SFCRs: the good, the bad and the ugly
Matt Francis, KPMG

Summary

• Scope of Pillar 3 reporting and key challenges
• How useful is the SFCR?
• Approaches taken by insurers
• Where to next for regulatory reporting?
Scope of Pillar 3 reporting and key challenges

- Volume
- Detail
- Data quality
- Materiality
- Complexity
- Coordination and ownership
- Consistency

Reducing reporting timeframes

Group and Solo Entities

National Specific Reporting Templates (NSTs)
Financial Stability Templates (FSTs)
Regular Supervisory Report (RSR) every three years (with an annual report for material changes)
Annual Quantitative Reporting Templates (QRTs)
Quarterly Quantitative Reporting Templates (QRTs)
Annual Solvency and Financial Condition Report (SFCR)
Annual Quantitative Reporting Templates (QRTs)

Group and Solo Entities

• Group
• Solo

2016
After quarter end
After year end
7 weeks
8 weeks
5 weeks
6 weeks

2017
After quarter end
After year end
8 weeks
14 weeks
6 weeks
12 weeks

2018
After quarter end
After year end
13 weeks
26 weeks
12 weeks
24 weeks

2019
After quarter end
After year end
11 weeks
14 weeks
13 weeks
12 weeks

Public disclosure

Private reporting

7 weeks
8 weeks
11 weeks
13 weeks
14 weeks
20 weeks
26 weeks
24 weeks
20 weeks
Post submission challenges

- Feedback provided to firms on validation and plausibility
- Re-submissions may be required or further explanation requested

Source: PRA

SFCR components

Source: PRA
How useful is the SFCR?

“The Solvency II solvency and financial condition report (SFCR) is causing consternation among insurers. How do participants balance the requirements of disclosure with confidentiality, or interpret this most loose fitting of regulatory diktats? With the first set of reports already published, the answer seems to be, not very happily.”

Kevin Borrett – Advantage Insurance Company

“Solvency II has helped provide a clearer picture of capital adequacy for European insurers, providing some guidance as to when dividends may be a risk or additional capital may be returned. However, Solvency II disclosures have not always considered the investor perspective, creating issues for external users in understanding performance and the dividend paying capacity.”

Andrew Crean, Autonomous Research

SFCR: Market comments

Overall
Limited market reaction

Good
Better view of capital adequacy
More granular view of subsidiary capital ratios, gearing levels and quality of capital

Bad
Not helpful for understanding performance, cash generation
Unclear around dividend paying capacity
Other disclosures provide incremental value add

Ugly
Long-term guarantee measures distort ratios
Investors see TMTP capital as lower quality
Colour palette for PowerPoint presentations

Dark blue
R17  G52  B88

Gold
R217  G171  B22

Mid blue
R64  G150  B184

Secondary colour palette

Light grey
R220  G221  B217

Pea green
R121  G163  B42

Forest green
R0  G132  B82

Bottle green
R17  G179  B162

Cyan
R0  G156  B200

Light blue
R124  G179  B225

Violet
R128  G118  B207

Purple
R143  G70  B147

Fuscia
R233  G69  B140

Red
R200  G30  B69

Orange
R238  G116  B29

Dark grey
R63  G69  B72

Source: S.22.01 QRT from SFCRs

TMTP and MA impacts on coverage ratios

* Note: Rothesay Life capped the impact of removing TMTP and MA such that eligible own funds do no go negative in S.22.01

Solvency II coverage ratio
Solvency II coverage ratio without TMTP
Solvency II coverage ratio without TMTP and MA

