BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP16/14

Transposition of Solvency II: Part 3

August 2014

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Responses are requested by Friday 7 November 2014.

Please address any comments or enquiries to:
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1 Overview

1.1 This consultation paper (CP) sets out proposed changes to the Prudential Regulation Authority's (PRA's) rules in order to implement the Solvency II Directive (the Directive), as amended by the Omnibus II Directive (OMD II). Transposing the Directive into UK law requires a combination of changes to primary legislation (on which HM Treasury is consulting) and changes to the PRA Rulebook. This CP is of primary interest to all UK insurance firms within the scope of Solvency II and to Lloyd's. It will also be of indirect interest to non-Directive insurance firms.

1.2 In this consultation, references to 'Parts' mean proposed Parts of the PRA's Rulebook.

Background

1.3 This CP is the third consultation on rules to transpose the Directive. CP11/22[1] covered the majority of the Solvency II Directive. CP 12/13[2] covered areas of the Directive that were deferred in CP11/22, such as the treatment of Lloyd's and with-profits and contained feedback on CP11/22. This CP consults on rules to transpose the amendments to the Directive introduced by OMD II and on the implementation of areas deferred from the previous two CPs.[3]

1.4 The OMD II amendments to the Directive and the development of the PRA's policy framework mean that the proposed rules previously consulted on have been updated and reshaped in this CP.

Objectives of Solvency II

1.5 Solvency II is a significant reform of European insurance regulation. It is intended to provide greater protection to policyholders through an enhanced prudential regime. The modernised framework better aligns capital requirements to firms' asset and liability profiles and enhances the quality of capital. In addition, Solvency II is intended to improve firms' own risk management with the aim of reducing the probability of firm failure. Solvency II also reforms the public disclosure of information about a firm's financial condition with the aim of encouraging the effective exercise of market discipline.

1.6 As a largely maximum harmonising Directive, Solvency II will replace and harmonise the disparate solvency requirements that have arisen from different Member States' implementation of Solvency I, allowing consistent prudential regulation across the European Union (EU).

Omnibus II

1.7 The Directive was amended by OMD II, which came into force on 23 May 2014. OMD II was necessary to bring Solvency II in line with the adoption of the Treaty of Lisbon and the creation of the European System of Financial Supervision (ESFS). In addition, a number of substantive changes to the prudential framework were made.

1.8 The most substantial component of these changes is the long-term guarantees (LTG) package. This comprises a set of measures designed to ensure that the regime is adequate for insurance products offering an element of guaranteed return. The changes will require amendments to the draft rules which were consulted on in CP11/22 and CP12/13.

1.9 OMD II also introduced a number of other provisions, including those relating to transitional arrangements and supervisory reporting. These will also require changes to the PRA rules.

Areas with no proposed rule changes

1.10 Other changes introduced by OMD II will not require new PRA rules, but nevertheless influence the PRA's implementation of the regime. This explains, for example, some of the material included in the proposed supervisory statements proposed in this consultation relating to the use of capital add-ons and the proposed implementation of exemptions from supervisory reporting. In other areas, transposition of the changes introduced by OMD II will require amendments to primary legislation and are being consulted on by HM Treasury.

Capital add-ons

1.11 OMD II makes changes to the circumstances in which capital add-ons may be applied following a supervisory review process. This reflects the LTG and transitional measures

(1) www.fsa.gov.uk/pubs/cp/cp11_22.pdf.
(2) www.fsa.gov.uk/static/pubs/cp/cp12-13.pdf.
(3) Directive 2014/51/EU of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No. 1060/2009, (EU) No. 1094/2010 and (EU) No. 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority).

OMD II introduces. Specifically OMD II extends the use of capital add-ons to situations in which the risk profile of a firm using the matching adjustment, the volatility adjustment or the transitional measures deviates significantly from the assumptions underlying the use of these measures. In the event of the application of a capital add-on, the add-on should be proportionate to the material risks arising from the deviation.

1.12 The PRA's implementation of the capital add-on regime consulted on in CP11/22 covers the new circumstances provided for in OMD II. There is no need for further substantive rule changes but firms should note the amendment to the definition of capital add-ons which takes account of the OMD II amendments to Article 37 of the Directive.

Supervisory reporting exemptions

1.13 OMD II makes changes to the provision in Article 35 of the Directive relating to information to be provided by firms for supervisory purposes. Specifically it allows the PRA to grant firms exemption from quarterly reporting and from reporting on an item-by-item basis, subject to certain criteria.

1.14 While it is the PRA's intention to use this discretion, there are outstanding issues regarding how this will be put into operation. These include European Insurance and Occupational Pensions Authority (EIOPA) guidelines elaborating further on the criteria allowing exemptions.

1.15 The PRA does not expect the implementation of supervisory reporting exemptions to require new rules. However, it intends to publish a supervisory statement outlining its approach to considering applications for exemptions.

Future consultations

1.16 The PRA anticipates further changes to its Rulebook and the issue of further supervisory statements in order to implement Solvency II. These areas include but are not limited to:

- The PRA's expectations for other approval processes. These are planned for Q4 2014.
- Further national specific reporting templates which the PRA may consider necessary. Chapter 12 of this CP and Appendix 3.1 outline a core set of national specific reporting templates. However, as discussed further in Chapter 12, the PRA expects to consult later in the year on further national specific templates not addressed by the set of Solvency II harmonised templates and that it considers necessary for the effective supervision of UK firms.
- Certain transitional measures to enable firms to adapt to the new regime in an appropriate and proportionate way.
- Further rules covering third country branches. As discussed in Chapter 9, the PRA expects that EIOPA will issue guidelines relating to third country branches. The PRA will therefore consider the need to make further rules or issue supervisory statements in the light of EIOPA's guidance. Some additions to the proposed rules on third country branches may also be necessary in light of changes proposed in future consultations to any provisions applicable to third country branches.
- The PRA's implementation of changes to the Approved Persons Regime.

Approved Persons Regime

1.17 The PRA will need to make amendments to the Approved Persons Regime to take into account the Solvency II measures relating to governance and the fitness and propriety of relevant individuals.

1.18 In addition, the PRA has indicated its intention to amend the approved persons regime for insurers to bring it closer to the corresponding regime proposed for banks. The PRA believes that we should expect those who run regulated firms to have clearly defined responsibilities and to behave with integrity, honesty and skill regardless of whether they work for global investment banks, regional building societies or in the UK insurance sector. Also, the PRA recognises that many groups contain both banks and insurers, and that operating two very distinct regimes would be complex and inefficient for such firms (and for the PRA itself).

1.19 However, the regime for insurers should not be identical to the regime for banks. The business model of an insurer and the risks it poses to the PRA's objectives are different from those of a bank. In addition, there are differences in the relevant legislative framework for insurers and banks respectively.

1.20 The PRA intends to consult on a set of proposals to implement these changes later in the year.

Implementation

The legal framework for the Solvency II Directive

The Solvency II Directive

1.21 Apart from a number of provisions recast from previous European Directives, Solvency II is a largely maximum harmonising directive. Therefore, as for CP11/22 and CP12/13, the PRA has followed the approach of 'intelligent copy out' in its transposition of the Directive. This means following the words of the Directive text as closely as possible in the PRA's transposition. However, where the Directive points to areas of

Member State discretion, these are addressed in the PRA's proposed rules and considered explicitly within this CP.

The Solvency II Regulations

1.22 The Solvency II Directive is supplemented by the Solvency II Regulations. The Solvency II Regulations include both Delegated Acts and Implementing Technical Standards (ITS). These will provide further detail in areas specified by the Directive.

