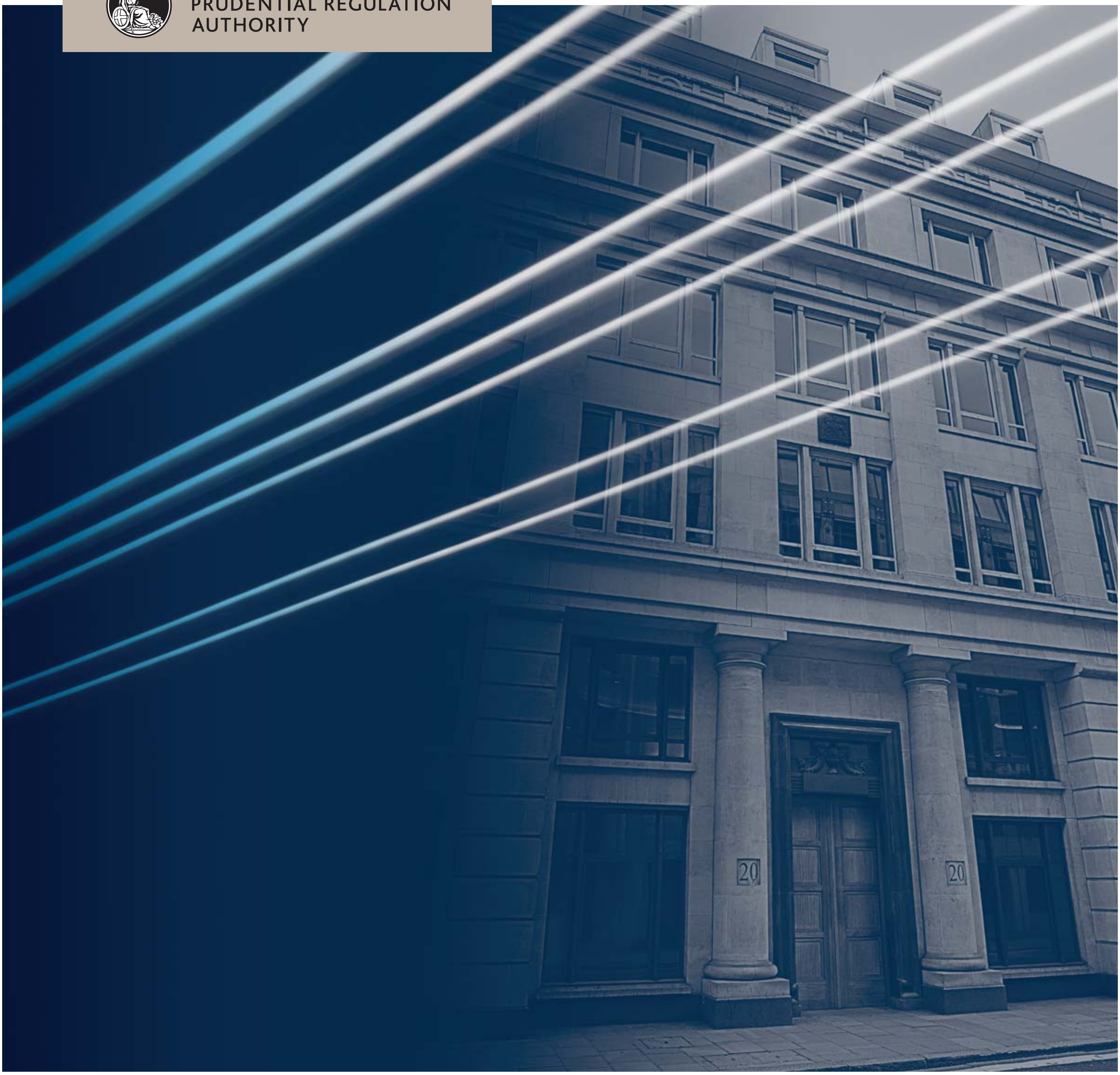
Supervisory Statement | SS4/13

Solvency II: applying EIOPA's preparatory guidelines to PRA-authorised firms

December 2013

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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Contents

1 Introduction

Purpose

1.1 This supervisory statement is aimed at firms and groups ('firms') within the scope of Solvency II. The purpose of the statement is to set out the Prudential Regulation Authority's (PRA's) expectations of firms during the preparatory phase for Solvency II in relation to the European Insurance and Occupational Pensions Authority's (EIOPA's) guidelines for the preparation of Solvency II ('the guidelines').[1]

1.2 The statement expands on the PRA's general approach, as set out in its Insurance Approach document,[2] and is designed to help ensure that the PRA meets its statutory objectives of ensuring safety and soundness of the firms it regulates and securing an appropriate degree of protection for policyholders. The statement sets out how the PRA expects firms to meet the outcomes detailed in the guidelines and highlights areas of particular significance, providing further clarity where needed.

