

Supervisory Statement | SS41/15

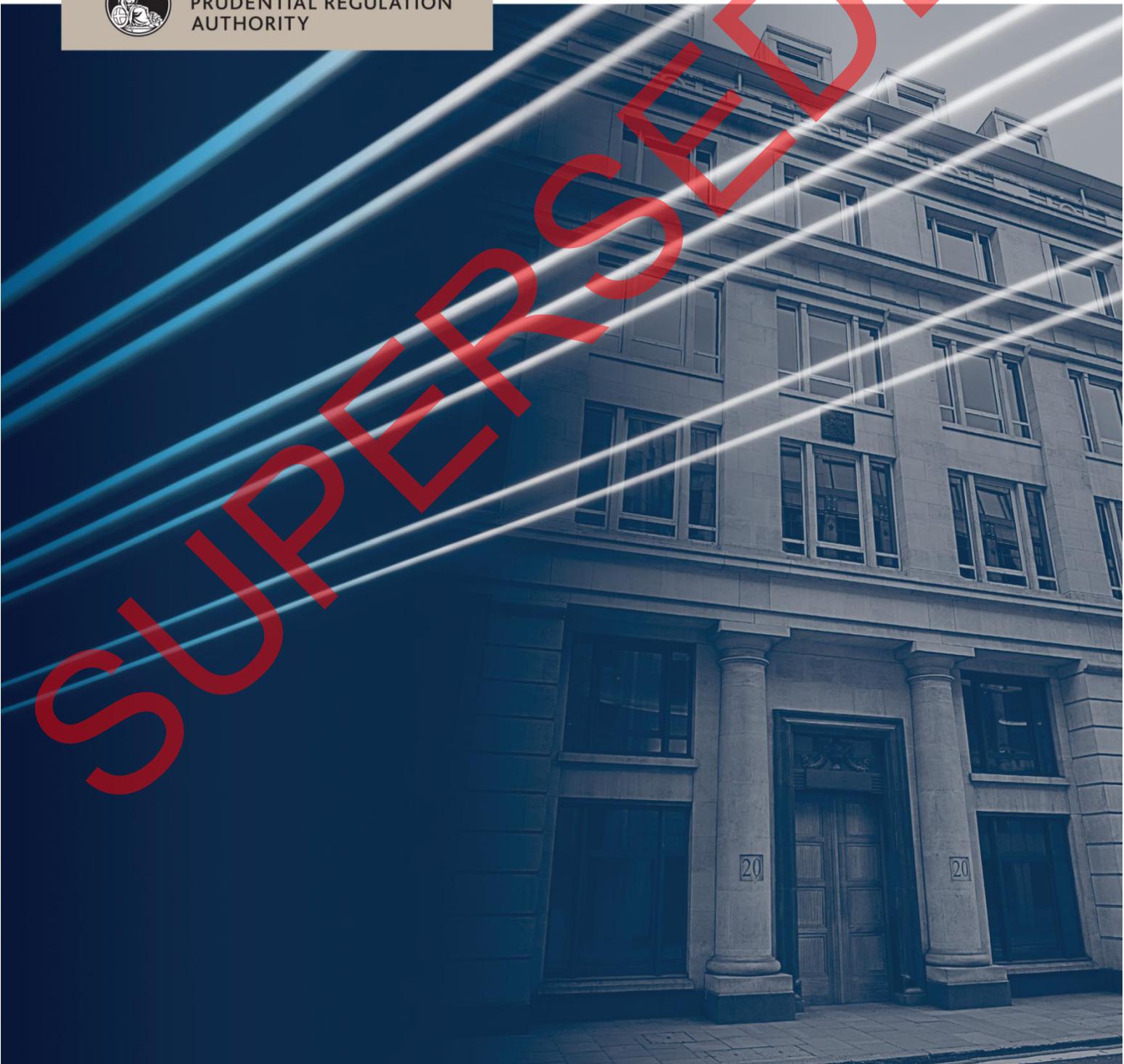
Solvency II: applying EIOPA's Set 2, System of Governance and ORSA Guidelines

October 2015



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PRUDENTIAL REGULATION
AUTHORITY

