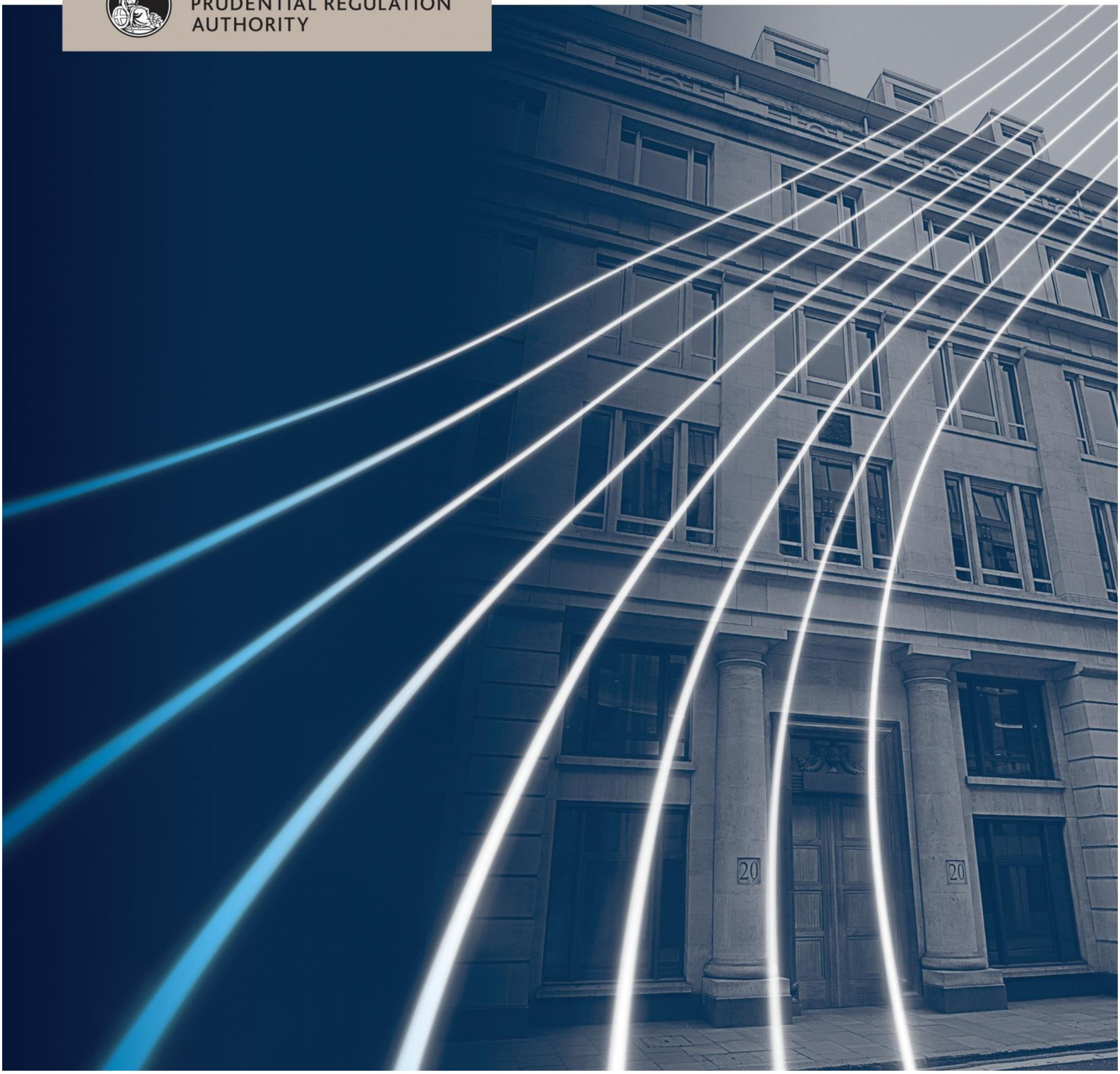
Policy Statement | PS24/18

Solvency II: Updates to internal model output reporting

October 2018

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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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) 10/18 'Solvency II: Updates to internal model output reporting'.[1] It also contains the PRA's final policy, as follows:

- updated Supervisory Statement (SS) 25/15 'Solvency II: Regulatory reporting, internal model outputs';[2] and
- updated SS26/16 'Solvency II: ORSA and the ultimate time horizon – non-life firms'.[3]

1.2 This PS is relevant to all UK Solvency II firms and the Society of Lloyd's in respect of each of their syndicates and in respect of outputs of the Lloyd's internal model.