1.23 Unlike the Directive, the Solvency II Regulations are directly applicable in all Member States without the need for implementation by a national legal instrument. Firms within scope of the Directive will be bound by the Solvency II Regulations directly. It is therefore important that firms consult the Solvency II Regulations as in some cases the Directive, and the intelligent copy out PRA rules which implement it, only specify high-level requirements, with more detailed standards existing in the Solvency II Regulations. An example relates to the limits to own funds where the detailed binding requirements are those expected in the Solvency II Regulations.

Alignment with regulatory reform in the United Kingdom

1.24 CP11/22 and CP12/13 were published before the changes to the UK regulatory structure. Previously the Financial Services Authority (FSA) was responsible for both prudential and conduct regulation and was the competent authority responsible for the implementation of all components of Solvency II. The Financial Services and Markets Act 2000 (as amended by the Financial Services Act 2012) (FSMA), split the FSA's powers and functions between the PRA and the Financial Conduct Authority (FCA).

1.25 As the prudential regulator, the PRA is responsible for implementing most of the provisions introduced by Solvency II. The FCA also has an interest through its own statutory objectives (for example, where Solvency II has implications for conduct of business) and so also has responsibility for some provisions of Solvency II. The PRA and the FCA have established a Memorandum of Understanding (MoU) to ensure the co-ordination on issues of policy where these affect either organisation's objectives.

Structure

1.26 This CP consists of four sections:

- Section I (Chapters 2–7) considers the proposed rule changes necessary to implement the Solvency II Directive (as amended by OMD II). This includes changes introduced as part of the LTG package within OMD II and other changes introduced by OMD II.

- Section II (Chapters 8–12) covers areas not considered in CP11/22 and CP 12/13, or where the PRA's approach has developed since the previous CPs. In particular it includes new proposals on surplus funds in response to feedback received in CP12/13.

- Section III (Chapters 13–14) provides feedback on responses to two parts of CP12/13:
  - the approach to Lloyd's;
  - public disclosure of capital add-ons and undertaking specific parameters (USPs).

- Section IV (Chapter 15) provides an economic cost benefit analysis that considers the impact, as a whole, of the most material proposed rule changes introduced in this CP — the LTG package. The analysis builds upon the economic cost benefit analysis for Solvency II carried out as part of CP11/22 and the impact assessment is updated in light of the significant changes introduced by OMD II. In addition, the costs and benefits of specific proposed rules are analysed within the relevant chapters of Parts I and II where the PRA anticipates a material impact or believes some further explanation may be helpful. Where proposed rules are not accompanied by an analysis of costs and benefits the economic effects are expected to be of minimal significance.

1.27 The PRA is considering the rules required for the prudential regulation of with-profits insurance business having regard to the PRA's objectives and approach to insurance supervision, the Solvency II requirements and how the PRA rules would interact with the FCA's conduct regime via the with-profits MoU. The PRA intends to consult on rules relating to with-profits business, which may be supplemented by a supervisory statement, later this year.

1.28 The PRA will not incorporate Chapter 21 of the FSA Handbook's Conduct of Business Sourcebook (COBS 21) in the PRA Rulebook or supervisory statements. COBS 21 relates to requirements which fall within the FCA's mandate. Therefore, changes to the rules on linked long-term insurance business in COBS21 are to be addressed by the FCA and feedback to this part of CP12/13 will be addressed by the FCA later this year.

1.29 Supervisory statements, proposed rules implementing Solvency II, as well as the national specific templates and log files outlined in Chapter 12 are contained in the appendices.

The PRA's policy framework

1.30 The PRA has set out in the its approach to insurance supervision[1] (the 'approach document') its intention to replace the PRA Handbook (which contains material carried

(1) www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

forward from the FSA Handbook) with a PRA Rulebook and to issue supervisory statements to provide additional general guidance. The aim is for this new policy framework to set out clearly and concisely what the PRA expects of firms.

1.31 The implementation of Solvency II is the first significant move towards establishing the PRA's new policy framework for insurance companies. CP11/22 and CP12/13 consulted on rules and associated guidance prior to the development of the PRA's policy framework. Consequently, as part of the transposition of Solvency II, the PRA's rules and guidance have been reshaped. The complete set of rules transposing Solvency II is therefore provided in the appendices. Firms should read these instruments and any accompanying draft supervisory statements together to understand the PRA's expectations. To support specific subject area rules, interpretative provisions and a central glossary are also provided.

1.32 In addition to newly proposed rules, the appendices contain the SOLPRU rules consulted on by the FSA re-drafted in the PRA's style. In this re-draft the associated guidance was removed. Where necessary, issues on which guidance was previously proposed have been addressed in draft supervisory statements in the appendices.

Scope

1.33 Solvency II will apply to around 400–450 retail and wholesale UK insurance firms and to Lloyd's. There will also remain approximately 100 small firms, classified as non-Directive firms (NDFs) under both Solvency I and II. The regulation of these firms will continue under existing rules.

1.34 Similarly, firms that are out of scope of Solvency II, but are subject to Solvency I, will remain within the scope of existing PRA Handbook rules, including the Interim prudential sourcebook for friendly societies (IPRU (FSOC)), the Interim prudential sourcebook for insurers (IPRU (INS)), the Prudential sourcebook for insurers (INSPRU) and the General prudential sourcebook (GENPRU).

1.35 Work on developing the regime for NDFs and other out of scope firms will start when the PRA determines its approach for these firms. Any proposals would be subject to the usual consultation process.

Statutory obligations

1.36 In discharging its general functions of making rules and determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of PRA-authorised persons and its insurance objective to contribute to securing an appropriate degree of protection for policyholders.

1.37 The main objective of Solvency II, as set out in the Article 27 of the Directive, is the protection of policyholders and beneficiaries. In advancing the prudential strength of the regulatory regime it will also promote the safety and soundness of insurers.

1.38 In developing the rules covered in this CP and establishing its practices and procedures, the PRA has had regard to the Regulatory Principles which apply to the PRA. For example, one of the Regulatory Principles is that regulators should exercise their functions as transparently as possible. The PRA has followed this principle in trying to make clear, where relevant, how responses to CP12/13 have been considered as part of the development of the proposals outlined in this CP. The regulatory principle of proportionality requires the PRA to develop and implement rules which have a burden or restriction proportionate to the benefits which are expected as a result. The PRA has followed this principle when developing the rules outlined in this CP and, where relevant, the PRA has set out how its approach is consistent with the principle of proportionality.

Economic impact

1.39 The PRA is also required to perform an economic assessment of the impact of its policy proposals. As the PRA is implementing a largely maximum harmonising directive it has limited flexibility in making the relevant rules. If the PRA did not make implementing rules the United Kingdom would not be compliant with the Directive and would risk being subject to infraction proceedings.

1.40 In Section IV of this CP the cost benefit assessment of the proposed rules has been carried out without consideration of the costs of infraction proceedings. However, the CP indicates instances where the PRA proposes rules to implement the Directive's maximum harmonising provisions in which there is no potential for the PRA to exercise discretion or interpretation. The cost benefit analysis of the rules should be considered in this context.

Impact on mutuals

1.41 The PRA has a statutory requirement to state whether the impact on mutuals will be significantly different from the impact on other firms. The provisions in Solvency II will affect mutuals. The cost benefit analysis outlined in CP11/22 sets out the extent to which mutuals would be differently affected. The PRA notes that mutuals are more constrained in their capacity to adjust to higher capital requirements.

1.42 Where the new proposed rules covered in this CP may result in a different impact on mutual firms this is discussed in more detail in the relevant chapter.

Impact on competition

1.43 The PRA has a secondary objective to facilitate effective competition. This means that in taking action which advances its general and insurance objective the PRA is expected to act in a way that advances its secondary objective. The Directive and OMD II provide the PRA with limited scope to choose alternative approaches to further its competition objective.

