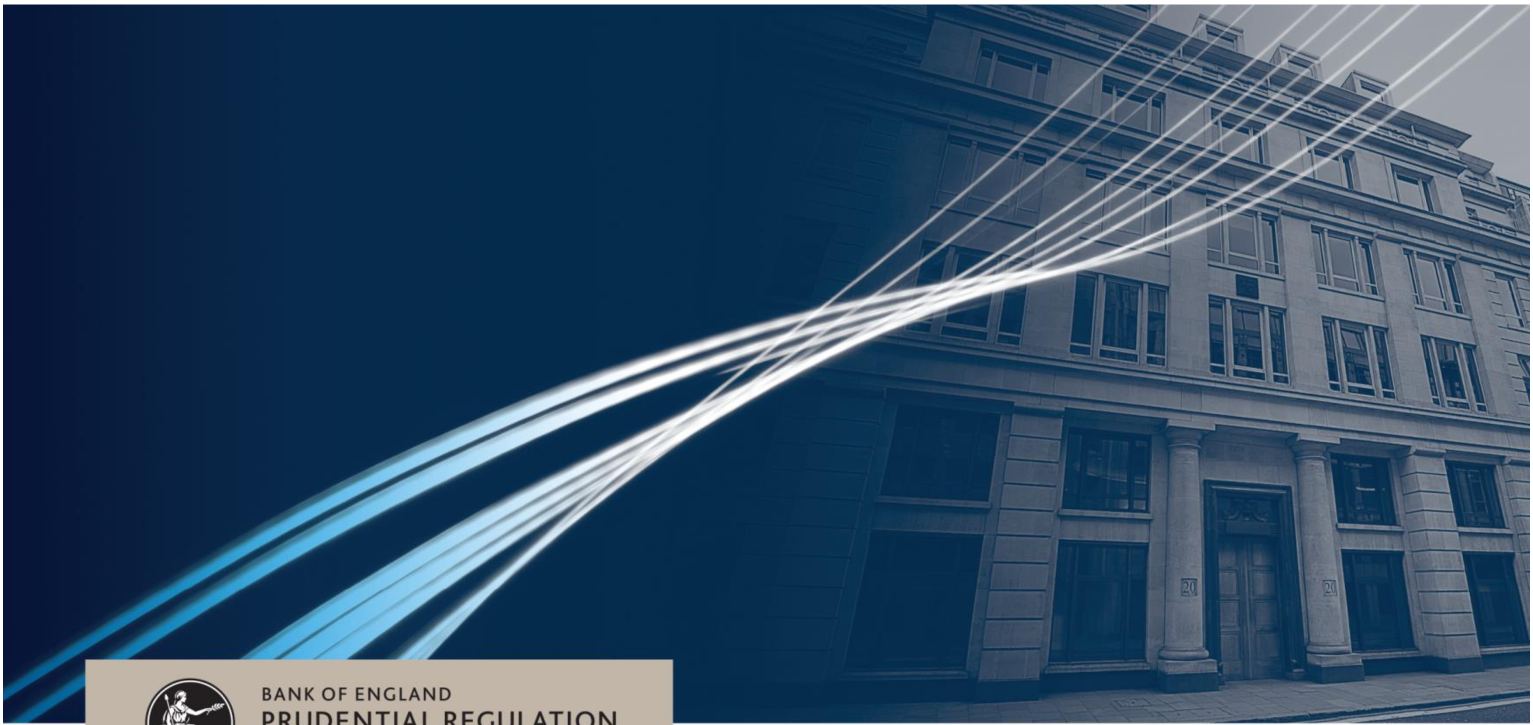

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP7/17

CP7/17 Solvency II: Data collection of market risk sensitivities

June 2017

Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

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Responses are requested by Monday 7 August 2017.

Please address any comments or enquiries to:
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Contents

1 Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA) proposed expectations for the reporting of sensitivities of solvency positions to key market risks by firms with material exposure to market risk.

