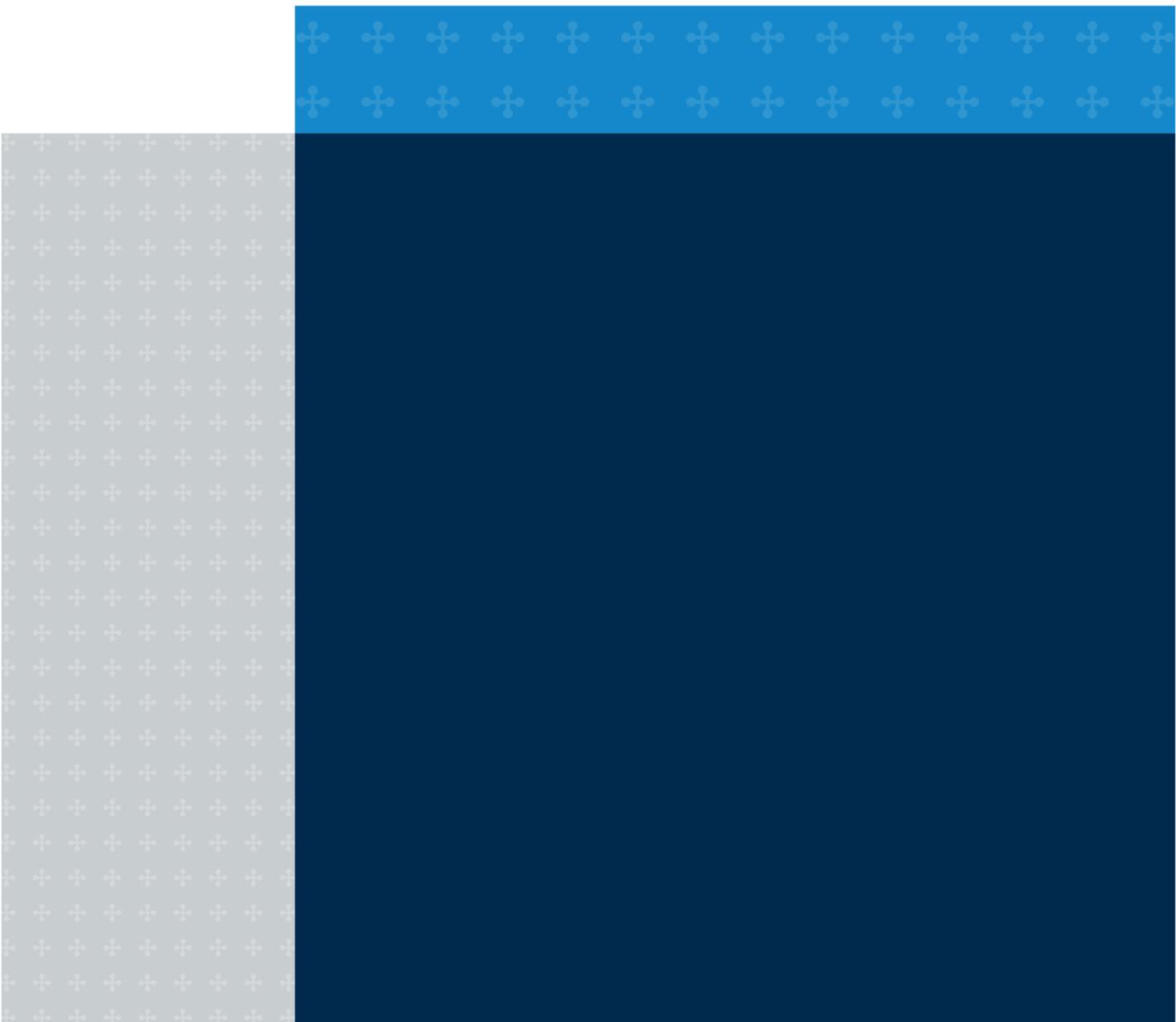




Policy Statement | PS2/21

Solvency II: The PRA's expectations for the work of external auditors on the matching adjustment