1.3 EIOPA's guidelines are addressed to National Competent Authorities (NCAs) and are aimed at ensuring that firms are preparing for the implementation of Solvency II. Firms are expected to have due regard to the guidelines in order to demonstrate to their NCA during the course of the preparatory period that they are making appropriate progress with preparations for Solvency II to ensure their eventual readiness for the Directive regime.

1.4 Firms are reminded that they must also continue to comply with PRA rules. Many of those provisions support the guidelines and these are identified in the relevant sections of the statement.

1.5 The PRA believes this statement is compatible with the Regulatory Principles[3] because the PRA has sought to set out proportionate expectations on firms in relation to the guidelines. Setting out these expectations clearly also uses the PRA's resources efficiently.

1.6 This supervisory statement will apply when EIOPA's guidelines come into effect, which is expected to be from 1 January 2014. The PRA anticipates that the statement will be withdrawn the day before Solvency II comes into force, expected to be on 1 January 2016.

1.7 The guidelines cover four areas which EIOPA considers fundamental to ensure effective and convergent preparations for Solvency II, starting from 1 January 2014:

i. system of governance (SoG);
ii. forward-looking assessment of the undertaking's own risks, based on the principles for the Own Risk and Solvency Assessment, henceforth 'ORSA';
iii. submission of information to NCAs; and
iv. pre-application for internal models.

1.8 This statement aligns with the four areas above, and provides clarification on the PRA's:

- expectations of firms as they prepare for Solvency II;
- approach to implementing the guidelines; and
- interpretation of aspects of the guidelines.

1.9 In this supervisory statement, the PRA articulates its expectations of firms in the preparatory period, including that firms should read, assess and implement the substantive provisions of the guidelines in order to achieve the intended outcomes. There are concepts specifically introduced for Solvency II (such as the pre-application process for internal models) where the PRA encourages firms to engage with the preparatory process in order to ensure their eventual readiness for the Directive regime.

1.10 The PRA expects EIOPA to launch a Q&A process during the preparatory phase to answer stakeholder queries. Firms are reminded that the guidelines are addressed to NCAs and articulate the outcomes which NCAs are expected to achieve with firms as they prepare for Solvency II. The PRA encourages firms to continue to include their supervisors in communications with EIOPA. The PRA also reiterates that it is the role of the NCA and, where applicable, the relevant college of supervisors to monitor and assess preparedness for Solvency II.

The PRA's approach to preparing for Solvency II

1.11 The PRA supports EIOPA's proportionate and pragmatic approach in preparation for the implementation of Solvency II. The guidelines and this statement are designed to work towards a consistent and convergent approach in preparations for Solvency II and not its early implementation.

1.12 In considering the PRA's strategic approach against the guidelines the PRA has:

- focused on the outcomes the guidelines are intended to achieve;
- focused on their preparatory nature, the fact that progress is intended to be incremental and that firms' preparations can reflect that;
- sought to achieve the outcomes intended by the guidelines in a way which is consistent with existing provisions in the PRA's Handbook, current expectations of firms and the PRA's Supervisory Approach;

(1) EIOPA's final Preparatory Guidelines, feedback statements and annexes are available at https://eiopa.europa.eu/publications/eiopa-guidelines/index.html.
(2) The PRA's approach to insurance supervision is available at www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.
(3) Section 3B of FSMA 2000.

- not sought to draft new rules or set substantially new expectations of firms; and
- been proportionate in the application of the guidelines to minimise the risk of periods of dual running.

1.13 Firms will be expected to apply the guidelines in a way that is appropriate to the nature, scale and complexity of their business. The PRA will review firms' preparations in a proportionate and risk-based manner to achieve supervisory outcomes, consistent with the PRA's overall approach to insurance supervision.

1.14 Many of the guidelines represent good practice in conformity with existing rules and should not present an additional burden for many firms. As it did when developing ICAS+,(1) the PRA will consider ways that firms may be able to use their preparatory Solvency II work to meet existing regulatory requirements.

1.15 The guidelines set out the following principles of application:

- 'general phasing-in' will be applied in areas where there are different expectations regarding the firm's progress over time. For example, the 2015 ORSA should demonstrate additional progress towards Solvency II compliance when compared to the 2014 ORSA;
- 'specific phasing-in' will be applied to the submission of information due to the need to establish internal processes and IT systems; and
- during the preparatory period, thresholds will be applied to the submission of information to the PRA, with firms below these thresholds not being required to submit information. EIOPA has set these thresholds to ensure a proportionate approach to the implementation of the guidelines.

1.16 The PRA will use its work with firms during the preparatory period to assess the progress being made by firms individually and across the industry.

2 Consultation response

2.1 The PRA consulted on this statement in CP9/13. Eighteen responses were received. Comments are summarised below alongside an explanation of the PRA's response.

2.2 Overall, stakeholders welcomed the pragmatic and proportionate approach the PRA is taking to apply EIOPA's preparatory guidelines.