1.2 This CP is relevant to Solvency II insurance and reinsurance firms holding, or intending to hold, material quantities of assets exposed to market risk.

1.3 The PRA analyses market sensitivity data to determine how a firm's solvency position may move under key market stresses. The PRA has found the data from previous ad hoc collections of market sensitivities very useful. It has been used:

(a) in setting supervisory priorities;

(b) for wider impact analysis to support the Bank's financial stability remit;

(c) to gauge the implications of policy options; and

(d) to engage more effectively with firms in relation to potential management actions which may be needed to remedy a deterioration in the firm's financial condition.

1.4 Many firms have similar processes to monitor ongoing solvency. By necessity, the PRA's approach uses standard stresses to a limited number of risks and these may differ from those used by firms. However, the PRA is willing to accept approximations in the data submitted so that firms can use data that is, as far as practicable, a subset of their firm's own internal reporting. The PRA takes a proportionate approach to regulatory reporting and welcomes suggestions as part of this consultation on more efficient or better ways to collect data to achieve its objectives.

1.5 The draft supervisory statement in the appendix contains a proposal to introduce half-yearly reporting of sensitivities in relation to firms' solvency positions. The template is included as an appendix to the draft supervisory statement in this document. Any template for firms to use will be available on the Bank of England website at all times via a link in the final supervisory statement should this proposal go ahead.

Responses and next steps

1.6 This consultation closes on Monday 7 August 2017. The PRA invites feedback on the proposal set out in this consultation. Please address any comments or enquiries to CP7_17@bankofengland.co.uk.

1.7 To be helpful to firms, by the end of June, their usual supervisory contact at the PRA will inform firms individually if they would fall within scope of the proposal. This does not preclude firms outside scope from responding to this consultation or, in due course, from submitting the return should they decide to do so following a discussion with their usual supervisory contact.

2 Proposal

2.1 The PRA proposes to request firms to submit half-yearly sensitivities to predetermined market stresses using the proposed template and instructions in the appendix to the draft supervisory statement.

2.2 Periodic collection of sensitivity data would assist the PRA to evaluate, in a timely manner, solvency positions and the management actions put forward by firms, while reducing the burden on firms in times of market volatility. Only obtaining such sensitivities in an ad hoc manner at a time of market volatility may be burdensome for firms, given competing demands for financial reporting at those times.

2.3 Most firms will be tracking similar sensitivity measures through their own risk management processes[1] and their regulatory obligation to monitor their solvency on a continuous basis.[2] A firm must recalculate its solvency position following a material change in risk profile at its own initiative or if requested by the PRA.[3] A formal recalculation, however, may not be timely and does not provide a consistent view across firms exposed to material market risk.

2.4 Maintaining good information with which to monitor, at a high level, firms' solvency between formal submissions requires information that is timely, consistent with the formal submissions, and at the right level of group structures.

Timing

2.5 The solvency position of a firm can change materially as a result of new business, changes to underlying risk exposures, or structural changes such as reinsurance or transfer of business to another party. Sensitivities therefore require regular updates to show a realistic position that is up to date and relevant to the current situation of a firm.

2.6 The timescales for submissions would be two weeks after the formal submission of Quarterly Reporting Templates (QRTs) for end-June and end-December, or following a significant change in the risk profile of the company (eg following a recalculation of transitional measure on technical provisions (TMTP) or a merger or acquisition). The PRA proposes that the first submission of sensitivity results be at the effective date of 30 June 2017, depending on the outcome of this consultation.[4]

Content

2.7 The PRA proposes that any information provided would be a materially accurate assessment of the sensitivities. The PRA anticipates it could be based closely on a firm's own internal monitoring processes and also consistent with the information contained in regulatory reporting by firms.

2.8 The PRA proposes that firms apply the principle of proportionality when providing these sensitivities. For example, ring-fenced funds could be excluded from the sensitivity analysis if they have a limited impact on the underlying solvency of the firm as a consequence of restrictions to Own Funds.