1.44 The provisions of Solvency II have the potential to change competitive conditions in the markets in which PRA authorised firms operate. This impact was considered as part of the cost benefit-analysis outlined in CP11/22. Where changes introduced in this CP may change the impact of Solvency II on competition they are discussed in more detail.

Equality and diversity

1.45 The PRA may not act in an unlawfully discriminatory manner. It is also required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. As part of this, the PRA assesses the equality and diversity implications of any new policy proposals.

1.46 CP11/22 concluded that the implementation of the Directive would not have any direct or indirect discriminatory impact under existing UK law. Changes introduced by this CP do not alter that conclusion.

Responses and next steps

1.47 This consultation closes on Friday 7 November 2014. Views are welcomed on the issues raised in the CP. Respondents are requested to structure their responses on a chapter by chapter basis.

1.48 In particular, respondents may wish to comment on:

- the proposed approach to implement the LTG measures;
- the PRA's decision to impose minimum requirements for UK branches — which only carry out reinsurance business — of firms that are headquartered outside the EU; and
- the proposed national specific templates.

1.40 The PRA will publish a policy statement with feedback, finalised rules and final supervisory statements in early 2015.

1.50 The PRA is required to transpose the Directive by 31 March 2015.

Section I:
Transposition of Omnibus II

2 The matching adjustment

Articles 77(b) and 77(c)

2.1 This chapter sets out the implementation of changes, introduced by OMD II, to the calculation of the relevant risk-free interest rate term structure under Solvency II. The Directive allows firms to apply a 'matching adjustment' to the relevant risk-free interest rate term structure when calculating a best-estimate valuation of a portfolio of liabilities that meet certain criteria, subject to prior supervisory approval.

2.2 The Solvency II provisions on the matching adjustment are intended to allow firms to benefit from the illiquidity premium that might be expected to arise from the use of assets held to maturity in a portfolio backing illiquid liabilities. The inclusion of the matching adjustment allows the regime to recognise the risk management benefits of appropriately matching asset and liability cash flows.

2.3 The proposed rule changes are explained below and set out in the rules in Appendix 1.3. In this area of the Directive there is no discretion and when proposing its rules the PRA has followed an 'intelligent copy out' approach.

Proposals

Matching adjustment to the relevant risk-free term structure

2.4 Article 77b of the Directive sets out the conditions under which firms may apply a matching adjustment to the relevant risk-free term structure. In order to be eligible for the matching adjustment, the portfolio of obligations must meet certain criteria, and must be closely cash-flow matched with an eligible portfolio of assets.

2.5 The eligibility requirements for assets in the matching portfolio are laid out in Article 77b and should be read together with other requirements in the Directive (including the prudent person principle). The PRA will assess applications on a case-by-case basis and will not prescribe a list of asset types that will be considered eligible or ineligible for a matching portfolio. Rather, firms will be expected to provide suitable justification that their matching portfolios meet the requirements laid out in the Directive.

2.5 Once adopted by the European Commission, an ITS on the subject of the matching adjustment (see EIOPA's consultation, CP 14/007)[1] will require the PRA to establish an approval process for firms that wish to apply a matching adjustment. The application process and the PRA's approach to assessing whether firms meet the criteria will be detailed later in 2014.

Calculation of the matching adjustment

2.6 Article 77c sets out the method for the calculation of the matching adjustment. This sets out the key principles for the calculation of the matching adjustment and some of the detailed calculation methodology in line with those principles.

2.7 The calculation recognises that when firms meet the criteria for approval of the use of the matching adjustment, they will face a reduced level of spread risk on the assets within the matching portfolio. However, the Directive requires that the matching adjustment not include the 'fundamental spread' which reflects the risks that are retained by the firm.

2.8 Article 77c sets out the framework for the fundamental spread. This will be further specified in the Solvency II Regulations.

Cost benefit analysis

2.9 The baseline for the assessment of the costs and benefits of the matching adjustment is the rules consulted on in CP11/22. In CP11/22, the view of the FSA was that the combination of market consistent valuation and a risk-free discount rate could create volatility for regulatory balance sheets and incentivise insurers to make greater use of derivatives to reduce any volatility.

2.10 Compared to the baseline, the benefits of allowing the matching adjustment are:

(a) For business eligible for the matching adjustment, there will be less need to sell assets unnecessarily during market down-turns or to incur the costs of setting up hedging arrangements to mitigate asset price movements.

(b) The increase in the discount rate is expected to reduce the amount of capital needed to be raised to meet the Solvency Capital Requirement (SCR) at the implementation of the Solvency II regime in 2016, reducing firms' costs of meeting capital requirements. This reduction is appropriate as it allows the recognition of the

(1) https://eiopa.europa.eu/consultations/consultation-papers/index.html.

risk management benefits of matching asset and liability cash flows.

The impact of the matching adjustment on the balance sheet will, however, vary over the economic cycle. The aggregate effect is considered in further detail in Part IV.

2.11 Compared to the baseline, the costs of allowing the matching adjustment are:

(a) The reduction in technical provisions and SCR resulting from the use of the matching adjustment could reduce policyholder protection compared to what it would have been under the baseline. However, the PRA does not expect financial resources to fall materially below their current levels under the ICAS regime, thereby maintaining current levels of policyholder protection.

(b) The application process to use the matching adjustment is expected to impose some incremental administrative costs. The PRA will consider these costs further in another communication on the approval process, to be published later in 2014.

2.12 The PRA expects that some firms may seek to re-balance their existing asset portfolios in order to meeting the eligibility criteria for the matching adjustment and this will affect the resulting impact of the matching adjustment. It is difficult to estimate the extent of these portfolio changes, as applications to use the matching adjustment are required to be reviewed on a case-by-case basis by supervisory authorities and firms may reallocate assets internally to avoid trading costs.

2.13 The PRA does not expect material impacts on competition to arise from the matching adjustment as the Directive allows firms to invest in different ways when designing their matching portfolios, so firms can adopt different pricing strategies and product designs. During periods of economic volatility, the matching adjustment may enable firms to avoid taking short-term strategies that could harm their ability to compete in the long-run.

3 The volatility adjustment

Article 77(d)

3.1 This chapter sets out the implementation of changes, introduced by OMD II, to the calculation of the relevant risk-free interest rate term structure under Solvency II. The Directive allows firms to apply a volatility adjustment to the relevant risk-free interest rate term structure when calculating a best-estimate valuation of a portfolio of liabilities. The adjustment is based on a proportion of the risk-corrected spread between the interest rate that would be earned by a reference portfolio (specific to the currency relevant to the insurance business) and the risk-free rate term structure for the same currency. The volatility adjustment is intended to allow firms to mitigate the impacts of short-term volatility in financial markets.

3.2 The Directive provides that Member States may require firms to obtain supervisory approval before applying the volatility adjustment. HM Treasury is consulting separately on whether the PRA will have a prior approval power for the volatility adjustment and the criteria the PRA would have to consider as part of an approval process. If the PRA does have a prior approval power, the PRA will need to set out an application process for firms to follow when seeking to use the volatility adjustment. This would be addressed in a communication to be released later in 2014.

3.3 The proposed rule changes are explained below and set out in the rules in Appendix 1.3. In this area of the Directive there is no discretion and when proposing its rules the PRA has followed an intelligent copy out approach.

Proposals

3.4 The Directive sets out a framework for how the volatility adjustment is to be calculated, which the PRA expects to be supplemented by detail in the Solvency II Regulations. Firms will be required to follow this calculation methodology.

3.5 The Directive also precludes the application of the volatility adjustment to insurance obligations that have been valued using a matching adjustment.