March 2021





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Policy Statement | PS2/21

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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 11/20 'Solvency II: The PRA's expectations for the work of external auditors on the matching adjustment'.¹ It also contains the PRA's final policy in the form of an updated Supervisory Statement (SS) 11/16 'Solvency II: External audit of, and responsibilities of the governing body in relation to, the public disclosure requirement' (Appendix).²

1.2 This PS is relevant to UK Solvency II firms (including mutuals) that have approval to make use of the matching adjustment (MA). It is especially relevant to those firms that are subject to an audit requirement in respect of their Solvency and Financial Condition Report (SFCR).³ This PS is also relevant for the auditors of such organisations and the users of these SFCRs.

Background

1.3 In CP11/20, the PRA consulted on updates to SS11/16 to clarify expectations for external auditors ('auditors') in relation to the MA, and to increase transparency on the respective roles of auditors and the PRA. The proposals were designed to set out the PRA's expectations regarding the way that auditors should consider the MA as part of their audit work. The proposals also clarified the scope of the PRA's approval of the MA. The proposals fall into two groups:

- clarifications and enhanced transparency on the existing position regarding the external audit of the MA; and
- new expectations of auditors in relation to the MA. These are referred to in the PS as the 'new expectations' and relate to auditors' communication about the MA.

1.4 The proposals supplement a significant amount of work on the MA that the PRA has already carried out in recent years. A large amount of this work has focussed on clarifying and updating expectations in relation to the MA approval and the PRA's approach to reviewing the amount of MA claimed by firms (eg through the Effective Value Test – EVT).⁴

Summary of responses

1.5 The PRA received eight responses to the CP. Respondents generally welcomed the enhanced transparency that these proposals provide to regulated firms, their auditors, and to wider stakeholders in relation to auditors' work over the matching adjustment. However, respondents also made a number of recommendations, observations, and requests for clarification, which are set out in more detail in Chapter 2.

Changes to draft policy

1.6 After consideration of the responses, the PRA has made some changes to the draft policy. Details of the changes are included in Chapter 2. The PRA has also made a number of minor editorial amendments to improve the clarity and readability of the SS.

¹ July 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pru-expectations-for-the-work-of-external-auditors-on-the-matching-adjustment>.

² October 2018: <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-external-audit-of-the-public-disclosure-requirement-ss>.

³ The external audit requirement for 'relevant Solvency and Financial Condition Reports' are set out in the External Audit Part of the PRA Rulebook.

⁴ The EVT is a diagnostic tool that the PRA uses as a means to identify circumstances where the calculation of the MA warrants further investigation. Further details are available from paragraph 3.20, SS3/17 'Solvency II: Illiquid unrated assets', April 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-2-matching-adjustment-illiquid-unrated-assets-and-equity-release-mortgages-ss>.