Source: S.22.01 QRT from SFCRs

Technical Provisions by product

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Life (excluding IL and UL)</td>
<td>182.5</td>
<td>15.8</td>
<td>61.3</td>
<td>9.9</td>
<td>173.3</td>
<td>36.5</td>
<td>19.8</td>
<td>21.6</td>
<td>19.0</td>
<td>25.7</td>
<td>15.4</td>
<td>32.1</td>
<td>44.5</td>
<td></td>
</tr>
<tr>
<td>Life (IL and UL)</td>
<td>148.3</td>
<td>6.00</td>
<td>222.1</td>
<td>2.1</td>
<td>27.1</td>
<td>20.5</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>32.0</td>
<td>45.0</td>
<td>75.9</td>
<td>103.9</td>
<td></td>
</tr>
<tr>
<td>Non-Life</td>
<td>124.0</td>
<td>0.00</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.3</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>Total TP's</td>
<td>344.0</td>
<td>15.8</td>
<td>382.8</td>
<td>13.4</td>
<td>210.5</td>
<td>60.0</td>
<td>19.8</td>
<td>43.1</td>
<td>31.0</td>
<td>57.7</td>
<td>62.2</td>
<td>108.3</td>
<td>145.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: S.22.01 QRT from SFCRs
Colour palette for PowerPoint presentations

- Dark blue: R17, G52, B88
- Gold: R217, G171, B22
- Mid blue: R64, G150, B184
- Light grey: R220, G221, B217
- Pea green: R121, G163, B42
- Forest green: R0, G132, B82
- Bottle green: R17, G179, B162
- Cyan: R0, G156, B200
- Light blue: R124, G179, B225
- Violet: R128, G118, B207
- Purple: R143, G70, B147
- Fuscia: R233, G69, B140
- Red: R200, G30, B69
- Orange: R238, G116, B29
- Dark grey: R63, G69, B72

Secondary colour palette

- Light grey: R220, G221, B217
- Pea green: R121, G163, B42
- Forest green: R0, G132, B82
- Bottle green: R17, G179, B162
- Cyan: R0, G156, B200
- Light blue: R124, G179, B225
- Violet: R128, G118, B207
- Purple: R143, G70, B147
- Fuscia: R233, G69, B140
- Red: R200, G30, B69
- Orange: R238, G116, B29
- Dark grey: R63, G69, B72

Source: S.23.01 QRTs from SFCRs

SCR by risk module

Quality of Solvency II capital

Own funds tiering

Tier 1 (unrestricted) Tier 1 (restricted) Tier 2 Tier 3

Source: S.23.01 QRTs from SFCRs
SFCR: KPMG observations

- Based on sample of SFCRs across life and non-life.

**Business and Performance**
- Majority do not have Brexit as a significant event
- Good level of disclosures about business without reference to other documents

**Valuation**
- Lack of quantitative explanation of differences between IFRS and SII
- Some confusion and lack of clarity around alternative valuation methods.
- Maximize the use of quoted market prices to determine fair value of assets and liabilities

SFCR: KPMG observations

**System of Governance**
- Good narrative disclosures on remuneration
- Few quantitative disclosures with focus on remuneration policies
- Clear distinctions of fixed and variable components

**Capital Management**
- Lack of disclosure around subordination and loss absorbency
- Availability of own funds around the group not well considered
- Minimum disclosure on capital management
SFCR: KPMG observations

Risk Profile

- Wide range of disclosures on stress testing and sensitivity analyses
- More thorough disclosures by large firms
- Sensitivity analysis on large unit-linked portfolios could be improved

QRTs

- Some confusion regarding private vs public QRTs
- Lack of cross-referencing between narrative sections and QRTs
- Signposting of audited and unaudited sections - particularly a challenge for internal model firms

SFCR – How useful is it?

Complexity

- Duplication
- Technical jargon
- ‘Lifting’ disclosures from elsewhere e.g. ORSA and accounts

Size

- Lack of quantitative information
- Actuarial assumptions too brief/barely covered
- Vague around valuation basis and methods