Cost benefit analysis

3.6 The baseline for the comparison of the costs and benefits of the volatility adjustment are the rules consulted on in CP11/22. In CP11/22 the view of the FSA was that the combination of market consistent valuation and a risk-free discount rate could create volatility for regulatory balance sheets and incentivise insurers to make greater use of derivatives to reduce any volatility.

3.7 Compared to the baseline, the benefits of allowing use of the volatility adjustment are:

(a) For business to which the volatility adjustment is applied, there may be less need to sell assets, unnecessarily, during market down-turns or to incur the costs of setting up hedging arrangements to mitigate asset price movements.

(b) The increase in the discount rate is expected to reduce the amount of capital raising needed to meet the SCR on the introduction of the Solvency II regime in 2016, reducing firms' costs of meeting capital requirements. The reduction in required capital is a benefit to the extent that it avoids firms holding capital against market volatility risks to which they are not exposed.

The impact of the volatility adjustment on the balance sheet will, however, vary over the economic cycle.

3.8 Compared to the baseline, the costs of allowing the volatility adjustment are:

(a) The reduction in capital needed to meet the SCR at the implementation of Solvency II could reduce policyholder protection compared to what it would have been under the baseline scenario. However, the PRA does not expect financial resources under Solvency II to fall materially below their current levels under ICAS thereby maintaining current levels of policyholder protection.

(b) The application of the volatility adjustment could lead firms with a liquid liability profile to underestimate their technical provisions. The volatility adjustment is a premium to compensate for the excess volatility in spreads over a short time and as such is an increase to the risk free rate (used in the valuation of technical provisions). But if the liquidity of the liability profile led to liabilities crystallising unexpectedly, firms would not be to be able to realise this premium, as they would have to sell those assets in order to meet their liabilities.

3.8 The PRA does not expect material impacts on competition arising from the volatility adjustment. During periods of economic volatility, the volatility adjustment may enable firms to avoid taking short-term strategies that could harm their ability to compete in the long-run.

4 Risk management for LTG measures

Articles 44 (2a), 45 (2a), 51 (1a), 77a

4.1 This chapter sets out the implementation of the changes, introduced by OMD II, to risk management requirements under Solvency II. The purpose of the Directive's provisions is to ensure that firms are managing appropriately the risks that arise from the application of the LTG package.

4.2 The proposed rule changes are explained below and set out in the rules in Appendices 1.3 and 1.12. In this area of the Directive there is no discretion and when proposing its rules the PRA has followed an intelligent copy out approach.

Proposals

Liquidity plan

4.3 OMD II introduces a requirement for firms that wish to use the matching adjustment or volatility adjustment to set up a liquidity plan projecting the cash flows of the assets and liabilities subject to those adjustments. The liquidity plan will include an assessment of the impact of these adjustments on the firm's ability to manage asset liability related liquidity risks.

4.4 A firm using the volatility adjustment must also include a written policy on the criteria for application of the adjustment in its overall risk management policy.

4.5 The primary benefit of the liquidity plan is that it will help to demonstrate the extent to which a firm's application of the LTG measures is generating a material liquidity risk to the firm's financial condition and the type and extent of measures and controls the firm may need to put in place to manage that risk. This would enable firms to take corrective actions or supervisors to intervene to maintain policyholder protection.

4.6 There may be some incremental costs arising from the need to describe the impact of either the volatility adjustment or the matching adjustment, depending on the extent to which the firm already has adequate systems in place to project incoming and outgoing cash flows at a sufficiently granular level. However, it is expected that these costs would be minimal, given the considerable investment in data and reporting capabilities to implement Solvency II.

Additions to the own risk and solvency assessment

4.7 Article 45 of the Directive introduces the own risk and solvency assessment (ORSA) requirement. Firms must, as part of their risk management system and their regular solvency reporting submission to the PRA, produce an ORSA based on their own assessment of their solvency needs, compliance with capital requirements and deviations of their risk profile from the assumptions underlying their SCR. The FSA consulted on the transposition of most of the requirements pertaining to the ORSA in CP11/22 and CP12/13.

4.8 OMD II introduces the requirement that firms using the matching adjustment, volatility adjustment or transitional measures relating to technical provisions assess their ongoing compliance with their capital requirements both with and without the impact of these measures. This assessment must also be included in firms' ORSAs.

4.9 The benefit of including these additional elements in firms' ORSAs is to allow firms and the PRA to assess the impact of these measures on firms' compliance with the capital requirements. In addition, it is beneficial to understand the impact on firms' compliance with capital requirements if they were no longer permitted to use the matching adjustment, volatility adjustment, or transitional measures. The additional elements of the ORSA can also help to identify cases where the PRA may wish to apply more scrutiny when considering whether firms are applying the adjustments correctly. These additions to the ORSA therefore enable the PRA to monitor firms' compliance with the requirements and intervene where necessary to promote policyholder protection.

4.10 The PRA does not expect material incremental costs from including these additional elements in a firm's ORSA, as the PRA expects firms would already have in place systems to recalculate their solvency position with the volatility and matching adjustments set to zero.

Public disclosure

4.11 OMD II introduces the requirement that firms using the matching adjustment include in their solvency and financial condition reports a description of the matching adjustment; the liabilities it is applied to and the quantification of the impact of reducing the matching adjustment to zero on their financial position.

4.12 Similarly, firms using the volatility adjustment must include in their solvency and financial condition report a quantification of the impact of reducing the volatility adjustment to zero.

4.13 The benefit of these requirements is that it will provide further information to the public on the risk profile of the firm and help ensure an efficient market through the provision of relevant information. The PRA does not consider this requirement to impose material incremental costs on firms given investments made by firms to meet Solvency II reporting requirements. Firms will already have to produce this information in their ORSA.

Risk-free rate term structure

4.14 Article 77a allows firms to extrapolate the risk-free rate term structure beyond that which can be determined from available market instruments, basing the extrapolation on a smooth progression from the last point obtained from market data to the ultimate forward rate relevant to the obligations being valued.

4.15 The ability to extrapolate the risk-free rate term structure will allow firms to value liabilities consistently across the term structure. There is a potential risk that different firms will use different extrapolation techniques resulting in the use of inconsistent term structures across the industry. Were firms to increase the discount rate through particular extrapolation techniques this would be to the detriment of policyholder protection. However the requirement to meet the ultimate forward rate should minimise this risk.

Cost benefit analysis

4.16 The baseline for the cost benefit analysis of the changes considered in this chapter is the rules consulted on in CP11/22.

5 Transitional measures

Article 308b (1)–(3), 308b (5)–(10), 308 (12), 308 (13)

5.1 This chapter sets out the proposed implementation of certain transitional measures relating to: own funds; firms in run-off; groups; and reporting and public disclosure.

5.2 The transitional measures and the PRA's implementation of these measures, where the PRA has discretion over the implementation, are intended to ensure a smooth progression towards the new regime.

5.3 The PRA will consult at a later date on proposed changes to PRA rules necessary to implement the Directive requirements relating to transitional measures for the calculation of technical provisions, application of the SCR, and the relevant interest rate term structure. At present, there is insufficient evidence to quantify the precise impact of changes to PRA rules. Responses from an industry data request are still to be received in order to inform the PRA's rule making. Therefore, the PRA will defer consulting on rule changes in this area until a later date.

5.4 The baseline for the analysis of costs and benefits arising from the proposed changes is the set of rules consulted on in CP11/22. A fuller examination of the costs and benefits of the changes introduced by OMD II is covered in Chapter 15, Economic analysis.

5.5 Proposed rules are explained below and set out in the rules in Appendix 1.18. In this area of the Directive there is no discretion and when proposing its rules the PRA has followed an intelligent copy out approach. Draft supervisory statements in the appendices further set out the PRA's expectations concerning transitional arrangements.