1.7 The most significant changes are as follows:

- The effective date for the changes to SS11/16 is delayed by six months to Thursday 1 July 2021. As such, the updated version of SS11/16 will replace the existing version on Thursday 1 July 2021, and apply to SFCR audits in respect of periods ending on or after that date. A delay to the effective date of changes to the SS was originally communicated in a PRA statement on Tuesday 15 December 2020.⁵
- The PRA has updated SS11/16 to confirm that the PRA's expectation that auditors form their own views in relation to the calculation of the MA would, as with any other element of the audit, be subject to materiality (and relevance to their opinion). This follows from the fact that for firms in scope of the audit requirements, auditors are expected to form a view on the calculation of the MA as part of their work to give an opinion, with regard to whether the relevant elements of the SFCR are prepared in all material respects in accordance with the PRA rules and the Solvency II regulations on which it is based.
- The PRA has included some examples in SS11/16 of specific calculation methodologies and judgements that can be used to determine the scale of the MA, but we do not consider that these examples are exhaustive. This detail was previously included in CP11/20, but not in the proposed changes to SS11/16.
- The PRA has explained what is meant by 'MA requirements' for the purposes of its new expectation that auditors pass on information if they become aware that the firm may not be compliant with such requirements. These include the legal requirements relating to the MA (including the eligibility criteria). A number of legal references have also been updated in the SS.
- The PRA has clarified that the new expectations included in SS11/16 are subject to other communication requirements that may be relevant, and that they do not override or alter the existing communication requirements or expectations that apply to auditors. This includes the communication requirements that are stated in regulations made pursuant to s342(5) and s343(5) of The Financial Services and Markets Act 2000 (FSMA) and auditing standards, as well as expectations set out in other supervisory statements, such as Legacy SS7/13 'The relationship between the external auditor and the supervisor: a code of practice'.⁶ The updates to SS11/16 provide additional detail that may be relevant to specific circumstances. To the extent that there is an overlap between the expectations in Legacy SS7/13 and the new expectations in SS11/16, then both apply.
- The PRA has made a small number of changes to the text of SS11/16 that are not based on feedback received. A new footnote (1) has been added to the SS which clarifies the terminology used following the end of the UK's transition period for exiting the European Union. In addition, a reference to EEA and non-EEA undertakings in paragraph 3.2 of the SS has also been updated given that the distinction now has limited relevance following the end of the transition period. Both of these changes are in line with the PRA's general approach to EU withdrawal.⁷
- The PRA has also deleted a reference in paragraph 4.2 of the SS to a consultation that had been ongoing when the SS was published but has since closed, and several references have been updated to the most up-to-date versions of auditing standards. In addition, the interchangeable

⁵ Available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pr-a-expectations-for-the-work-of-external-auditors-on-the-matching-adjustment>.

⁶ April 2013: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice-ss>.

usage of the terms 'insurers' and 'firms' in the SS has been recognised in paragraph 1.1 and a new footnote (2). These changes are for clarity only and do not result in any substantive changes to the PRA's policy.

1.8 The PRA considers that these changes make the final policy clearer and do not result in any additional requirements for firms or auditors compared to the original proposals. As a result, the PRA has not updated the cost benefit analysis or assessment of the impact on mutuals from that shown in CP11/20.

Implementation and next steps

1.9 The changes to SS11/16 will be effective from Thursday 1 July 2021, and the updated version will replace the existing version at that date. The new expectations set out in the updated SS will come into effect for audits in respect of accounting periods ending on or after Thursday 1 July 2021.

1.10 Where an external audit for the year ending December 2020 has been prepared in a way that is not consistent with the clarifications in the revised SS, the PRA considers it proportionate for that SFCR audit report to be produced based on existing audit procedures. In practice, that means that both the clarifications and new expectations in the updated SS11/16 are effective for SFCR audits in respect of periods ending on or after Thursday 1 July 2021. The PRA expects firms and auditors to make arrangements to ensure the external audit is produced on the basis of the clarifications and new expectations set out in the revised SS for periods ending on or after that date.

1.11 On Monday 19 October 2020, the Government published a call for evidence in relation to a review of Solvency II.⁸ This call for evidence is the first stage of the review of Solvency II. The call for evidence includes a discussion on potential areas of reform to the operation of the MA. As noted in CP11/20, the final policy in SS11/16 is based on existing requirements and does not pre-judge any changes that could result from such a review.

1.12 The proposals set out in this PS have been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.⁹ The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

⁷ The general approach to amending financial services legislation in relation to EU withdrawal was set out in [CP25/18 'The Bank of England's approach to amending financial services legislation under the European Union \(Withdrawal\) Act 2018' \(October 2018\)](#) as finalised in [PSS/19](#) with largely the same name.

⁸ Available at: <https://www.gov.uk/government/publications/solvency-ii-review-call-for-evidence>.