Scope

2.9 To capture all insurance firms with generally large market exposure and risk, the PRA proposes that the scope of the request would include all major UK life insurance firms together with composite and general insurance firms that have material exposure to market risks. This would indicate a focus primarily

1 Rule 3.1(1) of the Conditions Covering Business, Risk Management Part of the PRA Rulebook.
2 Rule 4.3A of the Solvency Capital Requirement - General Provisions Part of the PRA Rulebook.
3 Rule 4.4. of the Solvency Capital Requirement - General Provisions Part of the PRA Rulebook.
4 The current plans, the 30 June 2017 submission would be expected 6 weeks after the final supervisory statement is published to allow the process to become embedded in the relevant firms' planning and risk management calendars.

on 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. The PRA will inform firms individually, through standard supervisory channels, whether they would fall within the scope outlined above by the end of June 2017. A firm that has not been contacted but would like to submit information may do so after discussion with its usual supervisory contact

2.10 The PRA proposes reporting of sensitivities in relation to the solo capital positions of UK companies. Group sensitivities are out of scope for any group supervised by the PRA. For firms within a group, a template should be completed for each major UK solo firm without any consolidation.

2.11 The parameters and design of the information request are expected to remain constant. However they may be subject to minor revisions from time to time to take account of new risks that may develop as markets evolve, or insurers move into new asset or liability classes. To implement the collection of these sensitivities in a proportionate and risk-based way, the PRA will establish in the supervisory statement the overall definitions of the key market exposures and information to be requested. Firms should discuss with their usual supervisory contacts if they wish to depart from the precise format of the reporting template. It is proposed that any template for firms to complete will be available on the Bank of England website.

2.12 The stress used to derive each risk sensitivity is not intended to represent any particular probability of that stress occurring. The sensitivities requested would ordinarily be the impact of each single risk changing on its own.

2.13 The PRA is not aware of a market-standard way in which firms allow for non-linearity arising from interactions between combinations of market risks and management actions, tax or other factors. As such, the PRA does not propose to allow for non-linearity in the reporting of sensitivities.

3 Statutory obligations

3.1 The PRA has a statutory duty to consult when introducing new rules and a public law duty to consult widely on any other measures that significantly affect firms.

Cost benefit analysis

3.2 The PRA is required to perform a cost benefit analysis of the impact of its policy proposals.

3.3 The PRA assesses that the additional cost of running the sensitivities to market risk factors will be low, based on feedback received on past ad hoc data requests and the flexibility provided. Indeed, feedback has been that a regular submission of data will be less costly than ad hoc requests. The information requested is closely based on a firm's own internal monitoring processes so that firms can leverage existing analysis and systems. Some firms already have similar tools in place to estimate their solvency position based on market risk sensitivities. In addition, similar to the past ad hoc collections, following discussion with firms the PRA is content to accept information that is not in the precise format of the particular information request, or based on interpolations or extrapolations of readily available sensitivities.

3.4 Past ad hoc collections of market sensitivities from the major life insurance firms have allowed the PRA to project firms' Solvency II balance sheets and to assess their solvency positions through recent market volatility. This, in turn, has provided valuable inputs into supervision and policymaking. Regular updated sensitivities data will enhance the PRA's ability to response to market events, and thereby better deliver its statutory objectives.

3.5 The PRA therefore considers that this is a proportionate approach to arrive at a materially correct estimate of solvency levels under different market stresses.

Competition assessment

3.6 The PRA has a secondary objective to act, so far as reasonably possible, in a way which facilitates effective competition in the markets for services provided by PRA-authorised firms in carrying on regulated activities.

3.7 The proposal would enable the PRA to monitor firms' financial condition better and enhance the PRA's ability to respond to market events in a timely manner. This will help the PRA act proportionally as well as ensuring insurers have adequate capital to support the risks in their business. Acting proportionally and being mindful of the impact of PRA decisions on individual firms will facilitate effective competition.