Proposals

Transitional measures for own funds — Article 308b (9)–(10)

5.6 The Directive sets out transitional measures specifying the way in which firms' current capital instruments will be classified under the Solvency II regime.

5.7 As specified in the Directive, the transitional measures apply to instruments issued before a specified cut-off date, which will be the earlier of either 1 January 2016 (the date of application of Solvency II) or the date of entry into force of the Solvency II Regulations, which is currently expected to be late 2014 or early 2015.

5.8 The transitional measures will only apply to instruments that would not otherwise be classified in Tier 1 or Tier 2 under the Solvency II regime. They allow the capital instrument concerned to count towards a firm's available own funds, subject to certain limits, for a period of up to ten years after 1 January 2016. The PRA is excluding from the scope of the transitional measures items that are only eligible for the treatment specified by virtue of GENPRU Transitional Provisions 4 in the PRA Handbook.

5.9 Transitional measures for capital instruments are generally applied in the case of regime change. The benefits of these measures are that they permit orderly transition and avoid the market dislocation and costs for firms which would occur if many firms were to seek to replace capital at the same time. The fifth Quantitative Impact Study (QIS5) made clear that a transitional regime on capital instruments would be extremely important for the UK industry.

Transitional measures for firms in run-off — Article 308b (1)–(3)

5.10 The Directive sets out transitional measures for firms in run-off or administration and sets out which firms may be exempted from fully complying with Solvency II for a transitional period. The principal effect of this is that firms that do not meet their Minimum Capital Requirement (MCR) during the appropriate transitional period, and which meet all of the transitional criteria, will not automatically be subject to the withdrawal of authorisation.

5.11 Subject to meeting the transitional criteria, the transitional period specified in the Directive for firms in run-off is three years from 1 January 2016. For firms in administration, the transitional period specified in the Directive is five years from 1 January 2016.

5.12 Firms in run-off or administration that are not applying the transitional measures and may potentially be in breach of the MCR should refer to the PRA's draft supervisory statement in Appendix 1.5, which sets out the PRA's expectations for firms in breach of the MCR and the PRA's approach to withdrawing an insurer's authorisation in such circumstances.

5.13 The benefit of the transitional measure is to avoid the administrative costs, which would deplete the resources available to policyholders that would arise as a consequence of firms in run-off being de-authorised. No material incremental costs are expected.

Transitional measures for groups — Article 308b(13) and Article 308(12)

5.14 The Directive sets out a number of transitional measures most of which apply at the level of the group with the necessary modifications.

5.15 Article 308b(12) allows national discretion to set a transitional measure specific to group internal models. The PRA intends to exercise this option and allow groups, for a period of up to seven years after 31 March 2015, to apply for and use a group internal model applicable to part of a group, where both the undertaking and the ultimate parent undertaking are located in the same Member State.

Transitional measures for reporting and public disclosure — Article 308b (5)–(8)

5.16 The Directive sets out a number of transitional measures which apply to firms' supervisory reporting and public disclosure. The measures relate to:

- the regular supervisory report and annual quantitative templates, including annual national specific templates;
- quarterly quantitative templates, including quarterly national specific templates;
- the solvency and financial condition report; and
- reporting and disclosures for group undertakings.

5.17 These provisions allow firms longer reporting deadlines during the transitional period. The benefit of this measure is that it will help reduce the burden on firms compared to the reporting timetables envisaged under CP11/22.

6 External credit rating assessments

Article 44 (4)(a)

6.1 This chapter sets out the implementation of requirements, introduced by OMD II, relating to the use of external credit rating assessments. Specifically, the Directive sets the mechanism and requirement to avoid overreliance on the use of credit ratings when undertakings are calculating their technical provisions and their SCR.

6.2 The proposed rule changes are explained below and set out in the rules in Appendix 1.12. In this area of the Solvency II Directive there is no discretion and when proposing its rules the PRA has followed an intelligent copy out approach.

Proposals

Use of external credit rating assessment in the calculation of technical provisions and the Solvency Capital Requirement

6.3 The purpose of the provision in the Directive is to require firms to assess the appropriateness of their use of external credit assessments as part of their risk management. Firms are expected to use additional assessments wherever possible in order to avoid any automatic dependence on external assessments.

6.4 The Directive specifies that the mechanisms to be used when assessing external credit assessments will be developed further by EIOPA in ITS.

Cost benefit analysis

6.5 The impact of this rule will depend upon the detail of the ITS. Absent the ITS, the PRA does not consider that this rule will materially alter existing requirements on firms.

7 Groups

Articles 213 to 246, 256, 256a, 257 and 260 to 266

7.1 This chapter sets out the implementation of requirements, introduced by OMD II, relating to groups. The group provisions include, among other things, the application of group supervision, the levels at which groups are supervised, the approach to group solvency calculation and the group reporting requirements. The group provisions are consistent with the relevant solo provisions, with some additional requirements addressing group-specific issues such as group structures and intra-group transactions.

7.2 The proposed rule changes are explained below and contained in the rules in Appendix 1.14. The Groups Supervision draft supervisory statement in Appendix 2.8 further sets out the PRA's expectations. It outlines areas where groups need supervisory approval on various group provisions and contains guidance that was previously consulted on as part of CP11/22.

7.3 Towards the end of 2014 the PRA will publish supervisory statements that set out, in detail, its expectations and decision-making processes on:

- excluding entities from the scope of group supervision;
- the choice of the calculation method;
- assessing centralised risk management;
- allowing groups to produce a single ORSA report; and
- allowing groups to produce a single solvency and financial condition report.

Proposals

Rules requiring provision of information by parent undertakings

7.4 The PRA was granted powers to make rules requiring provision of information from qualifying parent undertakings under section 192J of FSMA.

7.5 At the time of CP11/22 these powers had not been finalised, therefore the rules consulted on in CP11/22 did not include references to them. These powers have now been finalised and as such the PRA Rulebook will reflect where the powers allow the PRA to transpose the relevant group provisions, particularly in relation to group reporting requirements, under Solvency II at the holding company level.

Extension of the application of group supervision to mixed financial holding companies

7.6 The Directive has been amended by the Financial Conglomerates Directive (FICOD 1) to extend the scope of group provisions to include mixed financial holding companies.(1) The PRA Rulebook has been updated to reflect this change. This ensures a consistent cross-sectoral approach to identifying the ultimate parent undertaking between banking and insurance conglomerates. These changes were previously consulted on by the FSA in CP12/40.(2)

Additional public disclosure requirements for the group

7.7 Article 256a sets out a new disclosure requirement, in the form of annual public disclosure of the group's legal and organisational structures. This improves public disclosure for groups, allowing external stakeholders to better understand how groups are structured and organised.

(1) Directive 2011/89/EU of the European Parliament and of the Council amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate.
(2) www.fsa.gov.uk/static/pubs/cp/cp12-40.pdf.

Section II:
Transposition of Solvency II

8 Insurance special purpose vehicles

Article 211

8.1 In CP12/13 the FSA consulted on the transposition of Article 211 of the Directive, which states that Member States must allow the establishment of special purpose vehicles, subject to prior supervisory approval.

8.2 The current regime under the Reinsurance Directive permitted Member States to allow the establishment of special purpose vehicles in their jurisdiction and establish a regime for their authorisation and regulation. The FSA exercised this option by introducing a regime for insurance special purpose vehicles (ISPVs) in INSPRU 1.6. CP12/13 proposed that the term ISPV would be retained and would also refer to special purpose vehicles established under Solvency II.

8.3 ISPVs authorised after 31 December 2015 will be subject to the Solvency II regime, for which the PRA expects much of the detail to be specified in the Solvency II Regulations.

8.4 This chapter sets out the PRA's proposals relating to ISPVs which are authorised under the existing regime. The proposed rule changes are explained below and set out in the rules in Appendix 1.3.