⁹ For further information, please see <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

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

2.2 The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions.

2.3 The structure is broadly aligned with the two main elements of the CP, along with some general responses that applied to both. The responses have therefore been grouped as follows:

- general comments;
- clarifications and enhanced transparency on the existing position regarding the external audit of the MA; and
- new expectations of auditors in relation to the MA.

General comments

2.4 Respondents generally supported the enhanced transparency that the proposals provided to regulated firms, their auditors, and wider stakeholders in relation to auditors' work on the MA.

2.5 One respondent supported the objectives of the proposals, but was unclear as to the ultimate impact of the proposals on the work of auditors and the implications for firms. This PS provides more details about the responses received and so the implication for firms. Responses confirmed that the work of auditors is broadly aligned with the PRA's proposed expectations set out in CP11/20 in most areas. However, six respondents noted that the proposed clarifications would or may change the auditors' approach to auditing the impact of the MA on technical provisions.

2.6 The PRA understands that in some cases, some auditors have treated the PRA's review of the calculation of MA methodology as indicating that the PRA has approved this methodology. If the MA calculation methodology were approved by the PRA, then as set out in paragraph 3.4 of SS11/16, this methodology would form a part of the framework that auditors audit against. In such circumstances, auditors would undertake audit procedures in relation to the calculation of the MA, but these procedures may differ for auditors that have not assumed the PRA's approval.

2.7 CP11/20 explained the position regarding aspects of the scope of the PRA's assessment of a firm's MA application, as distinct from what it actually approves in granting a firm the right to apply the MA to technical provisions. It clarified that the PRA does not approve the firm's MA calculation when approving the use of the MA. This clarification is expected to increase the consistency of approach that auditors take. Further details are provided below under 'audit and scope'.

Timing

2.8 The PRA proposed that the changes to SS11/16 would be effective for SFCR audits carried out in respect of periods ending on or after Thursday 31 December 2020.

2.9 Six respondents recommended or expressed a preference for a delay to implementation of the CP's proposals until the audit of financial years ending Friday 31 December 2021 because, as a result of the PRA's clarifications, auditors would have to carry out additional audit work in order to form their opinions. Three respondents noted particular additional challenges for the YE 2020 audit due to

Covid-19, and two noted the need for specialist resources, which may be especially pressured over the 2020 audit season.

2.10 Having considered the responses, the PRA communicated on Tuesday 15 December 2020 that any finalised approach would not be effective for audits of SFCRs with a Thursday 31 December 2020 reporting date. The changes to SS11/16 and the new expectations will be effective for accounting periods ending on or after Thursday 1 July 2021 and, as such, the updated version of SS11/16 will replace the existing version from that date. The PRA considers that this provides adequate time for auditors and firms to prepare for implementation of the changes to the SS. This takes into account the points raised by respondents as well as the timing of forthcoming SFCR audits.

2.11 In considering the implementation of the revisions to the SS, the PRA has taken account of the challenges outlined by respondents. As such, where an external audit for the year ending December 2020 has been prepared in a way that is not consistent with the clarifications in the revised SS, the PRA considers it proportionate for that SFCR audit report to be produced based on existing audit procedures. The PRA expects firms and auditors to make arrangements to ensure the external audit is produced on the basis of the clarifications and new expectations set out in the revised SS for periods ending on or after Thursday 1 July 2021.

Clarifications and enhanced transparency on the existing position regarding the external audit of the MA

Audit scope and cost

2.12 The draft amendments in the CP proposed to clarify that auditors should not treat the methodology used to calculate the MA as being part of the framework that they audit against. Paragraph 4.2H of the updated SS states that auditors are expected to form their own view on the calculation of the MA, as part of their work to provide an opinion as to whether the relevant elements of the SFCR are prepared in all material respects in accordance with the PRA rules and Solvency II regulations on which it is based.¹⁰

2.13 Six respondents stated or implied that the clarifications proposed in the CP would or may lead to an increase in audit scope, five of which noted that this would or may lead to an increase in audit costs. These respondents indicated that this increased audit scope would be due to additional work on the firm's assessment of internal credit ratings, a component of the MA calculation for some firms. Two respondents also mentioned the potential for additional audit procedures in relation to the valuation of the restructured assets, which can also be relevant for considering the impact of the MA on technical provisions.