2.3 Some respondents sought clarification of the PRA's expectations in certain areas.

i. In terms of how firms might approach EIOPA's guidelines on the system of governance, the PRA acknowledges the industry's concern that EIOPA's guideline (GL 30) on securitised instruments is not sufficiently clear to enable firms to work towards preparing for compliance. The PRA intends to explain to EIOPA that the guideline is difficult to interpret, primarily because of the inclusion of concepts and terminology used in other EU legislation incorporating very detailed and specific requirements. However, the PRA considers that if the guideline is read in the context of Solvency II's risk management and prudent person principles, firms should be able to meet its intended outcomes.

ii. Some respondents queried the PRA's expectations regarding compliance with the guidelines on actuarial functions. In particular the guideline concerning actuarial functions providing an opinion on underwriting policy and reinsurance arrangements (GL 41) and the PRA clarifies its expectation in paragraph 3.20 that firms should incorporate this activity into the tasks performed by the actuarial function during the preparatory phase to ensure their readiness for Solvency II.

iii. Some respondents queried the practicability of submitting information to the PRA using eXtensible Business Reporting Language (XBRL). The PRA considers it reasonable to expect firms to be able to submit data from June 2015 based on an implementation date of 1 January 2016. The PRA acknowledges concerns expressed by respondents where the ability to comply with the guidelines is affected by the late or incomplete availability of templates and taxonomy. The PRA will review the practicability of the reporting timetable in the event of delays to materials being made available.

2.4 Amendments have been made to some sections to enhance their clarity.

3 System of governance

Introduction

3.1 This chapter sets out the PRA's expectations in respect of the guidelines on the system of governance. It addresses the individual guidelines, highlighting those features of particular significance and providing further clarity on the expectations of firms.

3.2 These guidelines will assist firms in developing their governance policies and enhancing preparedness for Solvency II standards. Good systems of governance promote the safety and soundness of firms and contribute to the protection of policyholders. They will, therefore, advance the PRA's objectives.

(1) More information about ICAS+ can be found in Julian Adams' letter to industry on 'Solvency II — early use of Solvency II work to meet ICAS requirements', 29 January 2013 available at www.bankofengland.co.uk/pra/Documents/solvency2/29janletter.pdf.

Overall approach

3.3 The PRA considers the guidelines to be generally consistent with existing good practice in the United Kingdom, where effective governance has been a core part of the approach taken by the PRA (and its predecessor, the Financial Services Authority (FSA)) for a number of years. The immediate impact of the guidelines on firms that the PRA supervises might, therefore, be expected to be relatively limited. Nevertheless, firms will have to consider how they will achieve the intended outcomes of the guidelines in an appropriate manner. The main areas for potential development by firms are highlighted in the following sections.

3.4 The PRA will not prescribe how these requirements should be satisfied but will expect firms to develop them in a manner appropriate for their business. The PRA expects firms, when asked, to be able to explain what governance changes they need to make to satisfy the guidelines, how they plan to make those changes, what progress there has been to date and any particular difficulties they face.

3.5 It is anticipated that Solvency II will apply the system of governance requirements to groups, in the same way it does to solo entities. The PRA currently has expectations around general standards of group governance, systems and controls, approved persons and fit and proper criteria which are broadly aligned with the principles underpinning the Solvency II requirements. However the PRA recognises that the current approach does not have the same scope of application or set the same granularity of requirements as Solvency II. As such, the guidelines may present a change for some groups. In keeping with the preparatory spirit of the guidelines, firms are encouraged to make the most of this opportunity to ensure their readiness for Solvency II.

3.6 The guidelines are unlikely to change the PRA's approach to governance issues where the focus will continue to be determined by the nature, scale and complexity of a firm's business and the firm's risk category. The PRA may refocus some of its attention to those areas where firms are most likely to need to make changes as a result of impending Solvency II implementation in order to assess and facilitate the preparedness of firms.

3.7 Under Solvency II, firms will be required to publish an annual Solvency and Financial Condition Report (SFCR) and, in addition, to provide a Regular Supervisory Report to the PRA. The SFCR is expected to cover the system of governance and an assessment of its adequacy. The guidelines should help firms to prepare for the implementation of the SFCR.

Section I: General provisions (GLs 1–2)

3.8 These guidelines describe the general responsibilities of the NCA in respect of the timing and application of the guidelines to firms. Currently, the PRA expects all firms to have effective governance and risk management systems which have been documented and can be reviewed by the PRA. Firms are expected to introduce the appropriate changes to their governance and risk management systems to comply with any new requirements of these guidelines by the time Solvency II applies. To achieve this, firms will need to identify those areas where further strengthening of existing governance and risk management systems will be required and where existing policies need to be revised. They will then need to plan and take appropriate actions to effect these changes ahead of Solvency II's application.

