Institute
and Faculty
of Actuaries

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

IFoA response to Prudential Regulation Authority

7 August 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

CP 7/17
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

7 August 2017

Dear Sir,

IFoA response to Consultation Paper CP7/17: Solvency II: Data collection of market risk sensitivities

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the PRA's consultation on data collection of market risk sensitivities, under Solvency II (SII).

2. Our Life Standards and Consultations sub-Committee and Life Insurance Board have been involved in the drafting of this response. Members of the Committee and Board are actively engaged in financial reporting under SII, including the production of market and other sensitivities.

3. The IFoA recognises that the production of market risk sensitivities is useful for the PRA and for insurance firms alike. We agree that the production of updated sensitivities on a regular basis and in a stable format could potentially be helpful in avoiding the burden of generating ad-hoc sensitivities at times of market stress. The proposals also provide a degree of standardisation which could then be adopted by firms for their regular disclosures; this could then be more informative to stakeholders.

4. Paragraph 4.1 of the draft Supervisory Statement explains that the sensitivity information may be required *at the PRA's request* in the event of extraordinary market conditions. This is despite the fact that, in the introduction to the consultation, the PRA says that obtaining such sensitivities at a time of market volatility may be burdensome for firms, given competing demands for financial reporting at those times. If firms were to continue to receive additional requests under times of stress it would seem to defeat the purpose of having to prepare the regular ongoing information.

5. Despite their advantages, the PRA's proposals will increase the regular supervisory reporting burden. Many insurers have argued that reporting requirements are already excessive following the implementation of SII. The proposed information would also be in addition to the ORSA and the bi-annual EIOPA stress test process, and therefore increases the additional stress testing work required by firms, on slightly different bases.

6. The proposals envisage firms recalculating their Matching Adjustment (MA) and Transitional Measures on Technical Provisions, (TMTP). The work involved in producing sensitivities to these measures should not be under-estimated. For example, the MA optimisation process is a very time-consuming part of the process. Furthermore, some scenarios would require non-quoted assets to be revalued. We therefore suggest a more proportionate approach could be

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taken, particularly for non-Category 1 firms, that reflects the materiality of the risks to the firms themselves.

7. Paragraph 3.4 of the draft Supervisory Statement explains that the PRA will estimate a firm's financial position on a regular basis by interpolating the sensitivity information. It is unclear what the PRA are going to with this solvency estimate and why - given firms already have their own process for estimating the capital position -, they do not use these internal estimates. For example, many firms already have a monthly reporting process, which is generally more reliable and quite timely. We believe it would not be productive for either the PRA or the firms themselves, if using the proposed sensitivity results then leads to significant work in explaining why the actual capital position did not move in line with the PRA's estimates.

8. We welcome the PRA's intention to take a proportionate approach to the use of market risk sensitivities, including the potential acceptance of approximations in the results or extrapolation/ interpolation from a firm's internal sensitivity results. However, for some sensitivities, interpolation of the results could be unrepresentative.

9. The proposal to restrict the requirement for sensitivities primarily to Category 1 and 2 firms, and to exclude ring fenced funds where appropriate to do so, should also focus the requirements on material market risks. *Note, however, our comment in paragraph 6 in relation to the MA and TMTP.*

10. We would encourage the PRA to be flexible in terms of using insurers' existing internal sensitivities, since these are more likely to better reflect the true solvency sensitivities than some of the artificial aspects of the PRA templates.

11. The proposed sensitivities are in some cases quite large; e.g. property price falls of 25%. We accept that, although imperfect, interpolation between sensitivity results can be more accurate than extrapolation. However, given the use of financial options and guarantees, interpolation could still overstate a company's sensitivity to more moderate movements and create false alerts.

12. The use of single sensitivities may make the estimates of solvency movements to multiple risks less reliable, given that no allowance would be made for the 'non-separability' of multiple risks. The EIOPA stress tests which envisage specific scenarios may be more useful here, as they attempt to reflect what might happen in the real world.

13. The proposed requirement to disclose management actions separately would appear to be a duplication of some of the material presented to the PRA as part of the ORSA. The exclusion of management actions from the sensitivities themselves could also be unhelpful to firms' risk management processes.

Should you wish to discuss any of the points raised in further detail please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk / 0207 632 2146) in the first instance.

Yours sincerely

Marjorie Ngwenya
President, Institute and Faculty of Actuaries