2.14 After considering the responses, the PRA has decided not to change its proposed approach other than in relation to the timing of its effect. The clarifications relate to the existing position and do not impose new requirements; they therefore do not lead to additional costs when compared with existing requirements. The PRA understands that practices currently vary across the industry, and considers that the updated approach will ensure greater clarity and consistency. In finalising its position, the PRA has taken into account the expected benefit and burden of its proposals, including with the benefit of responses to the consultation.

¹⁰ As outlined in the CP, the PRA considers the size of the MA benefit that firms claim as part of its role as supervisor, and in line with its risk-based framework. The PRA may apply closer scrutiny and, where appropriate, would consider use of its relevant supervisory powers under section 55M FSMA where it has concerns about the compliance of a firm's MA calculation with Chapter 7 of the Technical Provisions Part of the PRA Rulebook. However, the CP clarified that reviews of the MA calculation do not mean that the PRA approves the MA calculation methodology.

Proportionality of audit work and avoidance of duplication

2.15 Two respondents said that the work carried out by auditors should be proportionate. In addition, two respondents said that it would be important to avoid duplication between the work of auditors and the PRA. One of these suggested that where duplication occurs, the PRA should reduce its work in this area.¹¹ This respondent also suggested that the skills required to form reviews of internal ratings may create a barrier to entry for smaller auditors.

2.16 After considering these responses, the PRA has decided not to change the draft policy. While the PRA would aim to avoid undue duplication of work with auditors, as with other areas where the PRA and auditors have a shared interest (eg technical provisions), it is appropriate for both the PRA and auditors to separately consider what is necessary in order to satisfy their respective responsibilities. Although the work of auditors may help to inform the work of the PRA, the PRA expects to continue to consider the MA calculation as appropriate, in accordance with its published supervisory approach.

2.17 The PRA does not anticipate that its proposed clarifications and expectations will have a significant additional impact on barriers to entry for smaller auditors in what is already a relatively specialised area.

Cost benefit analysis

2.18 As part of the PRA's policymaking process, CP11/20 included a cost benefit analysis (CBA) in paragraphs 3.4 to 3.7. One respondent acknowledged the need for an independent review of firms' own assessments of the scale of the MA, but observed that the CP did not contain a quantitative cost benefit analysis, and so asserted that the impact of the proposals is unclear.

2.19 After considering this response, the PRA considers that the CBA included in CP11/20 meets the requirements. The CP explained why no detailed quantitative CBA is necessary in this case, and further details about audit scope and costs are included in paragraph 2.14. The PRA has also taken the opportunity to clarify in the final SS that the new expectations regarding auditor communication do not require additional audit procedures to be carried out.¹²

Auditor suitability for assessing the MA

2.20 One respondent questioned whether auditors would have the necessary skills to be able to assess the calculation of the MA and suggested that it may be difficult for them to provide a 'clean' (ie unqualified) opinion. In addition, four respondents highlighted the potential for differences in views between stakeholders about the extent of assurance that the work of auditors provides (an expectation gap) and questioned whether an audit is the appropriate route for the PRA to achieve its objectives.

2.21 Having considered the responses, the PRA has decided not to change the draft policy. Responses did not demonstrate that auditors will not be able to form an opinion. It seems reasonable to assume that auditors are no less able to form a view as to the calculation of the MA

¹¹ Two respondents highlighted the significant review and validation work that the PRA already applies to the MA calculation. One respondent noted that review and validation work has included PRA review as part of MA applications, internal validation, independent third-party validation (including by External Credit Assessment Institutions), the effective value test (EVT) for equity release mortgages, PRA review as part of ad hoc/thematic regulatory activity (eg in relation to SS3/17 compliance), and Section 166 Skilled Person Reviews. Another noted that the use of internally-rated assets within MA portfolios has received significant PRA scrutiny and/or external validation.

