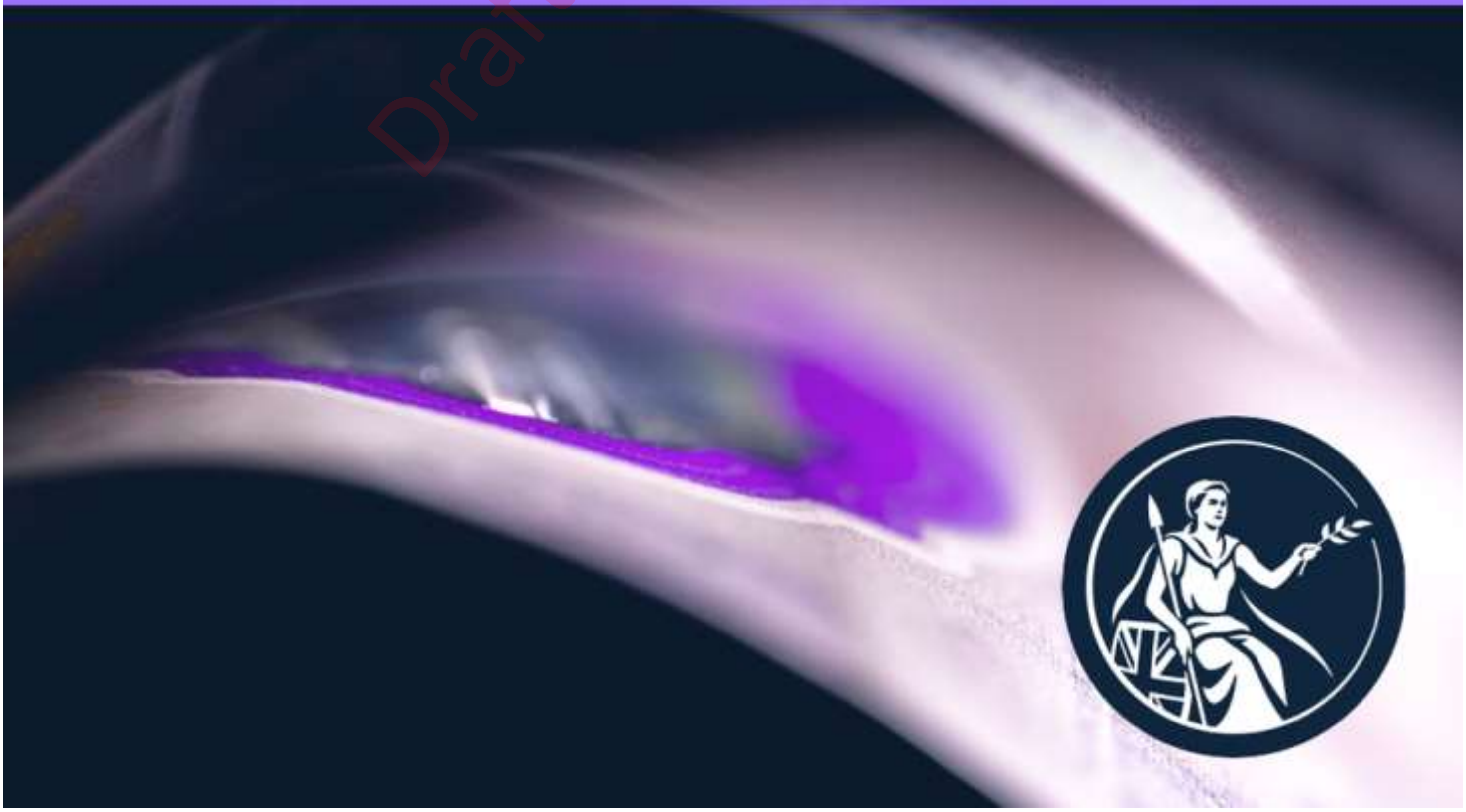
Bank of England PRA

Solvency II: Monitoring model drift and standard formula SCR reporting for firms with permission to use an ~~approved~~ internal model

Supervisory Statement | SS15/16

December 2024 (updating July 2018)



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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1: Introduction

1.1 This supervisory statement sets out the Prudential Regulation Authority's (PRA) expectations of firms with ~~an approved~~ permission under s138BA of the Financial Services and Markets Act (FSMA) to use an internal model, and provides further information on the PRA's approach to monitoring model drift and the reporting of standard formula Solvency Capital Requirement (SCR) information.

1.2 This supervisory statement is relevant to UK ~~solo~~ insurance firms within the scope of Solvency II, including undertakings where the solo SCR is calculated by a group internal model, the Society of Lloyd's in respect of each of their syndicates, and in respect of outputs of the Lloyd's internal model.

2: Monitoring model drift

2.1 The PRA has developed an approach to monitoring model drift~~ -~~, which the PRA defines as the risk that capital requirements calculated using an internal model may, ~~drift~~ over time, become less reflective of the risks to which firms are exposed.