Relevance
SFCR – size of solo submissions

<table>
<thead>
<tr>
<th>Section</th>
<th>A Business Performance</th>
<th>B System of Governance</th>
<th>C Risk profile</th>
<th>D Valuation for Solvency purposes</th>
<th>E Capital management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry average</td>
<td>07</td>
<td>16</td>
<td>10</td>
<td>13</td>
<td>07</td>
</tr>
<tr>
<td>for 30 solo</td>
<td>(no of pages)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum</td>
<td>02</td>
<td>04</td>
<td>01</td>
<td>04</td>
<td>02</td>
</tr>
<tr>
<td>(no of pages)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum</td>
<td>13</td>
<td>36</td>
<td>21</td>
<td>29</td>
<td>19</td>
</tr>
<tr>
<td>(no of pages)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Industry average 54 pages

Source: KPMG analysis

Disclosures on using cost method

- Provides rationale for using cost method as approximation for fair value
- Uses the cost method as an approximation for fair value, but does not explain why this is appropriate
- Provides limited rationale for using cost method as approximation for fair value
- Does not use the cost method as an approximation for fair value

Source: KPMG analysis
Disclosures on alternative valuation techniques

- Provides no disclosures relating to alternative valuation techniques
- Refers to fair value disclosures in company’s annual report and accounts
- Provides limited disclosure in relation to alternative valuation techniques
- Provides extensive disclosure in relation to alternative valuation techniques

Source: KPMG analysis

Disclosures on capital management

- Provides limited information on capital management objectives policies and processes with no reference to time horizon used for business planning
- Provides limited information on capital management objectives policies and processes
- Provides detailed information on capital management objectives, policies and processes over the time horizon used for business planning

Source: KPMG analysis
Disclosures on own funds composition

- Provides little or no quantitative information on the tiering of own funds
- Provides breakdown of eligible own funds into tiers, but does not explain how the reconciliation reserve is calculated
- Provides breakdown of eligible own funds into tiers and explains how the reconciliation reserve is calculated

Source: KPMG analysis

Disclosures on group consolidation

- Clearly discloses the method of consolidation (i.e. method 1, method 2)
- Clearly explains adjustments in relation to intragroup transactions and quantifies their impact
- Quantified the value of their entities
- Clearly discloses the valuation basis for individual entities (including reference to local solvency rules)

Source: KPMG analysis
Disclosures on fungibility & transferability

- Clearly identifies the reason for any own funds not-available at group level
- Clearly identifies any own fund instruments that are treated as non-available at group level
- Discloses the calculation of related undertaking’s contribution to the Group SCR
- Quantifies the amount of the restriction (i.e. non-available capital in excess of related undertaking’s contribution to Group SCR)
- Provides definition of concepts which give rise to non-available own funds (i.e. fungibility, transferability)
- Identifies local capital or solvency requirements as potential cases of own funds not-available at group level

Source: KPMG analysis

Where to next for regulatory reporting?

- Sam Woods
  - Written evidence to Treasury Select Committee
  - 15 March 2017

"I plan to conduct a review of our implementation of Solvency II reporting requirements, with a view to identifying ways in which we might reduce insurers’ reporting burdens while fully meeting out statutory objectives… We remain open to discussions with the ABI and other stakeholders and will survey a sample of insurers to gather information on the impact of reporting through the firm. We will also review the ongoing usefulness of the data collected in supporting the PRA’s supervisory functions, and the extent to which the information collected helps the PRA to meet and balance its objectives."
Where to next for regulatory reporting?

David Rule
Speech to ABI
6 July 2017

- It would be *unhelpful for the PRA to be too prescriptive about the depth of SFCRs*. But it strikes me that some areas *could be made more consistent*. For example, changes in Solvency Capital Requirement coverage could be broken down to show what is attributable to changes in capital, to changes in modelling and to changes in risk assumptions. *Insurers need to explain fully to policyholders, investors and others what lies behind their Solvency II ratios*. This is particularly true in more complex areas like internal models and the matching adjustment. Otherwise we run the risk of a loss of confidence in those numbers in a crisis.

Questions

Comments

The views expressed in this presentation are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this presentation.

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this presentation be reproduced without the written permission of the IFoA and KPMG LLP.
Contact details

Matthew Francis
Phone: 0207 311 5506
Email: matthew.francis@kpmg.co.uk