

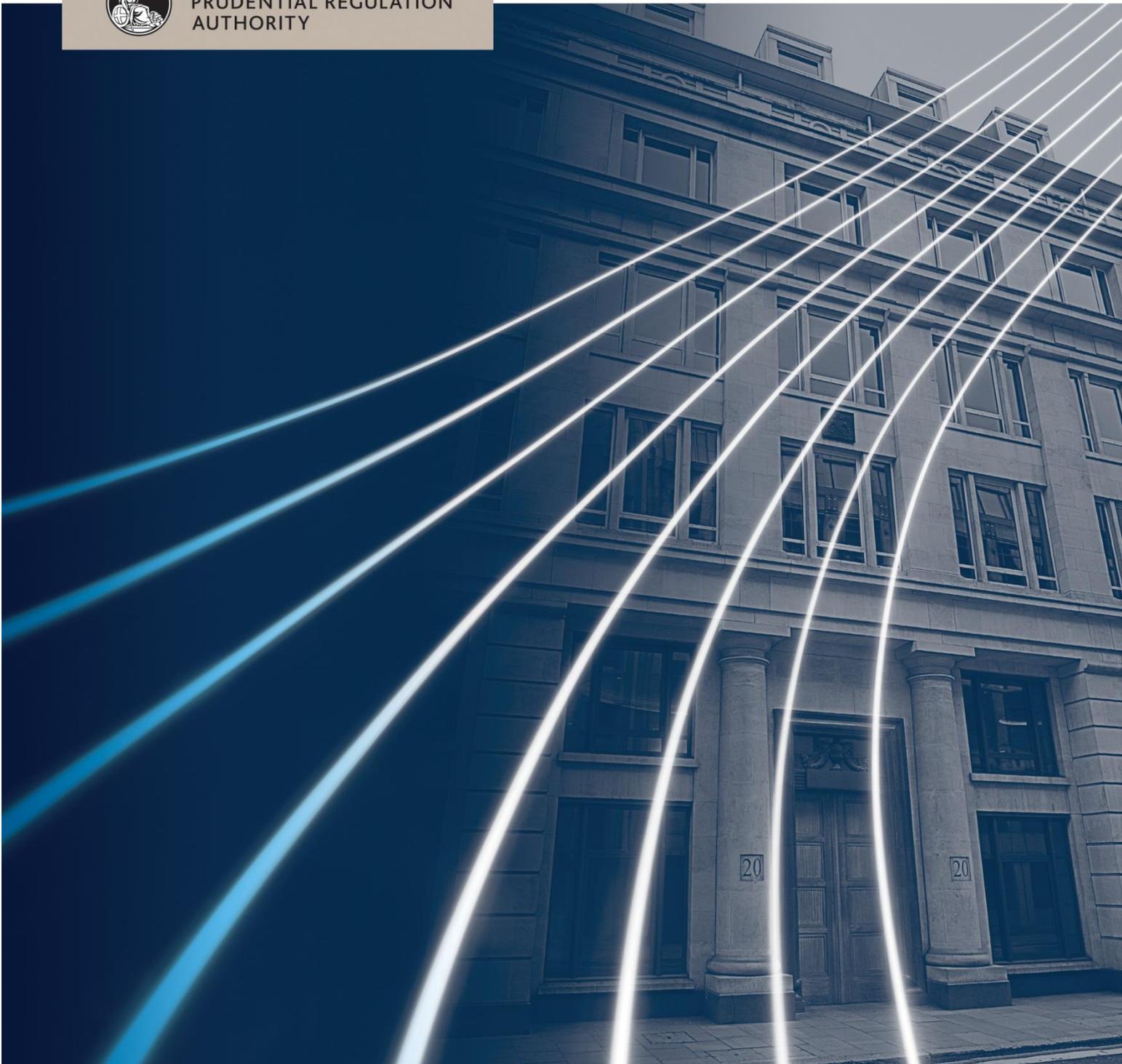
Policy Statement | PS17/18

Solvency II: Group supervision

July 2018



BANK OF ENGLAND
PRUDENTIAL REGULATION
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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback on the responses to Consultation Paper (CP) 38/16 ‘Solvency II: Group supervision’,¹ and the final Supervisory Statement (SS) 9/15 ‘Solvency II: Group supervision’.

1.2 This PS is relevant to all UK insurance firms within the scope of the Solvency II Directive (‘the Directive’)² and to the Society of Lloyd’s.

1.3 SS9/15 (see Appendix) sets out the PRA’s updated expectations for group supervision and incorporates the PRA’s letter ‘Solvency II: An update on implementation’ published on 25 July 2014.³ The letter will be archived following the publication of the updated SS.