Section II
Chapter I — General governance requirements (GLs 3–10)

3.9 This group of guidelines describe the overall responsibilities of firms to set up an appropriate governance structure and related internal policies. The concepts are largely consistent with SYSC in the existing PRA Handbook and with the PRA's Approach document, although firms need to be fully aware of, and ready for, the expectations that will be placed on their Boards when Solvency II is implemented. Firms should ensure that people with the appropriate skills and experience will be in place for the specific roles of the key function holders (see GL 5). Firms should also determine an appropriate allocation and segregation of responsibilities and reporting lines, along with suitable measures for the handling of any possible conflicts of interests (SYSC 2, 3 and 14). However, this is not intended to duplicate roles at group and solo level.

3.10 The PRA may approach those persons the firm or group identify as key function holders ahead of Solvency II to understand better how a firm's preparations are proceeding in their particular area of responsibility.

Chapter II — Fit and Proper (GLs 11–14)

3.11 These guidelines set out the criteria and procedures for firms' and groups' assessments of whether Board members and key function holders, are fit and proper for their respective roles. In general they are consistent with the criteria and considerations set out in the existing Handbook (FIT 2, SUP 10B, APER 2) governing approved persons and controlled functions and the PRA's supervisory approach. During the preparatory period firms should review their existing policy for assessing fitness and propriety and whether it needs updating in advance of Solvency II.

Chapter III — Risk management (GLs 15–24)

3.12 These guidelines set out the general protocols and procedures to be followed by firms in operating a risk management system in terms of preparing an overall risk management policy together with specific risk policies. In line with the PRA's current approach, firms should ensure that material risk issues receive sufficient attention at Board level and that their Boards play an active part in setting and reviewing the overall risk-appetite and tolerance limits.

3.13 Firms will be aware that robust risk management represents an integral part of the PRA's regulatory regime (set out in various chapters of SYSC plus GENPRU 1 and INSPRU 4 and 5) at all levels of the organisation. Specifically for groups the guidelines build on the contents of SYSC, particularly SYSC 12. The preparatory period should therefore be used by firms to ensure that their framework remains suited to their business needs across all areas, including suitable mechanisms and methodology for connecting to their ORSAs and for carrying out regular stress and scenario tests. The progress made will form part of the PRA's continuing supervisory assessment, applied on a proportionate basis.

Chapter IV — Prudent person principle and system of governance (GLs 25–30)

3.14 These guidelines provide further information on the approach to investment decision-making that is expected to be applied under Solvency II. The Prudent Person Principle (PPP) will be used to govern investment decisions and asset allocation. In particular, firms will be expected to exercise prudence in relation to the acquisition and holding of assets and to ensure that assets are appropriate to the nature and duration of the liability. The PRA considers that this is largely consistent with current expectations. During the preparatory period, the PRA encourages firms to consider how to manage the transition to the new regime and to assess the impact on existing asset portfolios of Solvency II requirements. This need not necessarily mean that changes have to be made to firms' investment strategies or portfolios but firms are encouraged to work on an incremental basis towards demonstrating that they meet the requirements of the PPP.

3.15 The PRA recognises that making the transition may stretch the resources of some smaller firms, both as regards their own decision-making processes and in validating data and information provided by third parties. In keeping with the PRA's proportionate supervisory approach, firms are expected to take suitable steps to adapt to the new investment regime and the PRA may look to review firms' progress.

Chapter V — Own fund requirements and the systems of governance (GLs 31–32)

3.16 The guidelines in this section set out capital management requirements for firms that are consistent with, but more detailed in certain areas than, material in the current PRA Handbook in GENPRU 1.2. The PRA regards the development and implementation of such policies and plans as an integral part of sound risk and capital management for all firms, especially as their management and Boards assess the implications of the forthcoming Solvency II own funds and capital requirements. As part of the PRA's supervision of firms, management will be expected to share their progress on such plans with the PRA, if asked.

Chapter VI — Internal controls (GLs 33–34)

3.17 These guidelines address the importance of appropriate internal controls at firms and monitoring and reporting mechanisms within the internal control system which provide management with the relevant information. The PRA's view is that these guidelines are consistent with the existing provisions of SYSC in the PRA Handbook. However, firms should ensure that their internal controls are sufficient to meet the requirements set out in the guidelines and the PRA may look to review this analysis and any plans to alter the control framework.

Chapter VII — Internal audit function (GLs 35–37)

3.18 The guidelines cover the independence of the internal audit function within firms and the need for appropriate policies. Although these guidelines are more detailed than the existing requirements of SYSC in the PRA Handbook, the PRA considers them to be consistent with good practice. Firms should review whether their audit functions meet the provisions in the guidelines and put in place actions to fill any gaps identified. The PRA may look to review these plans.