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1 Introduction

1.1 This supervisory statement is addressed to all UK firms that fall within the scope of Solvency II, and to Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) expectations of firms and its general approach to the following European Insurance and Occupational Pensions Authority's (EIOPA's) Guidelines:

- (i) Set 2 of the Solvency II Guidelines ('the Guidelines'), published as final reports on 6 July 2015 and in all European Union official languages on 14 September 2015; and
- (ii) the System of Governance and the Own Risk and Solvency Assessment (ORSA), published as final reports on 3 February 2015 and in all European Union official languages on 14 September 2015.¹

1.2 Guidelines on supervision of branches of third-country insurance undertakings may be covered in a separate supervisory statement to be published at a later date.

1.3 This supervisory statement expands on the PRA's general approach set out in its approach to insurance supervision.² By clearly and consistently explaining its expectations of firms with respect to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and of securing an appropriate degree of protection for policyholders. The PRA has considered matters to which it is required to have regard, and it considers that this statement is compatible with the Regulatory Principles³ and relevant provisions of the Legislative and Regulatory Reform Act 2006.⁴ The PRA may not act in an unlawfully discriminatory manner. It is required, under the Equality Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.⁵ This statement is not expected to have any direct or indirect discriminatory impact under existing UK law.

1.4 This statement has been subject to public consultation⁶ and reflects the feedback that was received by the PRA. It sets out the PRA's expectation that all firms must comply with all of the Set 2, System of Governance and ORSA Guidelines. It does not address the expected EIOPA Guidelines relating to third-country branches as these have not yet been published in all official languages of the European Union. It also provides further commentary on certain Guidelines where additional considerations, largely set out in previous PRA supervisory statements, should be taken into account by firms.

1.5 The PRA has consulted with the Financial Conduct Authority (FCA) on this supervisory statement.

¹ EIOPA published the Guidelines on System of Governance and ORSA as final reports on 3 February 2015 and in all European Union official languages on 14 September 2015, after the rest of the Set 1 Guidelines were issued. Consequently, these Guidelines were not covered by *PRA Supervisory Statement 22/15*, 'Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorised firms', July 2015.

² PRA's approach to insurance supervision: www.bankofengland.co.uk/publications/Documents/praproach/insuranceappr1406.pdf.

³ See s.2H and s.3B of the Financial Services and Markets Act 2000 (FSMA): <http://www.legislation.gov.uk/ukpga/2000/8/contents>.

⁴ Legislative and Regulatory Reform Act 2006: www.legislation.gov.uk/ukpga/2006/51/contents.

⁵ Equality Act 2010, section 149(1).

⁶ *PRA Consultation Paper 30/15*, 'Solvency II: applying EIOPA's Set 2, System of Governance and ORSA Guidelines', September 2015; <http://www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp3015.aspx>.

2 Compliance with the Guidelines

2.1 It is the PRA's responsibility to make every effort to comply with EIOPA Guidelines and its intention is to comply with all of the Set 2, the System of Governance and the ORSA Guidelines. The PRA will take full account of the Guidelines in its ongoing supervision of the Solvency II regulatory framework.

2.2 The PRA expects firms to comply with all of the Set 2, System of Governance and ORSA Guidelines that apply to them, in a proportionate manner.

2.3 This supervisory statement also provides further commentary on certain Guidelines where the PRA considers that this is useful for firms. Those Guidelines on which further commentary is provided are:

- (i) recognition and valuation of assets and liabilities other than technical provisions;
- (ii) methods for determining the market shares for reporting;
- (iii) reporting for financial stability purposes;
- (iv) reporting and public disclosure; and
- (v) ORSA.

3 Recognition and valuation of assets and liabilities other than technical provisions

3.1 The PRA expects firms to comply with each of the Guidelines in all cases unless they intend to take advantage of the derogation in Article 9 (4) of the Commission Delegated Regulation (EU) 2015/35 ('the Delegated Regulation').

3.2 This derogation lays down criteria which, if met, allow a firm to recognise and value an asset or liability based on the valuation method it uses in preparing its annual or consolidated financial statements.