Compatibility with the PRA's objectives

3.8 The proposal would enhance the oversight of current solvency resilience in a major part of the UK industry. The PRA also has an obligation under the Solvency II Directive[1] to have appropriate monitoring tools in place to enable the identification of deteriorating financial conditions in an insurance or reinsurance undertaking and to monitor how that deterioration is remedied.

Regulatory principles

3.9 In developing the proposal in this CP, the PRA has had regard to the regulatory principles as set out in FSMA. Three of the principles are of particular relevance.

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1 Article 36 (3) of the Solvency II Directive.

3.10 The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction: the PRA considers that the burden of the proposal (as set out in cost benefit analysis) would be proportionate to the benefits as firms only need to provide the information on a half-yearly basis and the information can be based on interpolations or extrapolations of readily available sensitivities.

3.11 The principle of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of persons such as mutual societies and other kinds of business organisation) subject to requirements by or under FSMA: the PRA considers that the proposal is consistent with this principle as the scope of the information request includes only the largest UK solo firms, and any other category life firm, general insurance firm, or composite insurance firm that demonstrates material risk and exposure to market risks.

3.12 The principle that the regulators should exercise their functions as transparently as possible: the PRA considers that the proposal is consistent with this principle as industry views gathered in this consultation will be taken into account in deciding the approach taken.

Government economic policy

3.13 On 8 March 2017 HM Treasury made recommendations to the Prudential Regulation Committee about aspects of the Government's economic policy to which the Committee should have regard when considering how to advance the objectives of the PRA and apply the regulatory principles set out in FSMA.[1]

3.14 The consideration of 'Better outcome for consumers' is of particular relevance to the proposal outlined in this CP which is designed to enable more efficient analysis of the impact on firms of market movements. This is to enable the PRA to engage more efficiently with firms in relation to any potential management actions which may be needed to remedy deterioration in the firm's financial condition. Encouraging stability across the market aids the securing of an appropriate degree of protection of policyholders.

Impact on mutuals

3.15 The PRA does not believe that the proposal will have an impact on mutuals that differs significantly from other firms.

Equality and diversity

3.16 The PRA may not act in an unlawfully discriminatory manner. It is required, under the Equalities Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies. The PRA does not consider that the proposal gives rise to any equality and diversity issues.

1 Available on the Bank's website at www.bankofengland.co.uk/about/Pages/people/prapeople.aspx.

Appendix: Draft supervisory statement 'Solvency II: Data collection of market risk sensitivities'

1 Introduction

1.1 This supervisory statement sets out the Prudential Regulation Authority's (PRA) expectations in respect of the reporting of sensitivities of solvency position to various changes in market conditions by firms with material exposure to market risk.

1.2 It is relevant to Solvency II insurance and reinsurance firms holding, or intending to hold, material quantities of assets exposed to market risk.

2 Firms in scope of the request for sensitivities

2.1 The firms in scope are those insurance or reinsurance firms most exposed to risk from external (market) factors. 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 risk and exposure to external factors. The PRA will inform firms individually through their usual supervisory contacts whether they will fall within the scope outlined above. A firm that has not been contacted but would like to submit the information may do so after discussion with its usual supervisory contact.

2.2 Where a group exists, the solo firms within the group may each find themselves within scope. If the group holding company is also a life insurer the information request remains on the solo basis of reporting only; and consolidation of any subsidiary life firms is not intended.

3 The key market risks and information to be provided

3.1 The PRA expects firms in scope to report sensitivities to various changes in market risks half-yearly.

3.2 Market risks cover a range of exposures including to UK equity prices, property prices, swap rates, sovereign rates, spreads on corporate bonds over swap rates, downgrades on credit assets, inflation, currency exchange rates USD/GBP and GBP/EUR, and downgrades on credit-risky assets. New risks may develop over time, as markets develop or insurers move into new asset or liability classes. Similarly one or more of the existing risks noted above may become less significant over time. The population of risks surveyed is expected to stay constant until further notice.