Proposals

8.5 Article 211(3) of the Directive permits the PRA to maintain the authorisations of existing ISPVs under INSPRU 1.6 of the PRA Handbook. In considering the manner in which this might be achieved the PRA has taken into account the following:

(a) The PRA's ability to apply its existing rules to ISPVs relates only to the regime applicable to the ISPV itself. It does not relate to how a ceding firm recognises arrangements with, and investments in, an ISPV when it determines its technical provisions, own funds and SCR. The PRA expects the Solvency II Regulations to set these arrangements out in detail; the required approaches may be different to the methods that have been used under the current regime.

(b) Where a ceding firm uses the standard formula to determine its SCR, the PRA expects that the Solvency II Regulations will only permit the firm to take advantage of the risk mitigation technique in calculating the SCR if the current rules applying to the ISPV are equivalent to Solvency II. If the PRA were to maintain the authorisations of existing ISPVs under its current rules then it would need to ensure that those rules were equivalent to Solvency II. There would be little practical difference between maintaining a set of rules equivalent to Solvency II and applying the Solvency II rules themselves.

(c) An ISPV would, in any case, need to comply with the Solvency II Regulations for any new activities that it undertakes after 31 December 2015. While the nature of new activities would depend on the terms of existing contracts, the PRA's view is that any new risks ceded to the ISPV would be likely to constitute new activities and only in the case of run-off would it be certain that no new activities were being undertaken.

8.6 The PRA will therefore not maintain its existing requirements for ISPVs after 1 January 2016. The PRA proposes to introduce the rule set out in Appendix 1.3 which will permit existing ISPVs to maintain their current authorisation from 1 January 2016 provided that they comply with the requirements that will be set out in the Solvency II Regulations and that they continue to do so on an ongoing basis. The PRA intends to issue a supervisory statement in due course to provide further clarity in respect of its approach to ISPVs.

8.7 As noted above, the PRA expects the Solvency II Regulations to set out in detail how the ceding firm should recognise arrangements with and investments in an ISPV when it determines technical provisions, own funds and SCR. The PRA expects that the way in which the transfer of risk to the ISPV is incorporated into the calculation of the SCR of a ceding firm will be governed by different parts of the Solvency II Regulations, depending on whether the firm uses the standard formula or an internal model for the calculation of its SCR. In addition, the PRA expects that the Solvency II Regulations will not permit a ceding firm to apply a look-through approach to an investment in an ISPV which is a related undertaking when the firm is using the standard formula to calculate its SCR.

8.8 Given the change in regime as from 1 January 2016 and the need to have a proportionate approach, the PRA would expect any proposal for authorisation of an ISPV in 2014 and 2015 to take account of and anticipate the appropriate treatment for ISPVs under the Solvency II regime.

8.9 Firms which transfer risk to ISPVs should continue to discuss their implementation plans with their supervisors, including how the transfer of risk will be allowed for when determining technical provisions, own funds and capital requirements.

Cost benefit analysis

8.10 The proposals in this chapter would lead to existing ISPVs being subject to the same regulations as ISPVs set up after 1 January 2016. Given the PRA's requirements for ISPVs: to be fully funded; to comply with its senior management, systems and control requirements; and to respond to *ad hoc* requests for information from supervisors, it is not expected that the proposal would create material incremental costs or benefits.

8.11 The PRA would expect proposals for authorisation of an ISPV during 2014 and 2015 to take account of and anticipate the appropriate treatment under the Solvency II framework for the ISPV. It is not anticipated that this expectation will create material costs or benefits given preparation for Solvency II currently underway, for instance under EIOPA's preparatory guidelines. The main benefit of this approach is that the authorisation decision can take into consideration financial resources as the firm transitions to Solvency II in a comprehensive way, rather than as part of *ad hoc* information requests. It is not expected that these costs or benefits would be different for a mutual firm.

8.12 The proposals in this chapter are expected to facilitate effective competition by ensuring the same requirements apply to firms with newly established ISPVs as those with existing ISPVs.

9 Third country insurance branches

Articles 162–171, 174

9.1 This chapter sets out the implementation of Solvency II provisions affecting the operations of UK branches of insurance firms that are headquartered outside the EEA (third country branches), including branches that solely carry out reinsurance activities in the United Kingdom (third country pure reinsurance branches).

9.2 The PRA is using a two-stage approach to implementing Solvency II for third country branches. The first stage fulfils the obligations under the Directive to transpose the relevant articles (Articles 162–171) that relate to third country branches. The Directive allows the PRA some discretion to make further rules. Therefore, the PRA proposes to supplement the Solvency II provisions with certain additional requirements that clarify how the threshold conditions are to be satisfied by third country branches.

9.3 The second stage of implementation will take place after EIOPA has published guidelines related to third country branches. The PRA will consider the need for further elaboration of its approach when applying those guidelines to third country branches and may make rules or publish a supervisory statement, if elaboration is needed.

9.4 The proposed rules are explained below and set out in the rules in Appendix 1.7.

Proposals

Scope of entities captured under these proposed rules

9.5 The current regime (as set out in the PRA Handbook) exempts EEA-deposit insurers from certain requirements imposed by the PRA. EEA-deposit insurers are non-EEA insurers that have branches established in more than one Member State, and have been given approval by the PRA to have their solvency monitored by one of those Member States instead of the PRA. These insurers will continue to be exempt from solvency requirements.

9.6 The PRA applies rules to Swiss general insurers in line with the Swiss Treaty Agreement (No. 91/370/EEC). Because of this, the proposed rules in this CP will not be applied to Swiss general insurers and Swiss general insurers will continue to comply with their current rules. If the Agreement is amended in the future, the PRA will revisit the rules accordingly.

9.7 Unlike insurers headquartered in the EEA, there are no size thresholds or other exemptions under Solvency II that are applied to non-EEA (third country) insurers. The PRA recognises that while this can be partly offset by the PRA taking a risk-based approach to supervision, the costs of compliance with the proposed rules may be more significant for smaller branches.

9.8 As the PRA's proposed rules in this area apply only to UK branches of insurance firms that are headquartered outside of the EEA, they will not apply to mutual societies, therefore the PRA expects that there will not be any impact on mutual societies from the changes proposed.

Branches carrying out pure reinsurance activities

9.9 The Directive's provisions related to third country insurance branches do not apply to branches of third country (re)insurers that only carry out reinsurance business in the United Kingdom. However, the Directive does require that the PRA rules for pure reinsurance branches do not result in treatment that is more favourable than treatment of UK reinsurance undertakings. Therefore, the PRA has reviewed its rules for pure reinsurance branches.

9.10 The PRA believes the best approach is to apply broadly similar rules to reinsurance branches as those proposed for direct or mixed insurance branches. The PRA's policyholder protection objective is not limited to direct insurance policyholders, and section 55B and Schedule 6 of FSMA require third country reinsurers that wish to establish a branch in the United Kingdom to be authorised by the PRA and meet the PRA's threshold conditions (albeit with some differences) in the same way as direct or mixed insurance branches.(1)

9.11 Because the rules for pure reinsurance branches are not derived from EU directives, there is more scope for the PRA to apply them flexibly, as long as this does not result in a more favourable treatment when compared to UK-headquartered reinsurers.(2) The PRA considered introducing a threshold for application of the rules to pure reinsurance branches, similar to those in Article 4 and Article 12 for EEA reinsurers. However, the PRA prefers to take a judgement-based approach to proportionality. Rather than introducing a two-tiered regime, the PRA intends to apply a single regime. The PRA will

(1) The exception to this is that pure reinsurance branches are not required to lodge a deposit in the United Kingdom.
(2) Article 174 of the Solvency II Directive.

consider waiving specific rules on application by the third country reinsurer in accordance with FSMA.

