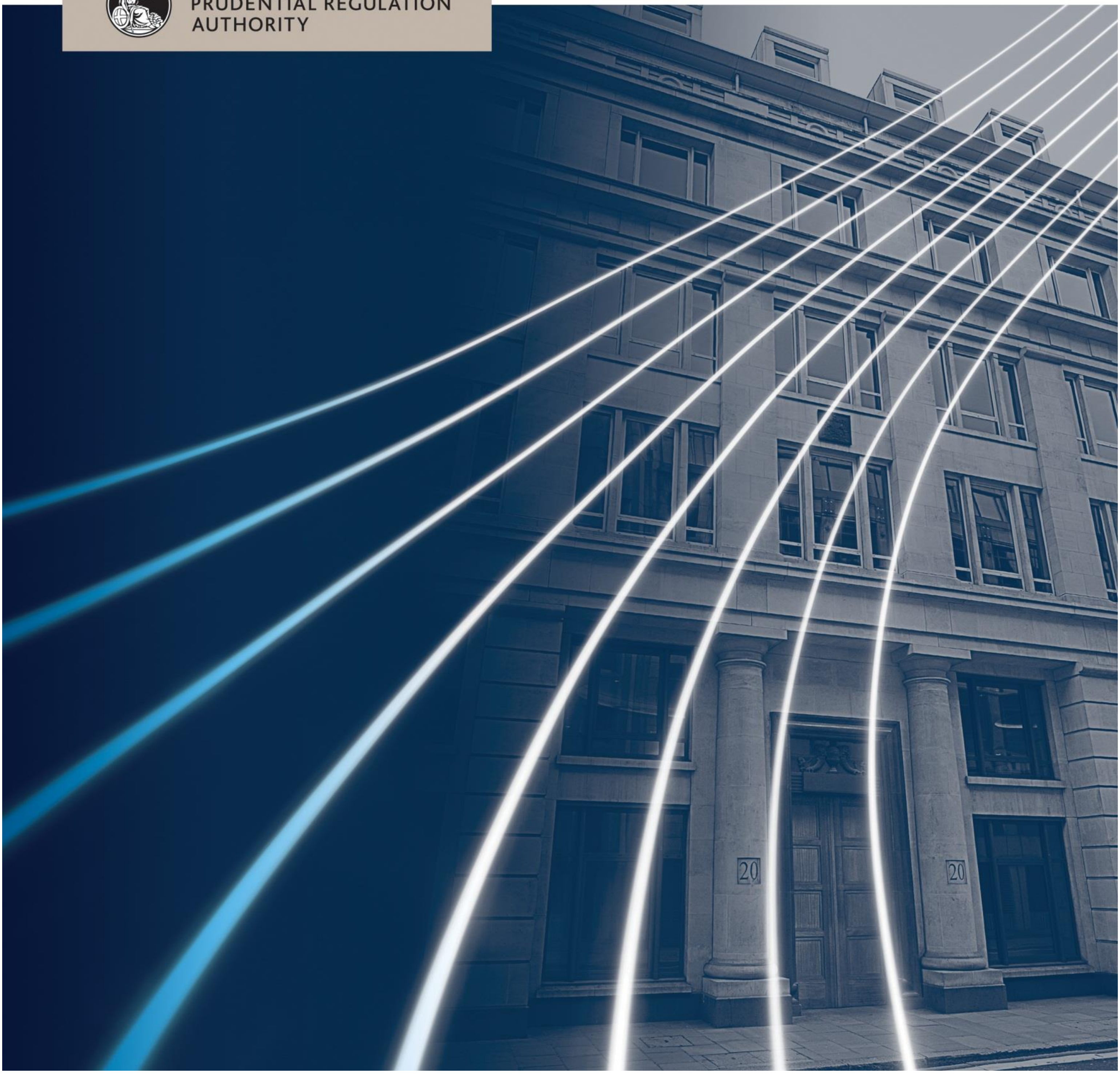
Policy Statement | PS20/18

Solvency II: Internal models update

July 2018

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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July 2018

Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 27/17 'Solvency II: Internal models update'[1] and the final updated expectations of firms in respect of the model change process set out in Supervisory Statement (SS) 12/16 'Solvency II: Changes to internal models used by UK insurance firms'[2] (Appendix 1), and internal model change policies set out in SS17/16 'Solvency II: internal models – assessment, model change and the role of non-executive directors'[3] (Appendix 2).

1.2 This PS is relevant to all UK Solvency II firms, the Society of Lloyd's and its managing agents. It is most relevant to firms that have an internal model approval. It may also be of interest to UK Solvency II firms seeking approval to use an internal model and to UK Solvency II firms that are part of the European Economic Area (EEA) or non-EEA groups with a group internal model.

Background

1.3 CP27/17 set out the PRA's updated expectations of firms in respect of the model change process set out in SS12/16 and SS17/16. The PRA proposed:

- an annual reset of minor model change accumulations which do not trigger the major model change threshold within an annual cycle, as a separate process to the process of resetting minor model changes when firms apply for a major model change, and expectations around the implementation of this process;

- clarification that firms' model change policies should contain clear definitions of model changes that cover a sufficiently broad scope, in line with EIOPA's Guideline 6 on the use of internal models; and

- submission of model change reports via the Bank of England Electronic Data Submission (BEEDS) portal within five weeks of the reference quarter end and an optional standardised template.

Summary of responses

1.4 The PRA received four responses to the proposals in CP27/17. Respondents welcomed the PRA's proposals but also asked for further clarification, guidance and alternative wording in some areas. The PRA's feedback to responses, and decisions, are set out in Chapter 2.

