Bank of England

Prudential Regulation Authority

Harriett Baldwin MP
Chair of the Treasury Sub-Committee on Financial Services Regulations
House of Commons
London
SW1A 0AA

Sam Woods
Deputy Governor, Prudential Regulation
CEO, Prudential Regulation Authority
sam.woods@bankofengland.co.uk

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Dear Harriett,

Thank you for your letter of 20 December 2022 following the Treasury Committee Sub-Committee on Financial Services Regulations' meeting to discuss the PRA consultations on 'Review of Solvency II: Reporting phase 2' (CP14/22), and 'Risks from contingent leverage' (CP12/22). These consultations both propose some new reporting in response to data gaps in key areas of supervisory interest, although CP14/22 will result in a net reduction of reporting for affected firms. I welcome the opportunity to expand upon the benefits of the new reporting set out in both consultation papers, as well as the PRA's consideration of the costs and usage of regulatory reporting.

What measurable benefits does the PRA expect to obtain from these new requirements?

CP12/22 'Risks from contingent leverage'

The proposed new reporting would improve the PRA's ability to monitor regularly and consistently one specific but important area of risk – namely, so-called "contingent leverage risks". This term is used to describe the risk that leverage ratio efficient trades conducted by banks are no longer available in a stress, for example due to adverse liquidity conditions or significant counterparty default. The crystallisation of this risk could lead to a fall in a firm's leverage ratio, tightening its capital constraint and leading to a potentially destabilising deleveraging process or a breach in capital requirements that could undermine confidence in a firm's safety and soundness and potentially affect the wider economy. The data collection would enable the PRA to apply enhanced supervision where necessary, and so reduce the probability of contingent leverage risks materialising in the future.

The PRA considers that existing reporting requirements do not provide the granularity needed for adequate monitoring of trades that may be a source of contingent leverage risk. As set out in the consultation, these are: collateral swaps; netted repos; agency trade models to transact in Securities Financing Transactions; and cash and synthetic prime brokerage positions. The PRA's proposed new data reporting requirement would address this gap.

The PRA also considers that the proposed data reporting requirement would be proportionate to the risk identified. It would only apply to the small number of firms (the PRA expects around 45 in total) that are sufficiently large to be captured by the PRA's minimum leverage requirement (and associated enhanced reporting requirements) – these are the firms are that judged to pose the most significant risks to financial stability. These firms also account for the vast majority of relevant trade activity and their safety and soundness is therefore most vulnerable to contingent leverage risks. Further, the proposed frequency of data collection is six-monthly, rather than the quarterly frequency of other regulatory reporting requirements. The data collection would also standardise the previous ad-hoc collection exercises on contingent leverage for firms, making reporting reliable and more efficient for firms.

CP14/22 'Review of Solvency II: Reporting phase 2'

CP14/22 proposes improvements to reduce reporting costs for insurers and better align Solvency II reporting with the PRA's supervisory needs in a number of areas. CP14/22 forms part of a series of consultations that the PRA expects to publish to improve Solvency II, and follows PS 29/21[1] which delivered the first set of 'quick win' reductions to Solvency II reporting last year.

The proposals focus primarily on rationalising and simplifying onshored EU Solvency II reporting in a number of areas which the PRA judges are no longer necessary for the UK market or are unduly burdensome for firms. Overall, the proposals in CP14/22 are therefore expected to deliver a further net reduction in reporting requirements for insurers on top of the reductions we have already implemented last year. However, alongside these further reductions some limited new reporting is proposed in a few

[1] PRA Policy Statement 29/21 'Review of Solvency II: Reporting (Phase 1)': https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1

areas of growing importance and relevance to the supervision of the UK insurance industry – cyber underwriting risk, excess capital generation and non-life insurance products – where we have judged that some new reporting is needed to advance the PRA's safety and soundness and policyholder protection objectives.