Solvency calculations

9.12 The current threshold condition of adequate financial resources will continue to apply (among others) to third country branches, and the PRA will continue to require that the undertaking as a whole has an appropriate level of capital to meet this threshold condition.

9.13 For direct and mixed insurance branches, as well as pure reinsurance branches, while the PRA does not intend to require a capital calculation for the entire undertaking based on Solvency II rules, the PRA will need sufficient information to be satisfied that the solvency position of the undertaking as a whole is adequate, given the type and volume of business carried out in the United Kingdom, and the nature and scope of the supervision by the third country regulator, including its assessment of the undertaking's capital position.

9.14 Third country pure reinsurance branches will now be required, after 1 January 2016, to submit a branch-level calculation. As for direct and mixed insurance branches, this will be based on Solvency II rules, although for pure reinsurance branches firms will be able to apply for these proposed rules to be waived on an individual firm basis.

9.15 The current requirement, transposed in INSPRU 1.5.48R, to localise assets of a value up to the technical provisions of the branch has not been recast in the Directive and will be deleted. The impact of this is discussed further in the cost benefit analysis below.

9.16 The proposed capital rules for the Solvency II capital calculation emphasise the need to ensure funds are available to absorb losses and to be paid to policyholders when claims are made. Ensuring assets are available to policyholders in the event the insurer enters financial difficulty (noting that a branch's policyholders may be subject to the winding-up regime of the home jurisdiction) is essential in reducing the negative impact of any winding-up of a PRA authorised third country insurer on its branch policyholders. The PRA must have an adequate understanding of the whole undertaking's solvency and also the extent to which branch policyholders may be competing with other policyholders or creditors, or may rank behind other policyholders or creditors according to the home jurisdiction's winding-up regime.

Reporting requirements

9.17 Current reporting requirements will be replaced with new requirements to reflect the new Solvency II reporting templates which are due to be developed by EIOPA. In addition, third country branches will be required to submit an ORSA report and regular supervisory reporting related to the operations effected by the branch. Reporting requirements are not covered in detail in this consultation as they will be consulted upon as part of the second stage of implementation.

Cost benefit analysis

9.18 The PRA recognises that its proposed rule changes will have an impact on some branches. The baseline for the comparison of the costs and benefits of rule changes is the rules consulted on in CP11/22.

9.19 Third country insurance branches currently make up a very small proportion of the UK insurance market. The PRA currently authorises fewer than 50 third country insurance and reinsurance branches.

9.20 The PRA has identified two aspects of the proposed rules that could have a significant impact on third country branches.

9.21 First, changes to the calculation of capital requirements for branches may result in incremental costs through the one-off changes to their systems and processes to generate the capital calculation. The impact will be slightly greater for pure reinsurance branches that do not currently calculate a separate branch-level solvency position. Insurers are already required to demonstrate adequate undertaking-wide financial resources, and the administrative costs of implementing Solvency II were estimated for the entire industry in CP11/22.

9.22 Second, there may be ongoing costs if the new capital requirements are significantly different from the level of capital required under the current rules. The PRA has considered the likelihood that third country undertakings would need to raise additional capital and believe that some may need to allocate more capital to the branch business, or raise new capital if surplus capital is not available to absorb the additional capital needs of the branch.

9.23 Based on analysis of QIS5 data for a sample of firms of similar scale and insurance sector to third country insurance branches, the PRA estimates approximately 50% of insurers may need to increase the capital allocated to their branches. The PRA estimates an increase in Solvency II own funds of 25%–80% for these insurers, implying an overall increase for branches in the region of approximately 10% to 40%, dependent on size and business model (this could differ significantly between branches). Incremental capital costs are difficult to estimate as it depends on how insurers respond and the extent to which entities are able to reallocate capital internally. This estimate of capital impact could be further affected, for example, by insurers wishing to hold buffers above their capital requirements, insurers choosing to use an internal model, or differences between the final capital calculation rules and those used for QIS5, as well as the approval of waivers.

9.24 In terms of other forms of impact, the PRA has identified that the loss of localisation requirements for direct and mixed insurance branches could result in a loss of policyholder protection. However, while localising assets is one way of increasing safety and soundness and policyholder protection, the PRA acknowledges that localisation requirements no longer ensure, in practice, that the assets will be available to pay branch policyholder claims in the modern global financial system and the PRA is considering whether additional measures are needed for appropriate protection for branch policyholders. Further changes to the PRA's rules may be made in the second stage of implementation once the EIOPA guidelines are published.

9.25 Although these impacts may be significant for some branches, the PRA considers the proposed rules changes to be proportionate to the benefits that are expected to result. The PRA expects the proposed rules to ensure that third country branches operate to standards that give branch policyholders an equivalent level of protection to policyholders of an EEA-headquartered undertaking. The proposed rules will ensure that the PRA has the necessary information to effectively monitor third country insurance branches and to protect policyholders in the event of winding-up. Further, by providing at the level of the branch a regime that is equivalent to that for an EEA headquartered undertaking, the PRA expects to reduce the incentive for regulatory arbitrage. Reducing incentives for regulatory arbitrage facilitates more effective competition as branches and subsidiaries will be able to compete on a more equal basis.

10 Surplus funds

Article 91

10.1 This chapter sets out feedback on responses to CP12/13 regarding the treatment of surplus funds as they apply to with-profits business. The PRA has made changes to the proposed rules in light of feedback received and further policy consideration. This chapter also serves to consult on these rule changes.

10.2 The FSA had consulted on rules for firms to calculate approved surplus funds. The rules specified the basis for determining amounts which have not been made available for distribution to policyholders, and were intended to constitute the relevant national law for the purposes of Article 91 of the Directive. Under that Article, provided they meet the criteria as set out in Article 94(1) of the Directive, these amounts would count as Tier 1 own funds, rather than as insurance liabilities.

10.3 The proposal was based on the calculation of asset shares for with-profits policies, with appropriate adjustments to recognise the cost of, among other things, guarantees, options, and smoothing. An alternative approach based on a prospective calculation was proposed in cases where an asset share approach is not appropriate.

10.4 To count as own funds, approved surplus funds calculated using the prescribed approach would also need to satisfy the criteria for the classification of Tier 1 own funds. The FSA also proposed to introduce guidance clarifying the requirements regarding classification of approved surplus funds and any restrictions and ring-fencing adjustments that may apply.

10.5 The proposed rule changes are explained below and set out in the rules in Appendix 1.9. A draft supervisory statement is included in Appendix 2.11.

Responses to CP12/13

10.6 Several respondents interpreted the calculation of surplus funds as optional, given that SOLPRU 2.4.7 stated that firms 'may' exclude any approved surplus funds from the technical provisions, and SOLPRU 2.2.24G(2) used the phrase 'not required to include', rather than 'required not to include'. Many respondents commented that they would favour optionality because a closed fund may wish to have all its liabilities treated as technical provisions in order to reduce the capital requirements for calculating its SCR.

10.7 A respondent commented that the calculation rules rely more on INSPRU rather than Solvency II terminology. Another queried whether the calculation of surplus funds includes planned enhancements, while another questioned the treatment of future shareholder transfers. The question of whether the rules properly took into account the need to hold a risk margin was raised by another respondent.

10.8 Some respondents welcomed the proposals to issue rules prescribing the determination and treatment of surplus funds. They recognised surplus funds as an appropriate way of ensuring that undistributed surplus and working capital were Tier 1 own funds, and available to meet capital requirements. In contrast, some respondents expressed confusion over the use of the terms 'with-profits fund surplus' and 'approved surplus funds', with different meanings.

Proposals

10.9 The PRA has considered these responses and is proposing a number of changes to the draft rules on surplus funds included in CP12/13. These proposed rules reflect both the PRA's response to feedback and changes as a result of the move to the PRA Policy Framework.