1.4 Simultaneously, the PRA is publishing CP15/18 ‘Solvency II: Group supervision’⁴ which sets out the PRA’s proposals to further amend SS9/15 for its expectations for assessments of the availability of own funds to cover the group solvency capital requirement. The proposals in CP15/18 provide details on certain aspects of how own funds should be assessed as available, and to address responses to CP38/16 on this aspect of the PRA’s proposed policy. The further consultation covers only material in Chapter 5A (availability of group own funds) of the SS.

Background

1.5 CP38/16 compiled elements from the PRA Directors’ letters issued in the period prior to (and shortly after) the Directive came into effect. When developing CP38/16, the PRA reviewed the Directors’ letters and has considered the extent to which any of that preparatory material should be carried forward, post-implementation of Solvency II, to become ongoing supervisory expectations of firms in the context of group supervision.

1.6 The elements proposed to be included in SS9/15 covered the following areas:

- determinations by the PRA of available group own funds;
- the choice of calculation method available to insurance groups;
- entities excluded from the scope of group supervision;
- single own risk and solvency assessment (ORSA) reports;
- single group Solvency and Financial Condition Reports (SFCRs);
- responsibilities of the relevant insurance group undertaking; and
- group supervision in the absence of third-country equivalence.

1 November 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-group-supervision.

2 Directive 2009/138/EC (Solvency II) (recast).

3 www.bankofengland.co.uk/prudential-regulation/letter/2014/solvency-ii-update-july-2014.

4 July 2018: www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-2-group-supervision.

Summary of responses

1.7 The PRA received five responses to CP38/16 that focused mainly on firm's compliance with group provisions, choice of calculation method, availability of own funds, and group own funds brought in by deduction and aggregation.

Changes to the draft SS

1.8 After considering responses, the PRA has made changes to the draft SS9/15 consulted on as follows:

- The SS was amended in chapters 2 to 5A, and chapters 6 to 9 to clarify the aspects of the PRA's letter 'Solvency II: An update on implementation' published on 25 July 2014 on group supervision that are intended to have effect as ongoing supervisory expectations. This covered:
 - choice of calculation method available to insurance groups – setting out the expectation that firms are to apply for a PRA permission before calculating group capital requirements using method 2 – Deduction and aggregation;
 - entities excluded from the scope of group supervision – setting out the expectation for firms to apply for a PRA permission in order to be able to exclude an entity from scope of group supervision;
 - single ORSA reports and single group SFCRs – setting out the expectations that firms seeking to submit single group ORSAs and SFCRs need the PRA's prior approval; and
 - group supervision in the absence of third-country equivalence – providing for the process to be followed by firms seeking to make use of 'other methods' as an alternative to the PRA applying Solvency II group supervision at the level of the worldwide group headquartered in a non-equivalent jurisdiction.
- The section on centralised risk management has been deleted.
- Availability of group own funds - a section has been added to the SS in Chapter 5A that sets out the PRA's expectations of firms when they calculate the own funds available to the group. The SS clarifies that unless a formal assessment is made by the PRA, firms are expected to assume that all group own funds are available except where that own fund item is specifically excluded under Article 222 of the Directive and Article 330 of the Commission Delegated Regulation (EU) 2015/35.

1.9 Although not included in CP38/16, on the issue of regulatory determination on the availability of group own funds – the SS has been updated to include additional guidance to auditors of the group SFCR in Chapter 5B. The guidance describes the process that the PRA expects auditors to follow when assessing whether a regulatory determination has been made in respect of the availability of group own funds.

1.10 References to the PRA Rulebook in the SS have also been updated.

1.11 Further information on the above changes is set out in Chapter 2 below.

1.12 The PRA does not consider the changes made to the draft policy to be significant and the PRA has not reassessed the cost benefit analysis or impact on mutuals.

Implementation and next steps

1.13 The policy in the revised SS takes immediate effect.

1.14 The policy contained in this PS has been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including changes arising once any new arrangements with the European Union take effect.

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, and must publish in such manner as it thinks fit responses to the representations.¹

2.2 This chapter sets out the PRA's feedback to responses received, changes it has made to the draft SS, and its final decisions. The comments received dealt with the following issues: compliance with group provisions, choice of calculation method, availability of own funds, and group own funds brought in by deduction and aggregation (method 2).

Compliance with groups' provisions

2.3 Two respondents questioned the need for paragraph 1.6 in the draft SS, which set out the PRA's proposed expectations where the PRA is not the group supervisor. In particular, they felt that the statement set a requirement, rather than an expectation, on insurers to abide by the group supervision provisions under the Directive even where they are not part of an insurance group.

2.4 The PRA has clarified the wording, now included in paragraph 1.2 in the final SS, to cover cases where group supervision is carried out other than under the Directive and confirmed that all of the group insurance undertakings have a role in ensuring that group requirements are met if they are part of a group.

Choice of calculation method

2.5 Where a firm wishes to use a method for calculating the group solvency capital requirement (SCR) other than method 1 (accounting consolidation-based method), firms understood that they would be expected to provide an explanation to the group supervisor. However, one respondent questioned the need for this process to be formalised, which might unnecessarily increase complexity and documentation requirements.

