

Policy Statement | PS6/18

Responses to CP18/17 ‘Occasional Consultation Paper’ – Chapters 2 to 6, 9 and 10

March 2018



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Contents

1	Overview	5
2	Feedback to responses	6
	Appendices	10

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Chapters 2 to 6, 9 and 10 of Consultation Paper (CP) 18/17 'Occasional Consultation Paper' (the CP).¹ It also includes the final rules and updated Supervisory Statement (SS) 13/13 'Market risk', and SS36/15 'Solvency II: life insurance product reporting codes' as set out in the appendices.

Appendix	CP18/17 Chapter	Rulebook Part / SS
1	Chapter 2: Conditions governing business – minor amendments	Solvency II - Conditions Governing Business
2	Chapter 3: Market risk – Capital Requirements Directive (CRD) IV amendment	Internal Capital Adequacy Assessment Part
3	Chapter 4: Amendments to Transitional Measures Part to correct references	Transitional Measures Part
4	Chapter 5: Application requirements – Capital Requirement Regulation (CRR) and CRR amendments	Various
5	Chapter 6: Whistleblowing in UK branches of non-EEA deposit takers	General Organisational Requirements Part
6	Chapter 9: Application of EBA's Guidelines on corrections to modified duration of debt instruments	SS13/13
7	Chapter 10: Life insurance product reporting codes	SS36/15

1.2 This PS is relevant to all PRA-authorised firms.

1.3 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA) requires the PRA to publish:

- (a) details of the difference together with a cost benefit analysis (CBA); and
- (b) a statement setting out, in the PRA's opinion, whether or not the impact of the final rule on mutuals is significantly different to the impact that the draft rule would have had on mutuals or the impact that the final rule will have on other PRA-authorised firms.

1.4 The PRA received no responses for Chapter 2, 4 to 6, and 9 of the CP. The PRA has made minor typographical changes to the draft rules and SS for these chapters, as well as for Chapter 3. The PRA received four responses to Chapter 10 and has made changes to the draft policy. These changes and their impact are set out in the next chapter.

1.5 The PRA has also added of its own initiative an additional clause in paragraph 2.3 of the SS to enable firms to use code 624 for any non-profit protection business if the amount of that business is not material. This change was made for proportionality reasons to benefit firms where new business, premium income, and technical provisions for protection business are all a very small part of the total for the firm.

1.6 The PRA considers that the changes made to the draft policy are not significant, and has therefore not provided an updated CBA or assessment of the impact on mutuals.

Implementation

1.7 The changes to the rules and SSs in this PS will take effect from 30 March 2018.

2 Feedback to responses

Chapter 2: Conditions governing business – minor amendments

2.1 The PRA proposed to amend the Conditions Governing Business part to correct rule 3.2(3)(b) by inserting the defined term ‘volatility adjustment’ in exchange for the word ‘volatility’.

2.2 The PRA did not receive responses to this chapter of the CP and is making amendments as consulted.

Chapter 3: Market risk – Capital Requirements Directive (CRD) IV amendment

2.3 The PRA proposed to amend ICAA 8.4 to reflect the text set out in CRD IV. CRD IV Article 83(3) clarifies that firms should fund themselves with adequate capital when they hold opposite positions in stock-index futures which are not identical in respect of either maturity, composition, or both. This builds on the existing ICAA 8.4 rule, which sets out that a firm which has netted off its positions in one or more of the equities constituting a stock-index against one or more positions in the stock-index future or other stock-index product, must have adequate financial resources and internal capital to cover the basis risk of loss caused by the future’s or other product’s value not moving fully in line with that of its constituent equities.

2.4 The PRA received one response to this proposal on the existing ICAA 8.4 text suggesting amendments to explicitly exclude some timing differences. The PRA has considered this response and states that the text and rule is a direct transposition from CRD IV, and the PRA notes both the ongoing review of CRD IV, and the draft Capital Requirements Regulation (CRR) Regulatory Technical Standards (RTS) on the Market Risk Internal Model Approach for Assessment Methodology, which covers this topic, and is pending final approval and publication in the EU Official Journal. Given the possibility for further textual change and/or additional European guidance, the PRA does not propose to explore this topic further at this time. No changes have therefore been made to the rules following consultation.

Chapter 4: Amendments to Transitional Measures Part to correct references

2.5 The PRA proposed to amend rule 13.3 of the Transitional Measures Part. This rule exempts groups from reporting capital add-ons or undertaking specific parameters (USPs) in the Solvency and Financial Condition Report (SFCR) for the first two financial years following the implementation of Solvency II. 13.3 will be amended so that it references Reporting 3.6 instead of Reporting 3.7 so that the transitional measure is effective.

2.6 The PRA did not receive responses to this chapter of the CP and the PRA intends to make the rules as consulted by updating the transitional measures to part.

