Implementing the EU solvency reporting and disclosure requirements

10/09/2015

Financial Services analysis: What are the Prudential Regulation Authority's (PRA) proposals for implementing the reporting and public disclosure requirements for the Solvency II Directive 2009/138/EC (Solvency II)? Risk and capital management expert, Omar Ripon, partner in accountancy firm Moore Stephens LLP, examines the proposals.

Original news

PRA seeks views on reporting and public disclosure options, LNB News 10/08/2015 110

A draft supervisory statement sets out the PRA's expectations of firms where it has an option to specify a different approach to that published in the Implementing Technical Standards (ITS) for the Solvency II reporting templates and the public disclosure templates. A consultation on options provided to supervisory authorities will last until 21 September 2015.

What is the background to the PRA's consultation paper?

The Solvency II regime introduces for the first time a harmonised, sound and robust prudential framework for insurance firms throughout the EU. It is based on the risk profile of each individual insurance company in order to promote comparability, transparency and competitiveness.

Over its 40 years of existence, the prior Solvency I regime showed structural weaknesses. It was not risk-sensitive--a number of key risks, including market, credit and operational risks were either not captured at all in capital requirements or were not properly taken into account in its approach.

Capital requirements under Solvency II are meant to be forward-looking and economic. They will be tailored to the specific risks borne by each insurer, allowing an optimal allocation of capital across the EU. They will be defined along a two-step ladder incorporating solvency capital requirements (SCR) and minimum capital requirements (MCR) in order to trigger proportionate and timely supervisory intervention. Insurers will be free to invest according to the prudent person principle and capital requirements will depend on the actual risk of investments.

On 10 October 2014 the European Commission adopted the Delegated Regulation (EU) 2015/35 implementing rules for Solvency II (the Delegated Regulation). Following its approval by the European Parliament and Council, this was published in in the Official Journal of the European Union on 17 January 2015. The implementing rules cover:

- the valuation of assets and liabilities--including the long-term guarantee measures
- how to set the level of capital for asset classes an insurer may invest in
- the eligibility of insurers' own fund items to cover capital requirements
- how insurance companies should be managed and governed
- equivalence assessments of third-country solvency regimes
- the internal model framework
- rules related to insurance groups

The Delegated Regulation has three pillars with the following objective:

- pillar 1--market consistent valuation and risk-based capital requirements (SCR)
- pillar 2 --enhanced risk management and system of governance
- pillar 3--increased transparency through enhanced reporting disclosure

The PRA paper consults on its proposals under pillar 3 which falls under ITS and Solvency II supervisory ITS. This ITS paper is still in draft form.

The new regime is meant to promote greater cooperation between national insurance supervisors such as the PRA, with a stronger role for the group supervisor. The European Insurance and Occupational Pensions Authority (EIOPA) is tasked with ensuring that the single rule book is applied consistently throughout Europe. EIOPA also has mediating powers in case disagreements which emerge between national supervisory authorities when supervising cross-border groups.

What are the main provisions of the consultation?

The consultation covers ten reporting areas. The PRA has only limited scope in this consultation as the detailed rules on Solvency II are already quite tightly defined by the Solvency 2 Regulations 2015, SI 2015/575 and the consolidating Delegated Regulation.

Most of these should not prove controversial or challenging for firms to comply. For example, on reporting currency, the PRA says it expects firms to use the currency used for the preparation of an insurance company's financial statements as the reporting currency to the PRA. Similarly, on exchange rates, the PRA expects firms to apply exchange rates from the same source as used for the preparation of its financial statements for conversion to the reporting currency.

Solvency II gives firms an option of reporting information on a line of business (LoB) by the year of accident or the underwriting year. The PRA is giving firms the choice of which reporting basis it wishes to use but says it expects this to be consistent with how the firm manages its business and reports data internally. Where firms wish to change reporting bases the PRA says it expects firms to discuss this with their regular PRA supervisory contact prior to any change being made.

There are detailed proposals for claims and sum insured reporting brackets of underlying distributions. This proposal may have the biggest impact for smaller firms and is considered in more detail in the next section.

The PRA expects firms to report non-life distribution of underwriting risks by sum-insured (SI) according to twelve different lines. The PRA is quite specific about this on page twelve of its paper. For some existing insurance products, it is not entirely clear into which PRA category they will fit. For example, the PRA lists 'miscellaneous financial loss' as one category and concludes with a catch-all one called 'assistance'.

There is a small section devoted to the reporting on annuities by currency stemming from non-life obligations but this does not appear controversial. In relation to claims which are 'reported but not settled' (RBNS), the PRA expects firms to use their own definitions for the number of such claims.