2.6 The PRA has considered this response, and decided not to make any change to this expectation in the final SS. The PRA considers that in the interest of legal certainty, and in light of the requirement for the decision of the group supervisor to be taken in consultation with other supervisory authorities concerned and with the group itself,² that the formality which comes with applying for a direction under FSMA section 138A is appropriate.

Availability of own funds

Solo and group SFCR and regular supervisory reporting (RSR)

2.7 Two respondents were of the view that it was unclear whether the analyses of availability referred to in paragraph 5A.2 were intended to be part of the solo or group SFCR and regular supervisory report (RSR).

¹ Sections 2N and 2L, FSMA.

² Article 328 of Commission Delegated Regulation (EU) 2015/35.

2.8 The PRA expects the analysis of the availability of solo own funds to meet the group SCR. As such, the PRA considers that the bulk of the analysis is best provided as part of the group SFCR and group RSR notwithstanding that a brief description is also required in any solo SFCR. This has been now included in paragraph 5A.2.

Disclosure of the analysis of group own funds

2.9 Four respondents expressed concerns that the information being requested by the PRA in the group SFCR was more detailed than that prescribed by the Commission Delegated Regulation (EU) 2015/35. In particular, firms were apprehensive that potentially market sensitive information would have to be included in the SFCR, and that this information, if not considered in the right context, could be misleading.

2.10 The group SFCR must contain qualitative and quantitative information on any significant restriction to the fungibility and transferability of own funds eligible for covering the group SCR.¹ A more detailed analysis, which can include market sensitive information, should be included in the RSR reported privately to the PRA or directly to the group supervisor. In aggregate the PRA expects to receive sufficient information and analysis to enable it to understand potential restrictions on availability and form its own view on whether it is appropriate for the own funds items to be included in group own funds. That would include a description of how any potential restrictions might be overcome in the view of the group. Paragraph 5A.2 of the SS has been amended to more accurately reflect the PRA's expectations.

Frequency of the analysis of group own funds

2.11 Two respondents interpreted the wording of paragraph 5A.1 of the SS to imply that firms would have to produce a detailed analysis of the availability of group own funds on a quarterly basis, ie at each reporting date.

2.12 The PRA considers that the analysis should be provided when requested by the group supervisor. The PRA has clarified in paragraph 5A.2 that own funds should be treated as available, unless a formal regulatory determination has been made by the group supervisor or as otherwise specified in the provisions of the PRA's rules transposing the Directive. If a determination has not been made and the firm considers an item to be unavailable (and the own funds aren't otherwise required to be deducted), the firm should contact their group supervisor for a formal review.

Group own funds brought in by deduction and aggregation (method 2)

2.13 Two respondents questioned the PRA's approach to the assessment of group own funds brought in by entities included in the group solvency calculation using method 2 and its consistency with the opinion issued by the European Insurance and Occupational Pensions Association (EIOPA) in September 2015.²

2.14 The PRA considers that the own funds brought in by method 2 are still subject to an assessment by the group supervisor of availability at the group level. In particular, the PRA applies the same criteria to assessing the availability of local own funds. The SS seeks to provide clarification that this assessment is expected and provides an example of how this would be applied. The PRA considers this approach to be consistent with the opinion issued by EIOPA as referenced above.

1 Article 359(e)(ii) of the Commission Delegated Regulation (EU) 2015/35.

2 EIOPA-BoS-15/201 25 September 2015 – Opinion of the European Insurance and Occupational Pensions Authority on the group solvency calculation in the context of equivalence.

Additional feedback received by PRA regarding regulatory determinations with regard to the availability of group own funds

2.15 Subsequent to the publication of the CP, the SS has also been amended to include details as to what constitutes a regulatory determination in respect of the assessment of the availability of own fund items.

2.16 This additional guidance has been provided following feedback from audit firms.

2.17 The SS includes the process the PRA expects auditors to follow when assessing whether a regulatory determination has been made by the PRA. The details of the process are set out in Chapter 5B of the final SS. The new chapter outlines:

- what should be considered as a regulatory determination made by the PRA;
- the assumption that an auditor is expected to make should there be no regulatory determination;
- the process that the auditor is expected to follow where a firm has assessed an own fund item as unavailable to cover the group SCR; and
- the PRA's expectation that the auditor obtain evidence on the firm's processes for the determination of the availability of own fund items.

2.18 This additional guidance is addressed to auditors reviewing group own funds availability assessments made by firms. There is no direct impact on the insurance firms (including mutual) in terms of associated implementation costs.

2.19 Audit firms will benefit from the additional guidance as it will allow them to discharge their role in relation to firm SFCR submissions detailing group own funds availability assessments.

Appendix

SS9/15 UPDATE 'Solvency II: Group supervision' available at:
www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-group-supervision-ss