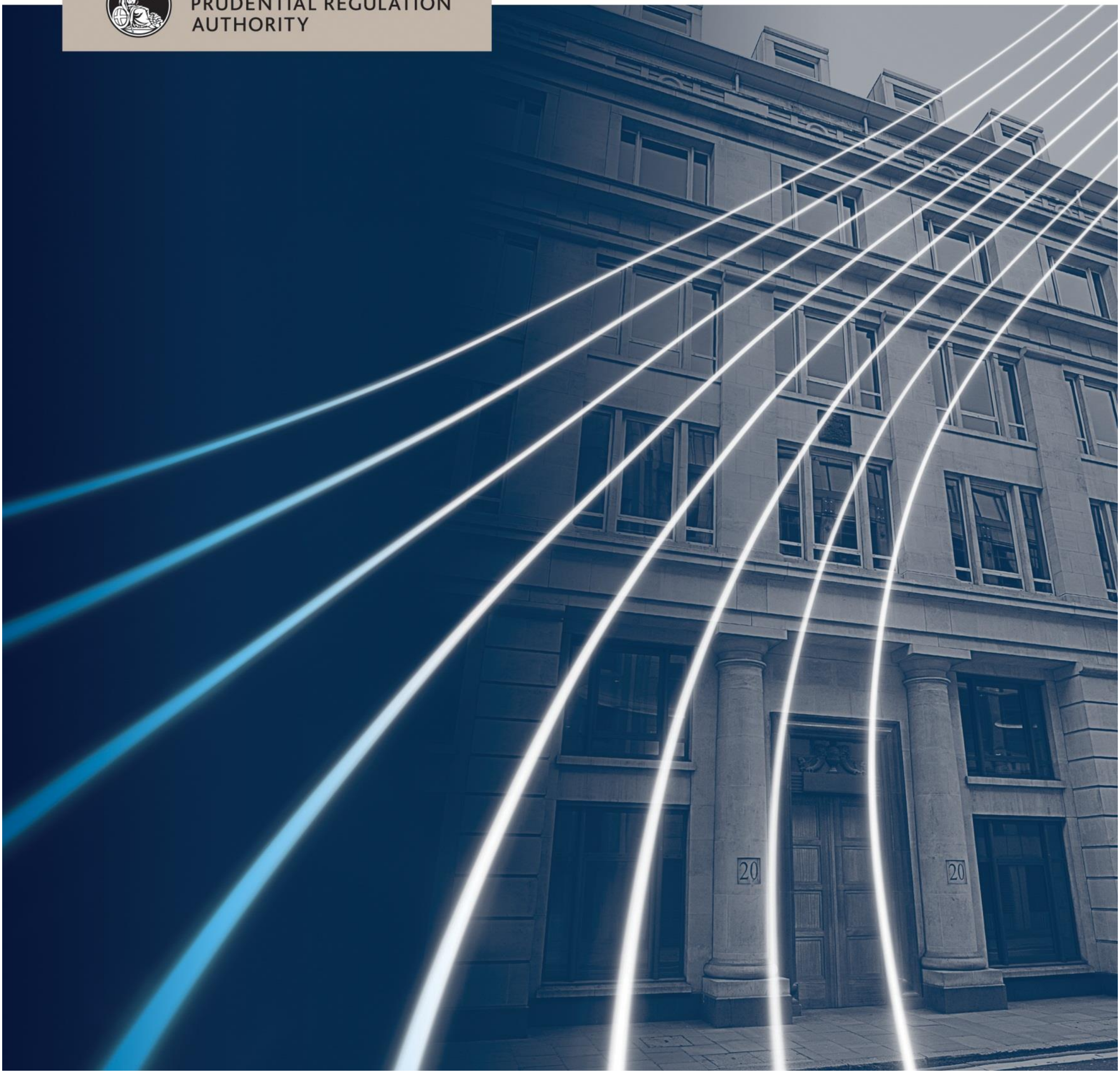
Policy Statement | PS25/17

Solvency II: Data collection of market risk sensitivities

October 2017

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 7/17 'Solvency II: Data collection of market risk sensitivities'[1] and includes a link to the final Supervisory Statement (SS) 7/17.[2]

1.2 This PS is relevant to PRA-regulated insurance or reinsurance firms that are most exposed to market risks. These are primarily Category 1 and 2 firms in the life sector, and any other category life firm or general insurance firm, or composite insurance firm that demonstrates material market risk exposures.

1.3 The PRA has developed the policy in this PS in the context of the existing UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes may be required in connection with the United Kingdom's withdrawal from the European Union.