Finally, the paper deals with group reporting where the PRA is the group supervisor. The PRA says it expects firms to consider is the items set out in paragraphs 11.3-11.5 of its paper before a firm discusses the information to be reported with their usual supervisory contact at the PRA. Again, as this could have a bigger impact for firms, it is considered in the next section.

What impact does the consultation have on the firms affected?

In section 5 and 6, the PRA proposes six base options for reporting the size brackets of incurred claims and SI. The Solvency II supervisory reporting ITS requires firms to submit in template S.21.01.01 of Annex I non-life distribution information aggregated by claim incurred brackets within an accident or underwriting year within a LoB. The aim of the exercise is to allow the PRA to build up a better understanding of the underlying statistical distributions for incurred claims and SI.

In paragraph 5.2 where the reporting currency is GBP, EUR, USD, CAD, CHF, AUD, NZD or SGD the brackets are defined as follows:

- 20 brackets of 250 plus 1 extra open bracket for incurred losses => 5,000
- 20 brackets of 5,000 plus 1 extra open bracket for incurred losses => 100,000
- 20 brackets of 50,000 plus 1 extra open bracket for incurred losses => 1 million
- 20 brackets of 250,000 plus 1 extra open bracket for incurred losses => 5 million
- 20 brackets of 1 million plus 1 extra open bracket for incurred losses > 20 million
- 20 brackets of 5 million plus 1 extra open bracket for incurred losses > 100 million

In paragraph 5.3 the size of brackets are defined as above, ie 5.2, but relate to reporting currency other than GBP, EUR,USD, CAD, CHF, AUD, NZD or SGD. However, for these 'other' reporting currencies the PRA expects all firms to use a fixed exchange rate factor which is defined as the European Central Bank EUR to reporting currency exchange rate at 31 December 2015.

In paragraph 6.2 where the reporting currency is GBP, EUR, USD, CAD, CHF, AUD, NZD or SGD the size brackets for SI are defined as follows:

- o 20 brackets of 1,250 plus 1 extra open bracket for incurred losses => 25,000
- o 20 brackets of 25,000 plus 1 extra open bracket for incurred losses => 500,000
- o 20 brackets of 50,000 plus 1 extra open bracket for incurred losses => 1 million
- o 20 brackets of 250,000 plus 1 extra open bracket for incurred losses => 5 million
- o 20 brackets of 1 million plus 1 extra open bracket for incurred losses > 20 million
- o 20 brackets of 5 million plus 1 extra open bracket for incurred losses > 100 million

In paragraph 6.3 the size of brackets are defined as above, ie 5.2, but relate to reporting currency other than GBP, EUR,USD, CAD, CHF, AUD, NZD or SGD. However, for these 'other' reporting currencies the PRA expects all firms to use a fixed exchange rate factor which is defined as the European Central Bank EUR to reporting currency exchange rate at 31 December 2015.

As an example if we assume we have the following claims only for an LoB:

£3,000 £17,000, £20,000, £100,000, £120,000, £1m

If we choose to use bracket size reporting option 3 then we have the following claims bracket:

[50,000], [100,000], [150,000], [200,000], [250,000], [300,000].............[1m],[=>1m]

Hence [50,000] will have three claims--that is--£3,000, £17,000 and £20,000

[100,000] will have two claims--that is--£100,000 and £120,000

Nothing for the remaining brackets, until [=>1m] with the £1m claim.

What advice should those advising insurers on Solvency II implementation give to their clients?

Smaller firms, and particularly those firms that were exempted from the 2015 PRA pillar 3 dry-run submissions, may find reporting bracket size options a challenge, as it requires some actuarial judgement and most of these smaller firms do not have an evolved actuarial or technical risk function. There is a risk that firms will not be able to carry out appropriate statistical data analysis to select and report using the best bracket size option for the PRA to get a good understanding of the loss and SI distribution of these firms.

In addition to the reporting options proposed in CP25/15 there are other pillar 3 forms such as S20.01 (Development of the distribution of the claims incurred), which requires firms to report annually for each LoB, an analysis of the year on year movement in the value and number of reported but not settled (RBNS) claims. Again, such reporting requirements requires technical statistical analysis and perhaps outside the current capacity of smaller firms within Solvency II external disclosure scope.

It would be beneficial for these smaller firms to seek external assistance in understanding the reporting options and more broadly pillar 3 data analysis which is an entirely new Solvency II regulatory reporting task. Many of our clients use Moore Stephens SII engine as an integrated reporting tool that provides a complete pillar 3 solution, including robust statistical data analysis which is implicitly required for complying with and selecting an appropriate reporting options.

Interviewed by David Bowden.

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