Chapter VIII — Actuarial function (GLs 38–43)

3.19 These guidelines set out the various responsibilities of the actuarial function as a key function and have been amended since the consultation process, removing those tasks related to Solvency II Pillar 1 valuations as set out in the EIOPA feedback statement. During the preparatory period, the work of the actuarial function will now focus on co-ordinating the calculation of technical provisions, providing an opinion on the underwriting policy and reinsurance arrangements and contributing to the development and performance of the internal model in the pre-application stage where relevant.

3.20 The PRA already approves the appointment of the actuarial function holder for life firms under SUP 4 and 10, as a controlled function. During the preparatory period, both life and non-life firms should carefully consider how this function should be organised and best carried out and are encouraged to develop clear lines of reporting and accountability reflecting the nature and complexity of the business and avoiding potential conflicts of interest. Where the activities of the actuarial function includes potentially new activities as a result of EIOPA's guidelines, for example providing an opinion on underwriting policy and reinsurance arrangements, the PRA expects firms to undertake this work during the preparatory period to ensure their readiness for Solvency II. In applying these guidelines to groups, the PRA encourages firms to plan for the actuarial function being used in a wider capacity through contributing to effective group risk management and governance.

3.21 During the preparatory period, the PRA may look to review firms' analysis of the areas required for improvement and understand the actions the firm is taking to resolve these.

Chapter IX — Outsourcing (GLs 44–47)

3.22 These guidelines set out the conditions for the outsourcing of activities, including key functions (under GL 14). Insurers currently observe controls in conformity with various parts of SYSC but, to the extent that the guidelines are more granular, firms should use the opportunity to review their present arrangements and their reliance on outsourcing during the preparatory period. The PRA expects firms to be able to document their overall approach to outsourcing, including contingency plans in the event of a service provider failure, to ensure that the efficiency of the service remains unimpaired and uninterrupted. Such actions are good practice and consistent with the PRA's overall supervisory approach. The PRA may look to review firms' overall approach to outsourcing and will be particularly interested in understanding any changes which have been made as a result of firms' preparations for Solvency II.

Section III: Group governance specific requirements (GLs 48–52)

3.23 As noted in paragraph 3.5 above, the scope and granularity of the group governance provisions of the guidelines are more granular than current PRA requirements. However, there is a good degree of alignment in the fundamental principles and expectations of the PRA approach and the guidelines. The PRA approach to supervision also places due emphasis on group governance. In particular, SYSC 12 and INSPRU 6 cover firms' exposure to group risk and group risk management processes and internal control mechanisms. The guidelines are more detailed in describing the system of governance and the nature of risks to be identified and managed at group level. Interdependencies between risks and between different entities should also be systematically addressed in groups, including those arising from non-regulated entities or holding companies and those that arise from third-country operations.

3.24 As noted in paragraph 3.23, the PRA already emphasises the importance of group governance and the responsibilities of group Boards to ensure that business is conducted in a prudent manner. Groups are encouraged to engage with supervisors during the preparatory period in identifying the responsible entity for group governance and on their plans for putting the necessary processes in place for compliance under Solvency II.

3.25 The PRA will be keen to understand how firms plan to implement these requirements at a group level in a way that ensures that the key functions at the solo firms maintain their independence and impartiality.

4 Forward-looking assessment of own risks (based on the ORSA principles)

Introduction

4.1 This chapter sets out the PRA's expectations in respect of the guidelines for the development of a forward-looking assessment of risks based on the own risk and solvency assessment ('ORSA') principles. The PRA considers its approach to be compatible with principles 2 (skill, care and diligence), 3 (management and control) and 4 (financial prudence) of the PRA's principles for businesses. Rules and guidance are set out in SYSC 14, GENPRU 1.2 and INSPRU 7. This chapter examines the individual guidelines highlighting those features of particular significance and providing further clarity where needed.

4.2 These guidelines will assist firms in developing their risk management framework and enhancing preparedness for the Solvency II standard expected for an ORSA. The assessment will promote the safety and soundness of firms and contribute to the protection of policyholders and will, therefore, advance the PRA's objectives.

Overall approach

4.3 The PRA will take a pragmatic approach to the way firms intend to develop their ORSA, recognising that developing the disciplines of a forward-looking ORSA will be critical to future compliance with Solvency II. The preparatory period is a time of development for firms in designing, compiling and trialling these assessments. The PRA will not prescribe the format or content of the ORSA, recognising that they need to reflect the specific risk profile and governance mechanism of each firm and group. However, during the preparatory phase, firms are encouraged to work towards ensuring that their ORSA adequately captures all known risks. The PRA will review assessments on a proportionate basis and give feedback where appropriate.

4.4 The guidelines anticipate two annual assessments being undertaken during the preparatory period. Each of these assessments is intended to be an opportunity for firms to demonstrate the progress which they have made towards preparedness for the submission of the ORSA under Solvency II. By the second year the assessment is expected to be of a higher standard, based on experience gained in the first year, and reflect the prevailing market conditions and any changes to the risk profile.