¹² It is noteworthy that auditors are already required to take action where an apparent breach of statutory or regulatory requirements comes to an auditor's attention, suggesting that the new expectations would not add significantly to costs. For more information, see [https://www.frc.org.uk/getattachment/09caed0b-34f9-4cc9-9a21-91e5bc4805d5/ISA-\(UK\)-250B-Revised-November-2019-Updated-With-Covers.pdf](https://www.frc.org.uk/getattachment/09caed0b-34f9-4cc9-9a21-91e5bc4805d5/ISA-(UK)-250B-Revised-November-2019-Updated-With-Covers.pdf). Other requirements to report, such as the statutory notification requirements set out in the Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001, may also be relevant.

than firms themselves. In addition, with appropriate planning, there seems little reason to expect that audit opinions would be significantly more likely to be qualified. The PRA's steps to clarify its expectations in relation to the audit of the MA would be expected to reduce the possibility for an expectation gap.

Request for additional guidance about audit procedures or the extent of review required

2.22 Five respondents suggested that further guidance or detail would (or may) be beneficial to ensure the consistency of auditor approaches. In some cases, respondents asked the PRA to provide additional guidance or confirm that certain audit procedures would be considered acceptable, and one respondent suggested that such guidance could come from outside of the PRA.

2.23 Having considered the comments, the PRA does not intend to provide additional guidance in relation to these issues. The PRA's rules, and the guidance provided in SS11/16, do not specify the nature or level of work by auditors in any area of the audit. The overall level of assurance that should be delivered is clear (ie 'reasonable assurance'¹³), and how to form this opinion is a matter of judgement for the auditor. This approach is no different for the MA than for other aspects of the audit.

2.24 One respondent suggested that the PRA confirm that the expectation (in paragraph 4.2F) that auditors 'are expected to consider the scale of the MA claimed by the firm' is subject to materiality. This is implicit in the fact that it applies 'to provide the audit opinion required in relation to the SFCR', as the opinion must confirm that 'the relevant elements of the SFCR are prepared in all material respects in accordance with the PRA rules'. This is also recognised in paragraph 4.2G, which states that 'the audit approach taken is likely to vary based on circumstances, materiality, risk and other factors'. However, the PRA has amended the final SS (in paragraph 4.2F) to clarify that the expectation applies to the extent that the MA is material to the auditor's opinion.¹⁴

Request for additional guidance about what is audited against

2.25 Four respondents requested clarifications about the framework against which an audit opinion is provided. For example, one respondent noted that it would be helpful to confirm whether the framework against which the auditor should assess a regulated firm's approach would be grounded in the Solvency II regulations or the methodology applied at the time of MA approval. Another respondent asked for confirmation about the impact of a firm not meeting the PRA's expectations (eg the EVT as specified in SS3/17). One other respondent suggested that auditors would need clear definitions of asset 'features' linked to the legal requirements of MA eligibility if a clean audit and comparability to firms' own assessments is to be achieved.

2.26 Having considered the comments received, the PRA has added some minor clarifications to the final SS. For example, it now includes examples of elements of the MA calculation that are not included within the PRA's MA approval. The PRA does not consider that further changes to the SS are necessary in relation to points raised by respondents. It is clear from the existing requirement set out in Rule 4.1(2) in the External Audit Part of the PRA Rulebook that the audit is not against PRA SSs or expectations introduced through correspondence between the firm and its supervisory

¹³ Rule 4.1(1) in the External Audit Part of the PRA Rulebook requires 'a reasonable assurance engagement on relevant elements of the SFCR'.