1.4 In CP7/17, the PRA proposed that:

- Category 1 and 2 firms in the life sector, and any other category life firm or general insurance firm that demonstrates material risk and exposure to external market factors, should report half-yearly to the PRA on sensitivities in relation to firms' solvency position to various changes in market risks;
- the firms in scope should submit the information two weeks after the formal submission of the end-June and end-December solo quarterly Quantitative Reporting Templates (QRTs), or following a change in the firm's risk profile (eg following a recalculation of transitional measure on technical provisions (TMTP), or a merger or acquisition) or upon the PRA's request due to extraordinary market conditions; and
- the first submission of sensitivity results should be at the effective date of 30 June 2017, and expected six weeks after the SS is published.

1.5 The PRA has had regard to representations made to the proposals in the consultation. It is now publishing an account, in general terms, of those representations and its response to them, as well as details of any significant differences from the proposals.

1.6 In the PRA's opinion, the impact on mutuals of the policies set out in the final SS is not significantly different from the impact on mutuals of the proposals consulted on in CP7/17.

1.7 The PRA received ten responses to CP7/17. Overall, the PRA considers that the responses require no material changes to its proposals. The PRA has made amendments to the draft SS to provide further clarity to firms. The amendments concern the scope of firms, timeline of data submission (including the regularity of data requests), and date of the first formal data submission. Chapter 2 explains these changes and provides further minor clarifications in light of feedback received.

1 June 2017: www.bankofengland.co.uk/pra/Pages/publications/cp/2017/cp717.aspx.
2 'Solvency II: Data collection of market risk sensitivities', October 2017: www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss717.aspx.

2 Feedback to responses

2.1 This chapter covers feedback to responses on CP7/17, and the changes the PRA has made to the draft SS as a result of its consideration of those responses.

Scope

Reporting of group rather than solo basis

2.2 One respondent stated that its reporting processes meant that it was easier to provide data at a holding company rather than a solo basis and requested that they were given the flexibility to submit on this basis.

2.3 The PRA's objective is to understand the sensitivity of the solvency position of UK insurance companies rather than wider groups, which may, for example, include material non-UK businesses. Where groups have primarily UK business, however, the PRA will consider giving firms the flexibility to report group numbers instead of solo numbers. Firms should contact their usual supervisory contact if they wish to take up this option.

Timing

Reporting deadline

2.4 Five respondents considered that the proposed deadline for submissions was too tight – particularly as the year-end submission of the market sensitivity coincided with the year-end QRT reporting process. The PRA has considered these concerns and has revised its final policy so that the proposed deadline is four rather than two weeks after the relevant solo quarterly QRT deadlines.

First submission

2.5 Four respondents were positive about making the submission a regular occurrence, as opposed to ad hoc. However, other respondents highlighted that this would require some process changes that would take time to implement. With this in mind, two respondents argued that the proposal in the CP for firms to submit data as at 30 June 2017 – six weeks after the publication of the SS – was too onerous.

2.6 The PRA has considered the additional burden involved in setting up systems for the first regular report of sensitivity data and has decided that the first submission should be data as at 31 December 2017.

Regular data submission

2.7 As noted above, four respondents welcomed a regular, rather than ad hoc, submission. The certainty on the timing and format of regular submissions would allow processes and systems to be set up in advance. While three respondents accepted that there could be circumstances where an 'out of cycle' request could be made by the PRA following a change in the firm's risk profile, there were concerns that 'change in the risk profile' had not been more clearly defined.

2.8 The PRA has considered these concerns and decided that it will be guided by a firm's definition of 'change in risk profile'. The SS gives examples of mergers, acquisitions or recalculations of the TMTP. Out of cycle requests will only be used when the existing data held by the PRA is too inaccurate to be used and the period before a resubmission is too long. The PRA anticipates that requests for resubmission by the PRA will be rare, and likely to follow an acknowledgement by the firm that the sensitivities used for internal purposes also need to be updated.

Frequency of submission

2.9 One respondent agreed with the PRA's view that the data should remain up to date. However, five respondents considered that annual submissions rather than half-yearly submissions were suitable for this purpose, particularly where there had not been a change in the firm's risk profile.

2.10 Based on experience from ad hoc requests, the PRA believes the sensitivity results are sufficiently volatile over time to justify half-yearly rather than annual submissions.

2.11 However, the PRA is willing to be proportionate in order to manage the burden on firms. Where firms have evidence that their risk profile has not changed materially since the previous submission and markets have been relatively stable, the PRA is willing to accept approximations to update the sensitivities.

Content

Number of sensitivities and calibration of the sensitivities

2.12 Three respondents highlighted that by collecting sensitivities to movements in single market variables, the PRA may miss the fact that sensitivities to combinations of movements in variables may differ. Two respondents also highlighted that sensitivities may not be linear: for example, sensitivity to large market movements may be proportionately larger or smaller than to small market movements.