2.2 The PRA's approach ~~includes~~ is based on the use of a number of supervisory tools. These tools include the monitoring of the internal model SCR against ~~certain objective~~ alternative measures of risk~~. The~~, analysis of internal model outputs, and analysis of quarterly model change reporting. ~~model drift ratios will be calculated at the point of model approval and re-based following a change in risk profile or major model change resulting in a material change in the SCR.~~

2.3 These ~~objective~~ alternative balance sheet measures ~~of risk~~, for which different measures may be used over time, include standard formula SCR, pre-corridor Minimum Capital Requirement (MCR), net written premium and best estimate liabilities.

2.3A Different supervisory tools may be applied to monitor model drift in different insurance sub-sectors, based on the risk profile characteristics for each sub-sector. In particular, different tools may be used for life and general insurance firms.

2.3B The PRA's approach may evolve over time, in order to make use of the most effective monitoring tools and to utilise new information as it becomes available. This includes information from the PRA's Internal Model Ongoing Review, as outlined in the 'Solvency II internal models: Permissions and ongoing monitoring' Statement of Policy.

2.4 Monitoring model drift is one tool that the PRA uses to help ensure that capital requirements under Solvency II remain reflective of the risks to which firms are exposed, ensuring that the safety and soundness of firms is promoted and the appropriate degree of protection for policyholders is not weakened over time.

2.5 This ~~tool~~ approach helps the PRA to monitor model drift at firm, sector and industry level.

3: Reporting the standard formula SCR

3.1 As set out above, the PRA considers that the standard formula SCR ~~is~~ can be a useful measure to monitor model drift. The standard formula SCR is one of a suite of available metrics that the PRA intends to use for this purpose.

3.2 ~~Firms that received approval to use an internal model before 1 January 2016 provided the standard formula SCR calculations as part of their internal model application, as well as the individual capital assessment (ICA) results leading up to implementation of Solvency II through ad hoc PRA data requests.~~ The PRA ~~considers~~ notes that firms with internal model ~~approval~~ permission may find it useful to ~~continue to carry out such calculations~~ calculate the standard formula SCR as part of their risk management, own risk and solvency assessment (ORSA) and other narrative reporting and model validation cycle.

3.3 Solvency Capital Requirement – Internal Models 3.4 part of the PRA Rulebook requires a firm with ~~an approved~~ permission to use an internal model to provide the PRA, upon request, with an estimate of the SCR determined in accordance with the standard formula.

3.4 Further, the PRA can revoke model ~~approval~~ permission in certain circumstances and a firm would in that case be required to determine its SCR using the standard formula.

3.5 Therefore in order to be able to comply with a request by the PRA to provide an estimate of the SCR calculated using the standard formula, or to calculate its SCR in case of revocation of model ~~approval~~ permission, the PRA expects firms with ~~an approved~~ permission to use an internal model to maintain the ability to calculate their SCR using the standard formula.

3.5A The PRA finds annual submissions of the standard formula SCR particularly useful in the monitoring of model drift for firms that have non-life technical provisions. The standard formula SCR generally provides a stable metric to compare against the internal model SCR for these firms.

3.6 ~~In addition,~~ As such, the PRA expects firms ~~using an approved~~ that have any non-life technical provisions, and are permitted to use an internal model to calculate their solo SCR, to report privately the results of their standard formula SCR calculation fully in XBRL (link to the technical artefacts included in the appendix).

3.7 ~~Firms~~ These firms are not required to have their standard formula calculation externally audited. Submissions should be approved by a member of the senior management team with suitable authorisation before being submitted.

3.8 The information should be submitted four weeks following firms' submission dates for their annual quantitative reporting templates in accordance with the rules for deadlines set out in the Reporting Part. ~~Firms that received internal model approval before 1 January 2016 should also submit the information as at the date of their opening Solvency II financial statements.~~

3.9 For groups that ~~use an approved~~ <u>are permitted to use a</u> group internal model where the PRA is the group supervisor, the PRA may request standard formula SCR information at group level. Firms will be notified of group level requests via their supervisor.

3.10 Firms may wish to submit supporting quantitative and qualitative documentation with their submission. For example, a firm may provide additional information as to the appropriateness of the standard formula SCR calculation for the purpose of monitoring model drift.

3.11 Completed information should be submitted through the Bank of England Electronic Data Submission (BEEDS) portal as 'occasional submissions'.

Appendix:

Templates and technical artefacts, available at www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-insurance-sector

Annex – SS15/16 updates

This annex details the changes that have been made to this SS following its initial publication in October 2016:

2018

July 2018

Following publication of Policy Statement 21/18,[1] this SS was updated to amend paragraph 3.6 to reflect that the PRA requests the information to be submitted fully in XBRL.

[1] 'Solvency II: Changes to reporting format', July 2018: www.bankofengland.co.uk/prudentialregulation/publication/2018/solvency-ii-changes-to-reporting-format.