¹⁴ In addition, one respondent suggested that the footnote relating to paragraph 4.2H is clarified. The additional text is consistent with that already included in the CP (footnote 16).

team.¹⁵ However, PRA publications, including supervisory statements (for example in relation to the EVT) may be relevant information for the auditor to consider in forming their own opinion.

2.27 In addition, whether features of an asset are sufficiently similar to fall within the scope of the MA approval is a matter of judgement for auditors. This reflects the fact that whether assets fall within the scope of an MA approval may affect the impact of the MA on technical provisions.¹⁶ However, as noted in paragraph 4.2E of SS11/16, auditors would not be required to assess the features of assets for the purposes of eligibility for the MA.

Mechanism to resolve conflicts between the views of auditors and the PRA

2.28 Two respondents noted the potential for different views between auditors and the PRA. One of these respondents suggested that there should be a mechanism for resolving potential differences in views.

2.29 Having considered the responses, the PRA does not propose to establish a formal mechanism to resolve differing views. The PRA and auditors are able to each make their own decisions based on their respective objectives, responsibilities, and focus. In the normal course of their engagement, it is likely that where apparent significant differences in views exist, there may be a discussion between the PRA and auditors to share views.

New expectations of auditors in relation to the MA

2.30 The PRA proposed two new expectations relating to the MA, which are set out in paragraphs 4.2J and 4.2K of the updates to SS11/16:

- 4.2J states that if an auditor becomes aware that the firm may not be compliant with MA requirements, then the PRA would expect the auditor to inform the firm in the first instance.
- 4.2K states an expectation that if a firm materially changes its approach to calculating the MA, and the auditor is aware that the PRA has not been informed, then it would be expected to pass this information on to the PRA.

MA requirements for this purpose

2.31 In relation to paragraph 4.2J, three respondents suggested that the PRA clarifies the term 'MA requirements', and in particular whether this extends to SSs or other supervisory expectations.

2.32 Having considered the responses, the PRA has clarified the wording used and added further details about what is meant by 'MA requirements' in the context of paragraph 4J of the SS. The SS now signposts the provisions that are relevant in this context, including MA eligibility conditions and calculation requirements. The updated SS also clarifies that the new expectation at paragraph 4.2J does not apply to SSs or other expectations that the PRA has set in relation to the MA (eg through individual correspondence).

¹⁵ External Audit 4.1(2) requires that an external auditor must 'produce a report that includes an opinion addressed to the governing body confirming that the relevant elements of the SFCR are prepared in all material respects in accordance with the PRA rules and Solvency II Regulations on which it is based'.

¹⁶ As noted in footnote 16 of CP11/20: 'Whether assets and liabilities that are included within the MA portfolio fall inside or outside of the scope of the MA approval can have implications for the calculation of the MA. For example, if assets or liabilities are included in the MA portfolio that are not within the scope of the approval then the MA would be miscalculated.'

Clarification in relation to the need for active search for information

2.33 In relation to paragraphs 4.2J and 4.2K of SS11/16, three respondents asked for clarification as to whether auditors are required to carry out an active search for relevant information.¹⁷ One respondent also said that it may be difficult to prove at a later date what the auditor was aware of. This respondent questioned whether that may mean that there is an implicit obligation for the auditor to seek evidence in areas that would not otherwise be part of the audit.

2.34 Having considered these responses, the PRA has added clarifications to the SS to confirm that the new expectations are not intended to require additional audit procedures beyond those already necessary to comply with relevant requirements (eg the requirement to provide an audit opinion).

Linkages between the new expectations and existing notification requirements

2.35 Regulations made under FSMA require that the auditor communicates with the regulator under certain defined circumstances.¹⁸ Three respondents noted that the proposals in the CP make no explicit reference to the statutory notification requirements, and suggested that the link between the expectation and the notification requirements is clarified.