Chapter 5: Application requirements – Capital Requirement Regulation (CRR) and CRR amendments

2.7 The PRA proposed to clarify the application of prudential requirements in the PRA Rulebook on an ‘individual basis’ to ensure that basis is altered to reflect any relevant CRR permissions granted by the PRA. The PRA proposed to amend the Capital Buffers, Internal Capital Adequacy Assessment, Internal Liquidity Adequacy Assessment, Leverage Ratio, Liquidity Coverage Requirement – UK Designated Firms; and Reporting Pillar 2 Rulebook Parts to reflect the clarification.

2.8 The PRA also proposed to amend the Capital Buffers, General Organisational Requirements, Internal Capital Adequacy Assessment, Internal Liquidity Adequacy Assessment, Liquidity Coverage Requirement – UK Designated Firms; Reporting Pillar 2 ; Risk Controls and

Skills, Knowledge and Expertise Rulebook Parts to adjust the wording of the consolidated/sub-consolidated application provisions to ensure they reflect any CRR Permissions granted by the PRA and any national discretions implemented through PRA rules which alter the scope of consolidation or sub-consolidation. A consequential amendment to the definition of 'consolidation group' was also proposed.

2.9 The PRA did not receive responses to this chapter of the CP, and the PRA intends to make the rules as consulted by updating the relevant parts.

Chapter 6: Whistleblowing in UK branches of non-EEA deposit-takers

2.10 The PRA proposed to amend the General Organisational Requirements Part to clarify that the requirement on firms to share details of their whistleblowing channels with UK branches of non-UK entities that are part of the same group applies to firms which are the UK parent company of the group as well as those which are subsidiaries.

2.11 The PRA did not receive responses to this chapter of the CP, and the PRA intends to make the rules as consulted by updating the General Organisational Requirements Part.

Chapter 9: Application of EBA's Guidelines on corrections to modified duration of debt instruments

2.12 The PRA proposed to amend SS13/13 to state that firms should comply with EBA Guidelines when making calculations under CRR Article 30.

2.13 The PRA did not receive responses to this chapter of the OCP and SS13/13 has been updated accordingly.

Chapter 10: Life insurance product reporting codes

2.14 The PRA proposed to amend SS36/15 to specify a structured approach that firms are expected to adopt when naming homogeneous risk groups for reporting best estimate liabilities in the annual Solvency II reporting template S.14.01.01 *Life obligations analysis* (S.14.01). The PRA also proposed to delete two paragraphs from SS36/15 where the 2017 amendment to the Solvency II Implementing Technical Standards¹ (ITS) on reporting addresses similar requirements.

2.6 The PRA received four responses to this chapter of the CP. A number of respondents sought greater clarity on aspects of the proposals and their implementation. The PRA's feedback to responses, final decisions, and amendments to the final policy are set out below.

Implementation of changes to SS36/15

2.7 Three respondents expressed concerns with the ability of firms to implement the proposed changes to SS36/15 for annual reporting as at 31 December 2017. The PRA can confirm that this is not required. The proposed changes will apply from the date of publication of this PS, so for the majority of firms they will apply from end-2018 reporting onwards.

2.8 Nevertheless, the PRA welcomes any changes firms can make to improve data quality for end-2017 reporting. For example, the incorrect reporting of homogenous risk groups has hindered the ability of the PRA and the Office of National Statistics to use the best estimate data in S.14.01. Where firms do not currently have one-to-one correspondence between homogenous risk groups and a product code, the PRA welcomes any improvements firms can make to the granularity of homogenous risk groups for 2017 year end.

¹ COMMISSION IMPLEMENTING REGULATION (EU) 2017/2189.

2.9 Firms are reminded that the 2017 Amendment to the Reporting Implementing Technical Standards (ITS)¹ (which affect the instructions to S.14.01) and the EIOPA Guidelines on the valuation of technical provisions² (that address the definition of homogeneous risk groups) are both effective for 2017 annual reporting.

Approximations in apportioning best estimate liabilities between homogeneous risk groups

2.10 Three respondents commented that guarantee costs are sometimes calculated for groups of products where the output of the method does not split the cost of guarantees by PRA product code. The PRA has updated SS36/15 to clarify that in this situation the PRA expects firms to make an approximate apportionment between the relevant product codes.³

2.11 One respondent highlighted that firms may be combining product codes when allocating trustee investment plans and group managed funds contracts due to uncertainty on the nature of the underlying pension scheme. In most cases the firm will know what type of pension scheme the insurance policy is supporting. In the case of doubt an apportionment between the relevant products codes should be made on a best endeavours basis. The PRA has updated SS36/15 to provide clarification.⁴

Contract count reporting

2.12 One respondent highlighted that the proposed deletion of paragraphs 3.2 and 3.3 in SS36/15 could have a ‘big impact on firms’ and could result in an artificial number of contracts reported.