Changes to draft policy

1.5 Following consideration of respondents' comments, the PRA has made a number of minor changes to the draft SS to provide greater clarity on the PRA's expectations.

1.6 The PRA considers that the changes are not significant, and will not increase the burden on firms (including mutuals), or have a differential impact on mutuals compared to other firms. Therefore, the PRA has not updated the cost benefit analysis from the CP, or provided an assessment of the impact on mutuals.

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1 December 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-ii-internal-models-update.
2 September 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-changes-to-internalmodels-used-by-uk-insurance-firms-ss.
3 November 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-internal-modelsassessment-model-change-and-the-role-of-non-executive-directors-ss.

Implementation

1.7 The PRA proposes that the updates to the minor model change accumulation process and reporting processes would take effect from the day of publication of this PS. Changes to the model change policy are subject to supervisory approval in accordance with Regulation 48 of the Solvency II Regulations (2015/575)[1] and the PRA's expectations of that procedure, set out in paragraph 2.14 of the updated SS12/16.

2 Feedback to responses

2.1 The PRA must consider representations that are made to it in accordance with its duty to consult on its general policies and practice, and must publish in such manner as it thinks fit responses to the representations.

2.2 The PRA received four responses to CP27/17. All of the responses supported the proposals. Some respondents asked for clarification and suggested alternative wording in selected areas to make the statements clearer. The section below provides the PRA's feedback to these responses. The responses have been grouped as follows:

- annual reset of minor change accumulation;
- scope of the model change policy;
- timing of minor change reporting; and
- reporting template QMC.01.

Annual reset of minor change accumulation

2.3 The PRA proposed that, in addition to the major change process an annual reset should apply to minor model changes which, when accumulated, do not trigger the major change threshold within the annual cycle specified by the firm.

2.4 Respondents requested clarification on the process for the annual reset of minor model changes. Firms may reset, at the end of an annual cycle (which they may specify), minor model changes which, when accumulated, do not trigger the major change threshold. Firms with approved internal models are expected to submit quarterly minor model change reports. Assessment of the annual minor model change reset will be carried out as part of the PRA review of the quarterly minor model change reports. Formal approval of the minor model change reset is not required from the PRA as it does not approve minor model changes. However, the PRA retains the right to challenge the firm upon review of the model change report. Firms are encouraged to discuss accumulated minor changes with the PRA prior to resetting accumulations to zero in order to ensure a common understanding of the interaction between the various minor changes and the model as a whole. The discussion with the PRA prior to resetting of accumulation to zero is proposed for the benefit of firms so as to reduce the risk the PRA will require the firm to address minor changes that may cause the model to no longer meet the Solvency II tests and standards.

2.5 The PRA was asked to clarify its expectations with respect to model drift in the context of the annual reset. The proposals do not directly impact model drift assessment as the PRA would not expect the Solvency Capital Requirement (SCR) to be rebased for the purpose of model drift due to the annual reset of minor model change accumulations.

1 http://www.legislation.gov.uk/uksi/2015/575/pdfs/uksi_20150575_en.pdf.

2.6 Minor changes to the drafting on these sections were made as a result of feedback.

Scope of the model change policy

2.7 The PRA proposed that firms update their model change policies to contain clear definitions of model changes that cover a sufficiently broad range of potential sources of changes, in line with the European Insurance and Occupational Pensions Authority's (EIOPA's) Guideline 6 on the use of internal models.

2.8 One respondent asked whether the timetable for review of the model change policy had been agreed with other national supervisory authorities. The PRA refers to existing guidance in SS12/16 (paragraph 1.2) which states that where the firm is part of an EEA or non-EEA group the college of supervisors may need to co-ordinate and agree the overall process for approving a major change application, which may differ to that set out in the supervisory statement.

Timing of minor change reporting

2.9 The PRA proposed that firms with an approved internal model submit model change reports via BEEDS within five weeks of the reference quarter end.

2.10 One respondent recommended that firms submit quarterly minor model change reports in alignment with already established Solvency II quarterly reporting requirements for solo insurance firms and groups. This would include the use of transitional timelines.

2.11 The PRA considered the recommendation and agrees that the timing of minor change reporting may follow the Solvency II quarterly reporting schedule for groups (as summarised in the PRA's quarterly reporting schedule)[1] in order to allow firms sufficient time to follow their internal governance processes. However, the PRA encourages firms to submit these reports earlier where possible, to enable early engagement. The supervisory statement has been amended accordingly.

Reporting template QMC.01

2.12 The PRA encourages firms with an approved internal model to submit their quarterly minor model change information using a template provided by the PRA. The use of the template is optional.

2.13 One respondent asked the PRA to clarify whether firms may submit a minor change report at the group level. The PRA considers it appropriate for firms to submit consolidated group model change reports as long as model changes and their impacts applicable to each subsidiary that uses the internal model to calculate the SCR is separately identifiable within this.

2.14 Another respondent requested that examples be specified in the template for the ease of firms and that all terms are defined in the LOG file. More detailed guidance has been provided on populating cells C0200, C0250, and C0210. The PRA has reflected this in the LOG file.

2.15 It was requested that the template should allow for estimates where the actual impact on SCR cannot be calculated. The PRA has reflected this in the LOG file.

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1 Available in section 1c on the Bank's website at: www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-insurance-sector.

Appendices

1	**SS12/16 'Solvency II: Changes to internal models used by UK insurance firms', available at: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-changes-to-internal-models-used-by-uk-insurance-firms-ss.**
2	**SS17/16 'Solvency II: internal models – assessment, model change and the role of non-executive directors', available at: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-internal-models-assessment-model-change-and-the-role-of-non-executive-directors-ss.**