2.36 Having considered the responses received, the PRA has amended the SS to clarify that these new expectations are subject to other communication requirements that may be relevant. As such, the new expectations would apply unless meeting these expectations would be incompatible with an existing requirement. The new expectations in 4.2J and 4.2K do not override or alter existing expectations or communication requirements and, in some cases, more than one may apply. Firms should therefore read these paragraphs in conjunction with existing communication requirements and the expectations set out in Legacy SS7/13.

Consistency with other expectations

2.37 The new expectations proposed in CP11/20 have a much narrower scope than those in Legacy SS7/13, given that they are only applicable to the MA.

2.38 One respondent noted that the two new expectations in CP11/20 are slightly different, in that one states an expectation that the PRA is informed, while the other specifies that the auditor informs the firm in the first instance. The same respondent suggested that these new expectations about communication should be consistent in expecting a notification to the PRA in both cases. The respondent also questioned whether these new expectations are consistent with existing expectations that are specified as part of Legacy SS7/13.

2.39 Having considered this response, the PRA has decided not to change the draft policy. The new expectations in SS11/16 provide additional detail that may be relevant to specific circumstances. The two new expectations are worded differently, as each serves a different purpose. In addition, the PRA has clarified in the SS that the new expectations do not override or alter the existing communication expectations set out in Legacy SS7/13.

2.40 As such, subject to statutory or other reporting requirements, the PRA would expect auditors to inform the firm in the first instance if they are aware that the firm may not be compliant with MA requirements. This is consistent with the expectations set out in Legacy SS7/13.

¹⁷ One respondent asked whether the auditor would be expected to actively enquire about whether information has been passed on to the PRA.

¹⁸ The Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001.

Subjectivity of what constitutes a material change to the MA calculation

2.41 The new expectation in paragraph 4.2K of the SS sets out circumstances under which auditors would be expected to pass on information to the PRA about material changes to the MA calculation.

2.42 One respondent felt that there is some subjectivity in what constitutes a material change, and suggested that auditors should seek to discuss the matter with the firm, to understand the reasons for not seeking approval for a change, before informing the PRA. This respondent also noted that where the PRA is informed of changes via auditors, in some instances this should be viewed as part of the ongoing dialogue between the PRA, firms, and auditors, rather than as a breach.

2.43 Having considered this response, the PRA has decided not to change the draft policy. The PRA notes that Legacy SS7/13 (principle 3) states that in many cases matters will already have been discussed with management as appropriate, and that the amendments to SS11/16 do not preclude such an approach. In addition, the PRA agrees that the circumstances under which an auditor may inform the PRA of material changes may differ. As such, it would not expect to view all such cases as a breach of requirements by the firm.

Form of reporting to the PRA

2.44 Two respondents suggested that it would be helpful to clarify the contents, timings, and format of the dialogue between auditors, the PRA, and senior management.

2.45 Having considered the responses, the PRA does not see a need to provide additional detail as to the expected contents, timing, or form of the information to be shared with the PRA or with firms. The PRA's expectations of the relationship with auditors are set out in Legacy SS7/13, which refers to information being disclosed 'in a timely fashion'. No specific format is specified, as these may vary according to circumstances and a variety of approaches may be reasonable.

Status of communications

2.46 One respondent suggested that the PRA state that a report made by an auditor in pursuance of an expectation expressed in this SS would be within the protection of FSMA s342(3).¹⁹ The PRA notes that it is not within its remit to interpret legislation, and Legacy SS7/13 already contains such a reference to highlight the existence of this protection. Therefore, the PRA does not consider it necessary to add such a reference to SS11/16.

¹⁹ 'An auditor or actuary does not contravene any duty to which he is subject merely because he gives to a regulator (a) information on a matter of which he has, or had, become aware in his capacity as auditor of, or actuary acting for, the authorised person, or (b) his opinion on such a matter'.

Appendix

- 1 **SS11/16 'Solvency II: External audit of, and responsibilities of the governing body in relation to, the public disclosure requirement', available at:**
<https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-external-audit-of-the-public-disclosure-requirement-ss>