general comments on its approach to a MTE from firms participating in an industry-sponsored dry-run exercise conducted in the latter half of 2016, the results of which were set out in the 'London Market looks ahead' White Paper published in January 2017.

3.2 This exercise generated a number of recommendations for the industry, some of which were also relevant for the PRA. These recommendations were grouped under the collective title of 'Collaborating with the PRA to clarify mutual expectations and ensure an effective post-catastrophe response' in the report.

3.3 The report recommended that the PRA consider providing further clarity on its 'activities, priorities and expectations' in responding to a MTE. The PRA considers that the publication of this SS clearly states its expectations of firms in preparing for, and responding to, a MTE. As noted in paragraph 2.8 above, the PRA is open to holding discussions with individual firms who would like to discuss their potential plans in more detail.

3.4 The PRA also provided further background on its approach in Chris Moulder's September 2016 speech, 'Dealing with a market-turning event in the General Insurance Sector'.[1] The PRA's priorities in managing such an event would be driven by the actions it deemed necessary to meet its statutory objectives. The PRA would expect to manage its response to a MTE by putting in place specific arrangements to: co-ordinate its response to such an incident; oversee the collection of data from firms on their potential impact; give guidance and direction to individual firm supervisors to inform their communication with individual firms; and assess an appropriate aggregate response. The PRA's established decision-making arrangements also ensure that significant decisions are escalated to PRA executive management and ultimately the Prudential Regulation Committee (PRC) where required.

3.5 The industry report also suggested the PRA could communicate and co-ordinate its expectations with Lloyd's. As outlined in paragraph 2.9 , the PRA has continued to work with Lloyd's since the publication of CP32/16 to agree co-ordination arrangements for a MTE to reduce any unnecessary duplication or inconsistency in information requested by both parties. Lloyd's is planning to publish further information on its own expectation of managing agents.

3.6 Finally, the report noted the importance of co-ordination between the industry and the various regulators and government bodies. It suggested that the industry work with the PRA to refine its communication channels and identify how, in response to a MTE, the PRA and the industry should engage with other stakeholders in the wider Bank of England, the Financial Conduct Authority (FCA), Her Majesty's Treasury (HM Treasury) and other relevant government departments in the United Kingdom and other countries. Since the publication of the report the PRA has also met with representatives of the London Market Group to explore what further co-ordination might be appropriate.

3.7 In the United Kingdom, the Bank of England, FCA and HM Treasury have an established crisis management framework called the Authorities Response Framework. This framework can be invoked to co-ordinate any response required by the FCA, Bank of England and HM Treasury to an event that results in major disruption to the financial sector and/or to the authorities.

3.8 The PRA would also expect to draw, as required, upon its established bilateral and multilateral relationships with other international insurance supervisors, through its membership of individual firm supervisory colleges and international regulatory fora, to share information as required following a MTE and co-ordinate any action. The final SS clarifies how the PRA would seek to use existing international supervisory colleges, where possible, to obtain information on a firm's wider group position in the event of a MTE.

1 29 September 2016: www.bankofengland.co.uk/publications/Pages/speeches/2016/928.aspx .

Appendix

Supervisory Statement 5/17 'Dealing with a market turning event in the general insurance sector' available at: www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss517.aspx.