The expected supervisory benefits to the PRA of the proposed new reporting include:

- **Cyber risk underwriting:** Reporting would enable the PRA better to understand and supervise firms' growing exposures to and management of their cyber risk underwriting activities, and assess which insurers are impacted by major claim events as these arise. Cyber risk insurance has been a major new area of focus for some general insurers in recent years, and as well as the opportunities it provides it is also a growing source of risk. It is important that we can adjust our monitoring where necessary to reflect significant changes in the UK market such as this. The proposals would allow us to identify and monitor the insurers who are writing the most significant volumes of cyber insurance business and to understand how well they are managing their exposures.
- **Excess capital generation:** Reporting on capital generation by large annuity writers (> £1 billion in premium) would allow the PRA better to understand and supervise risks facing these firms, including current and future balance sheet volatility, solvency coverage, and dividend affordability. The PRA currently receives limited information about how insurers have generated excess capital to date, how much excess capital they expect to generate in the near future, and the approach firms plan to use to generate that capital. Those UK life insurers who write significant levels of annuity business have millions of UK retail customers who depend on the robustness of the capital these insurers hold to support their ongoing safety and soundness.
- **Non-life products**: Reporting would allow the PRA better to understand the types of products (e.g. property, business interruption etc) that non-life insurers are writing. This is an area where existing reporting does not provide the PRA with useful information and the new reports would allow the PRA to tailor its supervision more appropriately to the different nature of risks within firms and their products.

Up until now, the PRA has had to rely on manual ad-hoc data collection on topics where the onshored Solvency II reporting has fallen short of providing sufficient transparency and insight. This sort of ad hoc reporting is sometimes necessary but imposes costs on firms and often generates data which is of a lower quality, limiting its usefulness. The PRA expects that the efficiency, quality and comparability of data reported on these three new areas would be enhanced through the proposed incorporation of them into the existing Solvency II taxonomy and reporting infrastructure.

Please can you set out how the PRA keeps track of the cumulative cost to firms of these proposed new reporting requirements?

Considering the estimated costs associated with proposed policy changes is an important part of the consultation process and a FSMA requirement (s.138J FSMA). Both CP12/22 and CP14/22 seek to quantify the potential incremental operational costs associated with introducing the proposed new reporting, with the help of voluntary submissions from insurers and banks. As part of our formal consultations, we also set out our assessment of the costs and benefits of proposed changes. We welcome feedback from firms as part of the consultation on our assessment of the likely costs involved in implementing our proposals, and we consider any feedback carefully when finalising our proposals after consultation. The PRA expects to collect similar data with any future reporting change proposals.

Can you also set out what processes the PRA has in place to make sure that all existing data being collected is still being used as intended, and that data which is no longer required is no longer requested?

Insurance reporting

Under the Solvency II review, which CP14/22 forms part of, the PRA has endeavoured to review all insurance reporting to evaluate whether it is required and continues to meet our needs. As part of this review the PRA has considered whether elements of the data collected are used either infrequently, or not at all, both internally and also by other users reliant on Solvency II data (e.g. the Financial Conduct Authority and Office of National Statistics).

The PRA's review has considered historical usage as part of business-as-usual activities and in stressed economic situations, both with regard to the relevance of the information reported and its timeliness to support supervisory analysis and action. The review has sought to reduce both the volume and complexity of insurance data submitted across the insurance industry, whilst maintaining data that is required to advance the PRA's objectives.

The first phase of the review – which was implemented in 2021 – delivered an average 15% reduction in Solvency II reporting compared with the reporting we inherited from the EU, with greater reductions for smaller firms. Pending the outcome of the consultation process, CP14/22 is estimated to deliver a further 15% net reduction in the returns submitted across the insurance industry. Together, these two phases of reform are expected to result in an insurance reporting package that delivers more insightful and relevant information, in a more efficient manner than the current onshored Solvency II reporting.

Given the costs involved in making substantive changes to reporting templates, we would expect there to be a period of implementation and embedding time between future reporting reviews. In the meantime, absent significant developments in the market updates to the reporting templates and taxonomies would generally be limited to the correction of errors, should these come to light.

Banking reporting

In due course, the PRA also plans to review the full range of bank reporting data it collects, in a similar way to what we have been doing with insurance reporting. As with insurance reporting, there are likely to be some areas where the historic reporting we have inherited from the EU is no longer appropriate or is not sufficiently tailored for the needs of the UK market. There are also a number of other important changes already under way to the bank prudential regime – for example the proposed implementation of Basel 3.1, and our plans to simplify the prudential regime for smaller banks through our ‘Strong & Simple’ initiative – and we are mindful of the need for any further reporting changes to be carefully planned alongside these other initiatives. We are considering these issues carefully and look forward to further discussions with the Committee.

Yours sincerely,

S. Woods

Sam Woods
Deputy Governor and CEO, Prudential Regulation Authority