4.5 A staggered approach has been adopted to the application of these guidelines. Certain guidelines (ie GLs 14–16) will only become operative in 2015 and will then affect a limited number of firms because of the application of the threshold in GL 3. Supervisors will be in contact with those firms which fall into the relevant category during the course of 2014 to ensure that those firms can take account of these guidelines when planning preparedness work for 2015.

Section I: General provisions (GLs 1–3)

4.6 These guidelines scope the general responsibilities of NCAs in relation to ensuring that guidelines are applied to firms within a specified time frame. The PRA expects all firms to develop a qualitative process to develop an ORSA which can be documented and reviewed by the PRA in line with its overall proportionate approach. Firms are encouraged to put a robust process in place to assess, monitor and measure all risks and to ensure that the output from the assessment forms an important part of the firm's strategic and decision-making processes. Once the process has been put in place, firms can then start to perform the assessment based on their overall risk profile and solvency needs.

Section II: Forward-looking assessment of own risks (GLs 4–10)

4.7 These guidelines set out the administrative and governance framework within which the ORSA should be performed. While the framework should be commensurate to the nature, scale and risks of the business, firms should recognise the need for effective documentation and record keeping. This should be extensive enough to cover both the policy defining the methodology under which the assessment is undertaken and observing protocols on the production of reports containing the eventual outcomes.

4.8 The PRA expects the Board to play an active part at various stages, providing initial steering on how the ORSA should be designed and documented, challenging on risk identification and mitigation along the way and culminating in the Board approving and communicating the finished product. Its involvement is likely to need to be far more extensive than setting risk appetites and tolerances and firms are expected to plan a schedule of Board meetings to allow adequate time and opportunity for discussion as work on the ORSA proceeds. The PRA may check that such arrangements have been made by firms.

4.9 As part of good capital management, regular stress and scenario tests should be carried out and recorded in a similar fashion as under the existing regulatory regime. The PRA expects these tests to be proportionate to the nature, scale and complexity of the business and for relevant management or mitigating actions to be incorporated as appropriate within the ORSA and before its conclusion.

4.10 The guidelines provide for both an internal report and supervisory report describing the outcome of the assessments. For all firms, and specifically to avoid smaller and lower risk firms having to produce two reports, the PRA will accept the internal report as the supervisory report, providing it is sufficiently detailed and granular to serve the latter purpose. In relation to larger and higher-risk firms, the PRA may ask to see additional information that supports the supervisory report. Reports should be approved by the Board and set out the process and methodology used, a record of the main findings and subsequent implications for the business of the firm.

4.11 To help capture data and information in a consistent way from firms and facilitate review the PRA is considering whether it may be beneficial to provide a summary sheet to firms. The PRA will aim to share further information in 2014 about how this might be delivered. For those firms participating in ICAS+ and involved with separate in-development ORSAs, the PRA expects the activities to be complementary.

Section III: Specific features regarding the performance of the forward-looking assessment of own risks (GLs 11–18)

4.12 These guidelines provide further detail on how the ORSA is to be performed over the two-year period covering own solvency needs and, in 2015, for certain firms only, continuous assessment with Solvency II capital requirements and technical provisions and assessment of deviations from assumptions under the Solvency Capital Requirement (SCR) calculation.

4.13 For this purpose, the assessment of own solvency needs should be based initially on valuations and capital requirements under the current regime for the individual firm be that ICAS or ICAS+ and Solvency I. All firms should then make a start on this basis in 2014. Firms should also be aware of the need to prepare for meeting full Solvency II requirements that will apply on and after the implementation date, including whether the ORSA incorporates a view on the expected Solvency II capital position.

4.14 The PRA expects the overall solvency assessment to involve input from across the whole firm and to consider risks not just on a one-year timeline but over the medium to long term to cover the normal business planning period.

4.15 In undertaking an ORSA in the second year, the PRA expects firms to go further and to perform their forward calculations on a Solvency II basis. Alternatively, as the final specification for Solvency II is expected during 2014, firms may reconcile the assessment with that which would apply if a Solvency II basis had been adopted for this purpose.

4.16 The assessment should cover all material risks, including non-quantifiable risks such as reputational risk or strategic risk, and the extent to which they are to be covered by capital or addressed by way of risk management techniques or a combination of both, with underlying reasons. If the risks are to be covered by capital, the level of materiality and amount of capital should be identified, together with how the funds will be managed. If the risks are to be managed with risk mitigation techniques, similar explanations should be given. When an insurer belongs to a group, its ORSA should also consider all group risks that may impact materially on the individual entity.

4.17 Guidelines 14–16 extend the scope of the ORSA to include a firm's continuing compliance with Solvency II capital requirements and technical provisions and deviations from assumptions underlying the SCR. These requirements do not apply to all firms but only those within the market thresholds as defined in the guidelines on submission of information and supervisors will make individual contact during the course of 2014 to discuss those guidelines. Final Solvency II capital requirements and technical provisions, including EIOPA's technical specification of the SCR calculation assumptions that will affect these discussions, are not expected until 2014.