1.3 In CP10/18 the PRA proposed to make changes to the life, counterparty and non-life templates and the associated instructions (LOG files in SS25/15 and SS26/15). The proposals followed the analysis of the year-end 2016 PRA internal model output (IMO), feedback from individual firms and the PRA's package of insurance reporting reforms, with the intent of clarifying and reducing the overall reporting burden.

Changes to draft policy

1.4 After considering the responses, the PRA has made a number of minor amendments to the expectations and LOG files. The PRA considers that the changes continue to reduce the overall reporting burden on firms and provide further clarity on completion of the relevant templates. In the PRA's opinion, the impact on mutuals of the policy set out in the updated SSs is not significantly different from the impact on other firms. Chapter 2 of this PS summarises the issues raised by respondents and provides further details of the changes.

Implementation

1.5 The policy will take effect for all financial year-ends on, or after, Monday 31 December 2018.

1.6 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 Before making any proposed rules, the PRA is required by the Financial Services and Markets Act (FSMA) to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its response to them.[4]

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1 See page 2 of 2: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-ii-updates-to-internal-model-output-reporting.
2 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-regulatory-reporting-internal-model-outputs-ss.
3 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-orsa-and-the-ultimate-time-horizon-non-life-firms-ss.
4 Sections 138J(3); 2L; and 138J(4) of FSMA.

2.2 The PRA received five responses to the CP. Respondents generally welcomed the PRA's proposals. Some respondents made a number of observations relating to further changes to be considered and requests for clarification which are set out below.

Internal model outputs for life insurance firms

2.3 The PRA received one response to the changes proposed for IM.01 template and LOG file, whereby the PRA proposed to request 'biting scenario' information for all risk variables.

2.4 The respondent asked the PRA to clarify whether the information previously requested to satisfy the ad hoc biting scenario information will continue to be acceptable to satisfy the embedded request proposed for template IM.01.

2.5 The PRA confirms that the information previously requested to satisfy the ad hoc biting scenario information will continue to be acceptable to satisfy its expectation for the provision of biting scenario information.

2.6 In addition, following the amendment to instructions for credit risk stresses in the IM.01 LOG file, the PRA now considers it no longer necessary for firms to provide separate calibrations for financial and non-financial bonds.

Internal model outputs for non-life insurance firms

General

2.7 The PRA received comments from two respondents of a general nature in response to the changes proposed to the IM.03 template and LOG file.

2.8 One respondent commented that the PRA may be wishing to reconstruct models for sensitivity testing purposes by requesting information at such a granular level, and proposed stipulating sensitivity tests as a separate request while looking to reduce the overall IMO reporting burden.

2.9 The PRA considers the IMO request an important tool to monitor and assess the ongoing appropriateness of internal models, and the use of this data is beyond only sensitivity testing. For example, the PRA may conduct change analysis and consistency analysis. Therefore the PRA considers the level of detail in the IMO to be appropriate to be contained in one information request.

2.10 Two respondents commented on template formatting. One respondent asked for clarity to aid in submitting data in the correct format or type. Another respondent asked the PRA to delete lines rather than hide them in the templates.

2.11 The PRA considers that the LOG files and templates clearly specify the units and format required of the input data. The move to submission in XBRL format will address outstanding issues.

2.12 Two respondents commented on the checks performed by the PRA, both before and after submission, in order to improve data quality.

2.13 The PRA expects some plausibility checking of the data to be carried out as part of the move to XBRL where possible. The concept of the plausibility checks are similar to Solvency II quantitative reporting template (QRT) submissions, where if certain rules are not satisfied then firms may receive a message in the Bank of England Electronic Data Submission (BEEDS) portal. However, there will be some data checks that may not be possible. For example, firms adjust underwriting profits outside of the model. Where this is the case, the PRA expects firms to provide additional commentary.

Catastrophe risk

2.14 The PRA received responses from three respondents to the changes proposed to IM.03 relating to catastrophe risk. These covered a wide range of issues.

2.15 One respondent commented that requesting only one-year catastrophe risk losses may be inconvenient for some firms, and suggested that the PRA could continue to allow both ultimate and one-year catastrophe loss data to be provided. The PRA expects firms to provide both one-year and ultimate catastrophe risk loss information, however if the two are identical firms have the option to indicate this.

2.16 One respondent commented that the request to separate man-made peril losses between property and liability could prove challenging. The PRA has removed the request for firms to separate man-made peril losses between property and liability lines of business.