2.13 The PRA’s proposal to delete paragraphs 3.2 and 3.3 was designed to address how SS36/15 interacts with the amended ITS, which was updated to include a technical solution for reporting of the contract count when products are already unbundled. The change to the ITS supports the pre-existing requirement to report unbundled products across multiple rows. Specifically, the amendment to the ITS requires the reporting of a contract count of 1 for each product component only when a firm is unbundling a product. Paragraph 3.2 of SS36/15 however, is relevant to contracts with multiple sub-policies, which may often be identical, and differ in nature from unbundled products. These are not expected by the PRA to be reported with a separate contract count for each sub-policy.

2.14 The proposed deletion of paragraph 3.2 from SS36/15 was intended to avoid confusion to firms arising from numerous instructions relating to contract count reporting for S.14.01. Although the instructions for rows R0040 and R0050 in S.14.01 of the ITS and paragraph 3.2 of SS36/15 differ in their application, the existence of two different instructions for contract count reporting had the potential to generate uncertainty over what is required.

2.15 After considering the responses, the PRA has decided not to delete paragraph 3.2, and has provided additional clarification in paragraph 3.2 that where firms are unbundling contracts and reporting these across multiple rows on S.14.01, the ITS instructions relating to C0040 and C0050 apply for contract count reporting.

2.16 Paragraph 3.3 of SS36/15 related to unbundled product reporting where the policyholder has a choice of investment options including unitised with-profits, and has both unitised with-

1 COMMISSION IMPLEMENTING REGULATION (EU) 2017/2189.

2 EIOPA Guidelines on the valuation of technical provisions: <https://eiopa.europa.eu/publications/eiopa-guidelines/guidelines-on-valuation-of-technical-provisions>

3 SS36/15 paragraph 3.9.

4 SS36/15 paragraph 3.9.

profits and unit-linked investments within these options. Policies such as these are required to be unbundled under Article 55 of the Delegated Regulation and the ITS now specifically address the reporting of contract counts for this reporting. Accordingly, paragraph 3.3 of SS36/15 has been superseded. Therefore, the PRA has decided to proceed with the proposed deletion of this paragraph to avoid inconsistency with the ITS.

Impact on Transitional Measures on Technical Provisions (TMTP)

2.17 One respondent asked for confirmation that there would not be an impact on TMTP were a firm to change homogenous risk groups. The PRA's expectation is that that there should be no impact on the calculation of TMTP where a firm changes a homogeneous risk group as a consequence of the changes to SS36/15.

Scope of the changes to SS36/15

2.18 One respondent asked whether the proposals set out in CP 18/17 applied to financial stability reporting. Firms and groups subject to financial stability reporting are required to report technical provisions at homogeneous risk group level in S.14.01.10. The PRA has updated SS36/15 to confirm that SS36/15 only applies to solo reporting QRT S.14.01.01.

Use of miscellaneous non-profit protection code 624

2.19 The PRA has added of its own initiative an additional clause in paragraph 2.3 of the SS to enable firms to use code 624 for any non-profit protection business if the amount of that business is not material. This change was made for proportionality reasons to benefit firms where new business, premium income and technical provisions for protection business are all a very small part of the total for the firm.

Appendices

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- 1 PRA RULEBOOK: SOLVENCY II FIRMS: CONDITIONS GOVERNING BUSINESS INSTRUMENT (AMENDMENT) 2018, available at:
www.bankofengland.co.uk/prudential-regulation/publication/2018/responses-to-cp-18-17-chapters-2-to-6-9-and-10
 - 2 PRA RULEBOOK: CRR FIRMS: INTERNAL CAPITAL ADEQUACY ASSESSMENT (AMENDMENT) INSTRUMENT 2018, available at:
www.bankofengland.co.uk/prudential-regulation/publication/2018/responses-to-cp-18-17-chapters-2-to-6-9-and-10
 - 3 PRA RULEBOOK: SOLVENCY II FIRMS: TRANSITIONAL MEASURES: REPORT ON FINANCIAL AND SOLVENCY CONDITIONS INSTRUMENT 2018, available at:
www.bankofengland.co.uk/prudential-regulation/publication/2018/responses-to-cp-18-17-chapters-2-to-6-9-and-10
 - 4 PRA RULEBOOK: CRR FIRMS: GROUPS (LEVEL OF APPLICATION) INSTRUMENT 2018, available at: www.bankofengland.co.uk/prudential-regulation/publication/2018/responses-to-cp-18-17-chapters-2-to-6-9-and-10
 - 5 PRA RULEBOOK: CRR FIRMS: WHISTLEBLOWING AMENDMENT INSTRUMENT 2018, available at: www.bankofengland.co.uk/prudential-regulation/publication/2018/responses-to-cp-18-17-chapters-2-to-6-9-and-10
 - 6 SS13/13 UPDATE ‘Market risk’, available at: www.bankofengland.co.uk/prudential-regulation/publication/2013/market-risk-ss
 - 7 SS36/15 UPDATE ‘Solvency II: life insurance product reporting codes’, available at: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-life-insurance-product-reporting-codes-ss
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