3.3 The PRA expects the sensitivities to show the impact on assets, technical provisions and other liabilities and ultimately to Own Funds as well as the Solvency Capital Requirement (SCR). In light of the potential for recalculation of the transitional measure on technical provisions, (TMTP) the PRA expects the impacts of that adjustment also to be provided, where applicable.

3.4 The PRA will estimate a firm's financial position on a regular basis by interpolating the sensitivity information. In order to do this, it is helpful to exclude from the sensitivities effects that could cause step changes in the financial position. One potential step change is the use of 'one-off' or 'out of model' management actions. Therefore the PRA expects the submission to show the impact of stresses excluding material, one-off management actions where such actions mitigate the Own Funds impact of such a stress only at a certain stress level. The PRA expects such actions to be described separately both as to the action and at what level of stress it would be initiated, with the impact quantified. Firms should engage with the PRA via their usual supervisory contact where the reporting of an immaterial ring-fenced fund would be disproportionate.

3.5 The data request also encompasses the sensitivity of the SCR to the defined stresses. The PRA expects this to be reported on the basis of the firm's current regulatory requirements, ie an approved full or partial internal model, or the standard formula.

4 Timescales and format

4.1 The information requested would enable the PRA to understand how a firm's financial situation, and through extrapolation that of the industry as a whole, may alter in a stressed scenario. Therefore, the PRA expects the sensitivities to be kept up to date as firms' exposures change over time. To this end, the PRA expects firms to submit the information two weeks after the formal submission of Quarterly Reporting Templates (QRTs) for end June and end December,[1] or following a change in risk profile of the company (eg following a recalculation of the TMTP, a merger, or acquisition) or upon the PRA's request due to extraordinary market conditions.

4.2 The PRA expects the format of the information to be consistent with solvency data reported to the PRA and across firms as far as practicable. As new key risks develop or become more significant over time, the format of the information request may need minor revision. The format of the request therefore needs to be sufficiently flexible to deal with required changes, while being appropriately stable to avoid unduly burdensome changes to firms' systems. It would be standard for all firms at any point in time. If a firm can respond to the request but not in the precise format of the particular information request, this would be dealt with as a matter of supervisory dialogue in the usual way.

4.3 The PRA expects an Excel spreadsheet to the firm's normal supervisory contact consistent with the process for Solvency II submission of information. The template is included in the appendix to this statement.

1 The 30 June 2017 submission would be expected 6 weeks after the Supervisory Statement is published to allow the process to become embedded in the relevant firms' planning and risk management calendars.

Appendix: Data collection of market risk sensitivities - Instructions and template

Instructions to assist firms when completing the market risk sensitivities data item.

	Please provide the following:
Section 1: Balance sheet data	Total assets, best estimate liability (BEL), risk margin, transitional measure on technical provisions (TMTP) and any caps to the TMTP benefit, other liabilities, other adjustments to Own Funds, Solvency Capital Requirement (SCR). Provide a brief description for other liabilities and adjustments to Own Funds in a separate document. Balance sheet data for A, B and C are provided to allow for any TMTP. 'Balance sheet A' should show the valuation date position (eg 31 December 2017), including the TMTP currently approved. 'Balance sheet B', a day after the valuation date (eg 1 January 2018), should show as the only change the approved TMTP after run-off directly post balance sheet date (1/16 or equivalent). 'Balance sheet C', should show as the only change to the balance sheet assuming the TMTP had been recalculated as at the valuation date (eg 31 December 2017) given the balance sheet position.
Section 2: Individual sensitivities to balance sheet date	For each sensitivity listed below, provide the movement in balance sheet components listed in Section 1 'Balance sheet A', assuming no change to the TMTP as at the valuation date (eg 31 December 2017). Please provide any commentary or further explanation in a separate document. Sensitivity 1) Equity prices fall by 25%. Sensitivity 2) Property prices (commercial and residential) fall by 25%. Please make no adjustment to the stress to allow for any future movements already anticipated in the current balance sheet. Sensitivity 3) Interest rates rise by 100 bps Sensitivity 4) Interest rates fall by 100 bps Sensitivities 3 and 4 to the interest rate should reflect a parallel shift, and implicitly assume that both Government bond yield and European Insurance and Occupational Pensions Authority (EIOPA) risk free rate move by the same amount. If necessary, interest rates should be allowed to go negative.