4.18 Given the dependencies outlined above, these specific guidelines will not apply until 2015 but the PRA recognises their complexity at a time when firms will still be regulated under the current regime and working to a different solvency and valuation basis. It is therefore important for the firms concerned, once identified, to engage with supervisors at an early stage to discuss and resolve any issues.

4.19 In relation to timing, the PRA does not intend to prescribe when firms should submit their ORSA. Firms should identify the best time to complete the required work. Firms should inform the PRA when their ORSA will be submitted well in advance of the submission date. Due to the high number of ORSAs which will be submitted, the PRA expects that it may have to stagger its review of these during the preparatory period in a way that is risk based and proportionate.

4.20 The PRA expects firms to take account of results and insights from their ORSA for the purpose of capital management and business planning, as well as product development and design. For most firms, this is likely to be an evolution of the management practices that they already follow.

Section IV: Specificities of the group in the forward-looking assessment of own risks (based on ORSA principles) (GLs 19–25)

4.21 These guidelines set out the specific framework and parameters affecting the preparation of a group assessment and should be treated as being additional to the preceding guidelines. The PRA recognises that for groups the prospect of producing a group ORSA as well as solo assessments for the individual subsidiaries may represent a significant addition to current approaches. While some groups do operate centralised risk management, this is unlikely to be sufficient, in itself, to meet the conditions of an ORSA as a risk and capital management vehicle when Solvency II applies. Moreover, the extent to which the group assessment should involve non-EEA entities operating under different risk and solvency standards adds further complexity to the task.

4.22 In view of the potential scope and impact of group assessments, the PRA strongly encourages those group undertakings concerned to make early contact with supervisors to identify the responsible entity for the group assessment and explain how they intend to plan and resource such exercises in order to make progress towards full compliance when Solvency II is implemented.

5 Submission of information

Introduction

5.1 This chapter sets out the PRA's expectations in respect of the guidelines for the submission of information. The PRA considers its approach to be compatible with the PRA's general powers to receive information under s.165 FSMA. The PRA also notes the obligations on firms to ensure adequate preparedness for Solvency II in SYSC and in accordance with the prudent management of the firm. The chapter addresses individual guidelines below, highlighting those features of particular significance and providing further clarity where needed.

Overall approach

5.2 The PRA will apply the proportionality principle and the PRA's risk-based approach to supervision when applying the thresholds for life and non-life firms, individual firms and groups set out in EIOPA's guidelines. The PRA will notify firms falling into the relevant thresholds no later than eleven months before the first submission reference dates set out in the guidelines.

5.3 In taking appropriate account of firm-specific characteristics, the PRA appreciates the role of dialogue between firms and their supervisors as to how certain guidelines might be applied during the preparatory phase.

5.4 The guidelines will be supported by EIOPA's technical specification to be finalised in 2014.

5.5 Any national specific templates for reporting under Solvency II which are developed in due course by the PRA will be subject to the PRA's usual consultation process, including consultation as to whether it may be appropriate for firms to complete these templates during the preparatory period.

5.6 While the PRA expects submissions from those firms falling within the relevant thresholds as described above, these guidelines may be helpful to all firms in preparing for the future submission of information to the PRA under the Solvency II regime.

Section I: General provisions for the guidelines (GLs 1–2)

5.7 These guidelines set out the overall expectations of NCAs during the preparatory period. In order to notify its intention to comply with the guidelines, the PRA expects firms to make progress towards establishing systems and structures to deliver high-quality information for supervisory purposes and to submit information to allow the PRA to review and evaluate the quality of the information and the progress made. As part of their work towards meeting this expectation, firms should:

- conduct data validation checks as set out in Technical Annex VI to the guidelines;
- submit quantitative information using eXtensible Business Reporting Language (XBRL), as previously set out in 'FSA statement on the use of XBRL for Capital Requirements Directive (CRD) IV and Solvency II', 25 July 2012;(1) and
- submit narrative reports in a Portable Document Format (PDF).

5.8 The PRA will review submissions and give feedback where appropriate.

Section II: Scope of the submission of information — thresholds to be applied (GLs 3–12)

5.9 This section provides detail on the thresholds for quantitative and qualitative reporting from life, non-life, individual firms and groups. The PRA expects to have an early dialogue with firms falling into the threshold that have a year-end other than 31 December to discuss the submission reference date for the submission of information in the preparatory phase.

Section III: Quantitative information (GLs 13–20)

5.10 The guidelines include detail of the quantitative information to be included in submissions from firms falling into the thresholds.

5.11 For the group solvency calculation, the PRA expects early interaction with firms to discuss the calculation method to be applied during the preparatory phase. The guidelines provide for the potential for two different calculation methodologies and allow firms discretion, provided they consult and agree a method with their supervisor. Firms are encouraged to consider which calculation methodology may be more compatible with ensuring effective preparation for Solvency II. Firms are reminded that the calculation method applied during the preparatory phase will be without prejudice to any future decision of the group supervisor for Solvency II at implementation.