3.3 Where firms intend to take advantage of the Article 9 (4) derogation, they should still apply Guidelines 1, 2, 4, 5 and 8 to 11. They should also refer to SS38/15⁷ in which the PRA sets out its conclusions as to which financial reporting standards (FRS) are consistent with Article 75 of the Solvency II Directive (the Directive)⁸ and therefore within the possible scope of the derogation.

4 Methods for determining the market share for reporting

4.1 The Guidelines set out the approach by which national competent authorities (NCAs) are to calculate these market shares.

⁷ PRA Supervisory Statement 38/15, 'Solvency II: consistency of UK generally accepted accounting principles with the Solvency II Directive', August 2015; <http://www.bankofengland.co.uk/pru/Pages/publications/ss/2015/ss3815.aspx>.

⁸ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast).

4.2 In Supervisory Statement 11/15,⁹ the PRA indicated that firms designated as either category 4 or 5 by the PRA, whether solo or part of a group, may meet the requirements of exemption from quarterly reporting. As indicated in Rule 2.2 (1) in the Reporting Part of the PRA Rulebook, this exemption, granted by waiver, is only available to firms that cumulatively represent less than 20% of a Member State's life and non-life insurance and reinsurance market shares respectively.

4.3 Firms should be aware that their eligibility for the exemption from quarterly reporting may change due to the re-categorisation of firms or recalculation of market shares in accordance with these Guidelines by the PRA. Should the PRA decide that a firm granted an exemption no longer meets the relevant statutory tests and the PRA Rule requirements, or determine that a firm becomes ineligible due to the re-categorisation of firms or recalculation of market shares, it will notify the firm that its waiver will expire and provide the firm a reasonable timeframe in which to start submitting the full quarterly reporting.

5 Reporting for financial stability purposes

5.1 Guideline 2 defines the criteria to identify the firms that need to report for financial stability purposes. For paragraphs 1.18a and 1.18b, the PRA has determined that firms should report for financial stability reporting purposes, where their total assets or the equivalent in the national currency in the Solvency II balance sheet are equal to or more than €12 billion in total assets. The PRA will advise those firms in-scope for financial stability reporting of this fact in due course.

5.2 Guidelines 4 and 5 relate to Regulation (EU) No. 1094/2010 ('the EIOPA Regulation'). In particular they provide guidance on how NCAs should collect data in accordance with Article 35 of the EIOPA Regulation.

6 Reporting and public disclosure

6.1 In accordance with the requirement of the PRA Rulebook, Composites 4.5, composite firms are required to prepare a statement on the basis of the accounts referred to in Composites 3.2 identifying the eligible own funds covering the notional minimum capital requirements (MCRs) of the life and non-life parts of the business. Section II on Regular Supervisory Reporting (Guidelines 16-29) also gives guidance on reporting issues. In order to fulfil all these requirements, as the template Own Funds (S.23.01.01) does not provide space for composite firms to report eligible own funds separately for life and non-life business, the PRA expects composite firms to submit such statements, on an annual basis, within Section E Capital Management of the Regular Supervisory Report, as described in Annex XX of the Delegated Regulation.

7 Own Risk and Solvency Assessment (ORSA)

7.1 By 1 January 2016, firms will have had two years' experience of producing ORSAs. Therefore, the PRA expects that by that point, firms will be familiar with the concept of assessing risks on a forward-looking basis, covering business plan and strategy timelines, and reflecting the specific risk profile and governance mechanisms of each entity or group.

⁹ PRA Supervisory Statement 11/15, 'Solvency II: regulatory reporting and exemptions', March 2015; <http://www.bankofengland.co.uk/prd/Pages/publications/ss/2015/ss1115.aspx>.

7.2 The PRA has provided general feedback to all firms on lessons learned from the first set of ORSAs. In addition, in SS26/15 the PRA has set out its expectations for non-life firms regarding the option of demonstrating that their risks have been projected to the ultimate time horizon.¹⁰ Firms should ensure that they capture own capital needs and reflect business risk profiles over both the short-term and the long-term.

7.3 As part of its supervisory process, the PRA will continue to review ORSA reports on a risk-based and proportionate basis.

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¹⁰ PRA Supervisory Statement 26/15, 'Solvency II: ORSA and the ultimate time horizon', June 2015; <http://www.bankofengland.co.uk/pru/Pages/publications/ss/2015/ss2615.aspx>.