2.17 Two respondents suggested that it was too early for firms to distinguish between terrorism and cyber perils, despite the growing significance of these lines of business. The PRA recognises that it may be too soon to separate losses between cyber, terrorism and other man-made perils. In the expectation that these lines may become increasingly important, the template retains this distinction, but the instructions in the LOG file have been amended to clarify that firms unable to allocate losses between these perils can put man-made losses into ‘all other man-made catastrophe perils’.

2.18 The proposal to remove the request for firms to show premiums and sums insured by peril was welcomed, but with a number of comments about alternative breakdowns of geographic regions and potential inconsistency in how firms complete this part of the template. The PRA has revised the proposed split: in particular US premiums and sums insured are expected to be split between the four areas used for the European Insurance and Occupational Pensions Authority (EIOPA) standard formula calculation. Recognising the nature of reinsurance contracts, the split for reinsurance premiums is at a lower level of granularity. The PRA recognises the concerns about consistency of interpretation and has clarified the instructions in the LOG file to cover issues such as limits that vary by peril.

2.19 In addition, the PRA recognises that the mapping of individual lines of business to each peril does not facilitate structured analysis and this request has been removed.

2.20 The PRA has also removed the split of aggregate exceedance probability (AEP) losses between direct insurance and reinsurance. This is consistent with the treatment of occurrence exceedance probability (OEP) losses, which was welcomed by respondents, but was inadvertently excluded from the consultation.

Premium and reserve risk

2.21 The PRA received comments from two respondents to the changes proposed to the IM.03 template and LOG file relating to premium and reserve risk.

2.22 One respondent commented that mapping firms’ own lines from the current year to the previous year could be difficult if there is a change in modelling granularity, and suggested basing the monitoring and analysis at Solvency II lines of business level.

2.23 The PRA has identified a number of limitations of Solvency II lines of business analysis which may distort year-on-year comparisons. For example, a change in the mix of firms’ own lines in a Solvency II line can demonstrate itself as a change in the volatility of the Solvency II line. Firms may have a different methodology to map lines which could be allocated to more than one Solvency II line affecting both the volatility and the correlations between Solvency II lines of business. Analysis of firms' own lines can reduce these limitations but requires a mapping to the previous year. The PRA considers that firms should leave the mapping blank for a new 'own' line that did not exist in the previous year or was created as a result of a change in granularity (eg split and merger), so that the own line mapping is always a one-to-one relationship.

2.24 One respondent commented that the usefulness of historical loss ratio data could be limited because firms may have different basis of loss ratio data (accident year or underwriting year), different granularity, and sometimes the quality of data may be poor.

2.25 The PRA acknowledges these factors, and also the actual parameterisation process is far more complicated than just looking at historical loss ratios. However, the PRA considers the historical loss ratios data requested in the IMO is helpful for identifying potential weaknesses and issues of premium risk parameterisation, which may warrant more detailed investigation and is information usually available to firms.

2.26 Another respondent asked if expenses should include commission and if premiums should be net of commissions.

2.27 The PRA confirms that firms have flexibility in deciding the composition of the cash flows of premiums, claims and expenses. A clear description of what these cash flows include should be provided in PRE002, PRE003 and RES002.

2.28 One respondent commented that rather than extending the net undiscounted data submission to just standard deviation, the PRA could extend the net undiscounted data submission to be entirely the same as gross undiscounted and net discounted, to enable consistency between each set of data.

2.29 The PRA has amended the submission to include net undiscounted data in addition to gross undiscounted and net discounted.

Market risk

2.30 The PRA received comments from one respondent on the changes proposed to the IM.03 template and LOG file relating to market risk.

2.31 The respondent commented that the PRA's reclassification of asset categories to align with the Solvency II balance sheet as reported in QRT S.02.01 may not be aligned with a firm's own view of how market risk should be modelled.

2.32 The PRA acknowledges that the categories by which market values of assets in scope of the model are reported at {IM.03.07.01, rows MKT201 to MKT214, column C101} might not be aligned with the categories by which firms model market risk. However, in these rows no internal model outputs are reported. The categories of assets in the market risk part of IM.03 (IM.03.07.01) helps to identify the quantum of assets on a firm's balance sheet but not in scope of its internal model, and to relate the market risk outputs to an appropriate base measure.

Appendices

1	**SS25/15 'Solvency II: regulatory reporting, internal model outputs', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-regulatory-reporting-internal-model-outputs-ss**
2	**SS26/15 'Solvency II: ORSA and the ultimate time horizon – non-life firms', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-orsa-and-the-ultimate-time-horizon-non-life-firms-ss**