5.12 The treatment of ring-fenced funds in quantitative reporting for individual firms and groups is an area where the PRA also expects to have early engagement with firms and which will need to take account of EIOPA's technical specification expected in 2014. The PRA has considered these issues and, in particular, the need to balance the reduction of unnecessary complexity in the group solvency calculation with the need for high-quality supervisory information. If, pending the release of EIOPA's technical specification, firms wish to discuss their approach to this issue with their supervisor, the PRA encourages them to do so.

5.13 The PRA will also expect to have early engagement with firms in the internal model approval process (IMAP) to agree the template for the reporting of the Solvency Capital Requirement calculated using a full or partial internal model.

Section IV: Narrative information on system of governance (GLs 21–27)

Section V: Narrative information on capital management (GL 28)

Section VI: Narrative information on valuation for solvency purposes (GLs 29–33)

5.14 The guidelines in Sections IV, V and VI include information about the areas relating to the system of governance for firms and groups and capital management, in particular information on own funds and valuation for solvency purposes. The PRA expects firms to include information at a point in time, related to the submission reference date. Firms are also encouraged, where relevant, to indicate where further development is expected as part of the firm's preparations for compliance with Solvency II. The PRA is willing to engage with firms to discuss how the firm's developing Solvency II work in this area may be used to meet current regulatory requirements, or support work being done in ICAS+ or IMAP during the preparatory phase to reduce any potential for duplication.

Section VII: Reporting process and undertakings' reporting policy (GL 34)

5.15 Firms will have internal policies and procedures to ensure that regulatory reporting and submission of information to supervisors complies with current expectations and requirements. In order to meet the requirements of Solvency II reporting, those policies and procedures are likely to require potentially significant revision. Firms should use the preparatory period as an opportunity to trial revisions to those policies and procedures, so that they are able to meet the Solvency II requirements on implementation. The PRA does not expect that preparatory reporting will be subject to a requirement for external audit but it may draw upon audited inputs.

(1) FSA statement available at http://webarchive.nationalarchives.gov.uk/20130201171633/http://www.fsa.gov.uk/library/communication/statements/2012/xbrl.shtml.

Section VIII: Dates of initial application and deadlines (GL 35)

5.16 The guidelines include information about the submission reference date, which assume a 31 December year-end. As set out in paragraph 5.9 above, the PRA expects to have an early dialogue with firms which fall into the threshold and have a year-end other than 31 December to discuss the submission reference date for the submission of information in the preparatory phase.

Section IX: Means for reporting, currency, units and data checks and others (GLs 36–39)

5.17 The PRA expects firms to submit information using XBRL, in units and in reporting currency. In addition, as set out in paragraph 5.7 above, the PRA would expect all firms to conduct data validation checks.

6 Pre-application for internal models

Introduction

6.1 This section sets out the PRA's expectations in respect of the guidelines for the internal model pre-application and is particularly relevant for firms currently engaged in IMAP and firms who intend to apply for entry to the process.

6.2 These guidelines support the ongoing pre-application process and the PRA will continue to work with firms in IMAP following the pragmatic approach previously set out using the Solvency II preparation work through the ICAS+ process or through regular IMAP activities.

Overall approach

6.3 The PRA expects firms engaged in the pre-application process to take steps to put into practice the relevant provisions of the guidelines as part of their preparation to submit an application to use an internal model for the calculation of the Solvency Capital Requirement.

6.4 The application of the principle of proportionality reflected in the guidelines is consistent with the judgement-based approach that the PRA will continue to apply in its engagement with firms.

6.5 Internal models continue to be developed and have not yet been approved. However, it is important that where models are sufficiently stable, firms are beginning to demonstrate their use and continue to refine their models with the benefits of experience. Therefore, the PRA anticipates that firms will be testing their policies for ensuring adequate control and governance of the model, including their model change policy. During the pre-application process, the PRA encourages firms to engage in early dialogue with their supervisor about changes to the internal model which are considered significant.

6.6 The pre-application process is not a pre-approval of the internal model nor of any element of the model. As part of their preparation for Solvency II, firms engaged in the pre-application process should prepare for the eventuality that their internal model may not be approved.

6.7 The PRA expects to provide feedback to firms on the reviews carried out on the internal model for the purpose of pre-application in line with the timetable agreed with firms either for ICAS+ or IMAP activities.

6.8 During the pre-application process, the PRA expects to agree with firms the specific templates to be used to submit the information regarding the internal model calculation of the Solvency Capital Requirement in accordance with the guidelines on the submission of information (see paragraph 5.13).

6.9 The PRA also expects to agree with firms the time frame and the appropriate level of granularity for the submission by firms of the Solvency Capital Requirement calculated according to the standard formula.