	Sensitivity 5) All Government bond spreads over EIOPA risk free rate (GSS) moves up by 50bps; ie the EIOPA and other investment rates and yields are unchanged but Government bond yields rise by a uniform 50bps across the curve. Sensitivity 6) Credit spreads (all ratings) increase by 100bps. This should reflect a uniform widening across the curve, assuming that EIOPA Fundamental Spreads are unchanged. Sensitivity 7) Downgrade - the impact of 20% of assets (both inside and outside the MA portfolio) downgrading from the current Credit Quality Step (CQS) to the next CQS. In respect of the cap on the size of the Matching Adjustment (MA) (as described in rule 7.2(3) of the Technical Provisions part of the PRA Handbook) please assume that for assets moving from CQS 3 no cap need be applied and that for assets with pre-stress CQSs 4 to 6 assume the cap remains unchanged. Participants should assume that the market value of the bonds is unaffected (ie the stress should be a change in the liability value only). Similarly, the calibration of the Fundamental Spreads should be assumed to be unchanged. For assets which are at CQS 6 pre-stress, it should be assumed that the whole asset defaults, with a recovery rate of the current market value. Participants should not assume any change in the assets within the MA portfolio for the calculation of the technical provisions. Internal model participants should use their existing methods of rebalancing the MA portfolio within the SCR calculation. They should also explain their approach. Standard formula firms need not rebalance their MA portfolio. Sensitivity 8) An increase in the market implied real interest rates over the nominal interest rates by a uniform 50bps across the curve. Sensitivity 9) GBP exchange rates fall by 25% (against all other currencies). The stress should be interpreted as the impact of GBP exchange rates falling by 25% would increase the value of assets held in currencies other than GBP would increase by 33% in GBP terms.
Section 3:	For each sensitivity (as listed in section 2), please give the estimated impact of a TMTP recalculation to the 'Balance sheet C'.
Section 4: Management	In the separate document for the scenarios specified in Section 2, please provide a narrative description of the following: (a) Potential management actions of the form identified in paragraph 3.4 of the

actions	supervisory statement. Please provide the level of stress the action is initiated and the estimated beneficial impact on solvency. Please also comment as to whether such management actions could be implemented irrespective of market conditions, or whether financial markets are assumed to function in an orderly way. (b) Any material changes to the previously described range of management actions (not of the type identified in paragraph 3.4 of the supervisory statement).
Notes:	The PRA expects the format of the information to be consistent with solvency data reported to the PRA as far as practicable. No allowance for a change in the size of the volatility adjustment should be made when calculating the sensitivities. Please explain in narrative form how approximations (eg to estimate changes to the risk margin) have been performed. Sensitivities 3, 4, 5 and 6 are described in more detail below: Sensitivity 3 tests the impact of a rise in the EIOPA risk free interest rate only. To facilitate this, the other rates (ie Government bond yield, corporate bond yield etc) also rise with this interest rate and hence spreads are unchanged. Sensitivity 4 tests the impact of a fall in the EIOPA risk free interest rate only. To facilitate this, the other rates (ie Government bond yield, corporate bond yield etc) also fall with this interest rate and hence spreads are unchanged. Sensitivity 5 is similar to sensitivity 3 and 4, but here the Government bond yields are assumed to rise whilst the EIOPA risk free rate is unchanged. Corporate bond yields are assumed to remain unchanged to ensure the corporate spread with respect to EIOPA risk free rate is unchanged. Sensitivity 6 involves a widening of credit spreads while keeping the EIOPA risk free rate and Government bond yield unchanged. This sensitivity is intended primarily to capture corporate bond exposures, but results based on other definitions of spread exposure are also acceptable. Provide further information, if the firms has, for example, significant supranational exposures which may materially affect the impact of the sensitivity. These four sensitivities can be summarised as per the table below. 'No change' indicates keeping the same position as in the base scenario:

Sensitivity	EIOPA risk free rate	Government bond yield	Government bond yield less EIOPA risk free rate	Corporate yield
3	Up	Up	No change	Up
4	Down	Down	No change	Down
5	No change	Up	Up	No change
6	No change	No change	No change	Up

Firm name	
FRN:	
Contact name	
Email	
Phone	

Key

	= Input cells
	= Auto populated cells

Date of valuation 30 June or 31 December

Date of submission Two weeks after the quarterly QRTs submissions for Q2 and Q4, respectively for above dates

Section 1

	Balance Sheet Component (£m)	Assets	BEL	Risk Margin	TMTP pre cap	TMTP post cap	Other liabilities (**)	Total liabilities	Excess of assets over liabilities (¬)	Adjustment to Own Funds (#)	Own Funds after TMTP	SCR	Capital surplus (θ)
Balance Sheet A	**Valuation date**												
Balance Sheet B	**A day after valuation date (*)**												
Balance Sheet C	**Assuming the TMTP had been recalculated as at the valuation date**												

Section 2 - Use base balance sheet and please provide the impact without any further change in TMTP

	Balance Sheet Component (£m)	Assets	BEL	Risk Margin	TMTP pre cap (≠)	TMTP post cap (≠)	Other liabilities (**)	Total liabilities	Excess of assets over liabilities (¬)	Adjustment to Own Funds (#)	Own Funds after TMTP	SCR	Capital surplus (θ)
Balance Sheet A	**Valuation date**												
Sensitivity 1	25% equity fall												
Sensitivity 2	25% property fall												
Sensitivity 3	100 bps rise in interest rate (parallel shift)												
Sensitivity 4	100 bps fall in interest rate (parallel shift)												
Sensitivity 5	50 bps change in GSS (government bond yield rise)												
Sensitivity 6	100 bps widening of credit spreads												
Sensitivity 7	20% of assets downgrading												
Sensitivity 8	50 bps rise in inflation												
Sensitivity 9	25% fall in GBP exchange rates												

Section 3 - Use base balance sheet and please provide the impact with estimated impact of further TMTP recalculations

	Balance Sheet Component (£m)	Assets	BEL	Risk Margin	TMTP pre cap	TMTP post cap	Other liabilities (**)	Total liabilities	Excess of assets over liabilities (¬)	Adjustment to Own Funds (#)	Own Funds after TMTP	SCR	Capital surplus (θ)
Balance Sheet C	**Assuming the TMTP had been recalculated as at the valuation date**												
Sensitivity 1	25% equity fall												
Sensitivity 2	25% property fall												
Sensitivity 3	100 bps rise in interest rate (parallel shift)												
Sensitivity 4	100 bps fall in interest rate (parallel shift)												
Sensitivity 5	50 bps change in GSS (government bond yield rise)												
Sensitivity 6	100 bps widening of credit spreads												
Sensitivity 7	20% of assets downgrading												
Sensitivity 8	50 bps rise in inflation												
Sensitivity 9	25% fall in GBP exchange rates												

Notes:

(*) A day after the valuation date to show TMTP run-off by 1/16 or equivalent, if the TMTP is not reduced by 1/16 or equivalent at the valuation date

(**) Other liabilities = Total liabilities *less* BEL *less* Risk Margin *less* TMTP post cap

(¬) Excess of assets over liabilities = Assets *less* Total liabilities

(#) Adjustment to Own Funds = Own Funds after TMTP *less* Excess of assets over liabilities

(θ) Capital surplus = Own Funds after TMTP *less* SCR

(≠) TMTP pre cap and TMTP post cap should be zero for the sensitivities 1 to 9, only for section 2