2.13 The PRA considered the feedback and decided that stresses for the market risks should be kept unchanged. The PRA considers that these issues could be resolved by requesting sensitivities on a more frequent basis. Similarly, data could be collected for a range of changes in market factors. While this would increase the accuracy of the estimates, it would also increase the onerousness of the exercise to the industry.

2.14 One respondent also questioned the realism of some of the stresses. For example, the credit spread stress has the same increase in spreads for all credit ratings, and the interest rate stresses assume the same change for all durations. In the interest of simplicity, the PRA has decided not to change these stresses.

Proportionality and approximations

2.15 Five respondents supported and appreciated the PRA's willingness to accept approximations and take a proportionate approach. In particular, they supported the willingness of the PRA to accept adjustments, if necessary, to the firm's internal sensitivities and that sensitivities on non-material risks or funds could be excluded. Three respondents also provided helpful comments that challenged the detail of the data request. In response, the PRA has added clarification in the final SS on the level of detail it expects.

2.16 One respondent noted that the CP included concrete examples on the application of proportionality while the draft SS asked firms to engage with the PRA on these areas. They expressed concern that the apparent flexibility in the CP was not reflected in the draft SS. The PRA considers that the SS should focus on the framework and process of agreeing areas of proportionality in order to give firms the flexibility to choose the approximations that are suitable for their business. The PRA has updated the SS to clarify this.

2.17 One respondent highlighted that its existing systems were set up to calculate the change in net value of assets and best estimate liabilities, so that approximations were necessary to split the net value between these. In the interest of proportionality, the PRA is willing to accept approximations to split the change in net value of assets and best estimate liabilities into components.

2.18 Two respondents commented that the detail in the credit default stress, a stress that had not been included in ad hoc data requests, could be particularly onerous for firms as it could include a matching adjustment asset portfolio optimisation exercise and revaluation of non-quoted assets. However, respondents did not provide an alternative proposal on how such a test could be designed in a less onerous way.

2.19 The credit default sensitivity proposed in the CP was considered necessary in order to give a full view of exposure to credit risk. The PRA proposes that firms use their own best judgement to complete this sensitivity. Supervisors are willing to discuss the approximations used by firms on a bilateral basis as necessary.

Use of firms' own solvency estimates

2.20 Two respondents highlighted that more accurate estimates of solvency were produced internally than could be achieved using the data collected by the PRA. It was highlighted that many firms had a monthly reporting process which is more reliable and timely. One respondent considered that detailed analysis on the differences between firm's own and the PRA's estimate of solvency would not be productive.

2.21 The PRA accepts this observation by the industry. However, the purpose of the data collection is to provide an indication of the financial position at industry as well as firm level. The PRA does not intend to use this information in isolation to come to a supervisory judgement, and where accurate estimates of solvency are required it will seek to use timely information collected direct from firms.

Recalculation of the volatility adjustment (VA)

2.22 Two respondents remarked that there was an expectation that in reality the volatility adjustment (VA) would be recalculated as market conditions changed. This contrasted with the assumption made in the data submission that the VA would not be recalculated.

2.23 In the interest of comparability of information between firms, the PRA will continue to request a static VA submission.

Management actions

2.24 Three respondents highlighted that listing potential management actions duplicated information already included in the Own Risk and Solvency Assessment (ORSA).

2.25 While this is potentially true for some firms, the data request allows the PRA to collect the data on a systematic basis and identify trends and limitations to the analysis.

Reporting burden

2.26 Five respondents suggested that the draft SS in CP7/17 would increase the reporting burden on firms in scope and noted that this would be in addition to other, already burdensome, reporting requirements. One respondent also noted that the request for Q4 data coincided with pressures from other regulatory and financial reporting, which some considered to be an advantage and others a disadvantage. However, the same respondents welcomed the PRA's willingness to accept approximations when submitting the sensitivities and highlighted that similar stresses were normally used by firms for internal purposes, such as continuous solvency monitoring. Two respondents suggested an alternative proposal that firms should be allowed to report on the internal reporting basis rather than PRA-prescribed stresses.

2.27 The PRA has considered requesting market sensitivity information based on the definition, calibration and reporting template of similar stress tests used by each firm for the purpose of their own internal management processes (eg a firm's own continuous solvency monitoring systems). However, using standardised definitions of risks and data reporting templates have the advantages of enabling the PRA to compare firms on a common basis and carry out industry-level analysis. It also reduces the risk of misinterpretation of the information by the PRA.

Appendix: Supervisory Statement 7/17 'Solvency II: Data collection of market risk sensitivities'

Available at www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss717.aspx.