10.10 The PRA proposes to drop 'approved' from the title of surplus funds, as these funds are not approved by the PRA and the PRA considers that the inclusion of 'approved' does little to aid comprehension of this topic.

10.11 In CP12/13 the FSA did not intend for the calculation of surplus funds to be optional. Similarly, the PRA intends for the calculation to be mandatory for all life insurance firms which engage in with-profits business, and the amended rules make this clear. The surplus funds calculation should not prevent those firms from making fair distributions to policyholders while meeting prudential capital requirements. The PRA does not support firms having a choice regarding the calculation of surplus funds, because it would introduce the possibility of inconsistent presentation of capital resources and capital requirements, which would hinder comparisons between firms and across the industry.

10.12 The PRA has amended the rules on the calculation of surplus funds to use terminology more consistent with Solvency II and to enhance clarity, which is consistent with the PRA's policy framework. The amended rules do not signal a change in policy intent. The drafting of the rules now recognises that not all firms use an asset share methodology for calculating with-profits liabilities. Instead, the rules now make reference to 'retrospective calculation' rather than asset shares, and the 'adjustments' to asset shares previously referred to in SOLPRU 2.4.23R are now referred to as 'future policy-related liabilities'.

10.13 In addition, within the draft instrument, the PRA does not use the term 'planned enhancements'. In CP12/13 the FSA suggested that surplus funds might include some part of planned enhancements, in a manner consistent with how this term has been understood in the current regime. However, as surplus funds are amounts that have not been made available for distribution, the term 'planned enhancements' may create confusion regarding how enhancements can be 'planned' without making such funds available for distribution. Some amounts which firms currently describe as planned enhancements include amounts which the firm is legally obliged to distribute to policyholders. Other amounts which some firms are currently describing as planned enhancements are amounts which firms plan to distribute to policyholders but which may be cancelled if needed to absorb losses, and thus are more consistent with future discretionary benefits. In both cases, such amounts would fall within the scope of technical provisions under Solvency II. The PRA has consulted with the FCA on this point, and the FCA will make consequential amendments to its rules, removing references to planned enhancements to ensure consistency between the PRA and FCA rules.

10.14 The PRA has also clarified in its proposed rules the original intent of the FSA in CP12/13 that future shareholder transfers arising from future discretionary benefits should not form part of surplus funds.

10.15 Regarding questions on the treatment of the risk margin, the PRA considers that the risk margin component of Solvency II technical provisions does not form part of the determination of surplus funds. This position is consistent with the FSA's policy intent in CP12/13. The surplus funds calculation identifies amounts within a with-profits fund that under PRA rules should not be considered as policyholder liabilities for the purposes of determining technical provisions. This is separate from, and does not affect, the requirement for firms to calculate and recognise a risk margin as an element of technical provisions as required by Solvency II.

10.16 In regards to potential confusion over terms relating to 'surplus' but with different meanings, the definition of surplus funds has been clarified as described above. The PRA recognises that the changes to with-profits rules consulted on in CP12/13 were wide ranging and the context for different terminology is important for meaning. With regard to surplus funds the context is that of national law, specifying those amounts which should not form part of policyholder liabilities in the best estimate element of technical provisions.

Cost benefit analysis

10.17 CP12/13 included a cost benefit analysis of the draft rules on surplus funds included within that consultation. Compared with the surplus funds rules consulted on in CP12/13, removal of the concept of planned enhancements will lead to benefits in respect of clearer rules, as the treatment of planned enhancements was a source of confusion. In general, the current treatment of planned enhancements is not consistent between firms. Removing this concept will align the approach taken by firms, thereby facilitating effective competition and permitting comparisons between firms and across the industry. This will also help to ensure that the national-specific UK with-profits regime is compatible with Solvency II.

10.18 The PRA does not expect the removal of the concept of planned enhancements to result in additional compliance costs for firms. The main cost expected to arise from this change is that firms will need to re-classify this portion of their with-profits liabilities as either guaranteed benefits or future discretionary benefits. However, firms will already need to do this for the purposes of Solvency II reporting.

10.19 All other amendments give rise to no additional costs and benefits as they aim to clarify rather than change policy intent.

11 Cancellation of dividends on ordinary shares

Articles 94(1) and (2)

11.1 This chapter explains how the PRA intends to implement the expected Solvency II provisions relating to the cancellation of distributions on ordinary share capital as a pre-requisite for the classification of that capital as Tier 1 own funds. In certain cases some ordinary share capital may need to be assessed against the features determining classification as Tier 2 basic own funds(1) in which case the relevant provisions require the deferral of distributions. The paragraphs below include references to Tier 2 and deferral in brackets in the case these provisions are applicable.

11.2 The explanations in this chapter also apply to capital of the equivalent quality for mutuals. While the rest of the chapter refers only to ordinary share capital the PRA's implementation also applies, with the necessary modifications, to capital of the equivalent quality for mutuals.

11.3 The PRA expects the Solvency II Regulations to provide that either national legislation or the legal and contractual terms governing the ordinary shares must allow for cancellation (or deferral) of distributions on breach or potential breach of the SCR. The PRA proposes to address this issue by introducing rules and a supervisory statement setting out its expectations.

11.4 The proposed rules are explained below and are set out in the rules in Appendix 1.4; the Own Funds draft supervisory statement is in Appendix 2.2. The PRA is adopting this approach in order to provide clarity as to the manner in which firms can demonstrate, when classifying their own fund items, that ordinary share capital can qualify as Tier 1 (or Tier 2) own funds.

11.5 The rule provides that firms cannot classify ordinary shares as Tier 1 or Tier 2 capital as applicable unless the firm has the right to cancel (or, for Tier 2, to defer) dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the Solvency II Regulations. The PRA anticipates that firms will either declare distributions on a conditional basis, and (where necessary) that firms will amend their articles of association to include a specific power for the firm to declare dividends subject to conditions or even for all declarations of dividend to be conditional.

Cost benefit analysis

11.6 For the purposes of cost benefit analysis, the baseline for the proposed rules this chapter introduces are the rules consulted on in CP11/22. The introduction of rules requiring firms to have the right to cancel (or defer) dividends and exercise that right at any time in the circumstances specified in the Solvency II Regulations represents the main change.

11.7 The incremental costs may include:

- the cost of reviewing articles of association to ensure that they do not prohibit the cancellation of a dividend at any time; and
- the cost of amending articles of association.

The PRA anticipates these incremental costs would be minimal.

11.8 The principal benefit of the rule is to ensure that firms' capital is more likely to meet the main criteria for the classification of basic own fund items into tiers, as provided for in Article 94 of the Directive and in the anticipated Solvency II Regulations. Without the rule, a significant proportion of firms may find that a major item of capital does not meet the criteria for Tier 1 (or Tier 2 basic as applicable) own funds.

11.9 The PRA does not expect the proposal to result in costs and benefits for mutual firms that are different to those for other firms. The proposed rule would apply to all firms equally and is therefore anticipated to be consistent with the PRA's competition objective.

(1) Where the ordinary shares do not possess other features necessary for Tier 1.

12 Reporting — national specific templates

12.1 This chapter sets out the PRA's proposal for a set of reporting templates to address those areas which stem from specific national requirements or specificities of local markets, which are otherwise not addressed in the set of Solvency II harmonised templates. The proposed templates will ensure that the PRA receives quantitative data that is essential for effective supervision of UK firms after the implementation of Solvency II. The PRA believes that good information is important for effective supervision.

12.2 The templates described in this section apply to solo firms only and are dependent on the finalisation of the Solvency II Regulations. Any changes in the final published versions of the harmonised templates that differ from the PRA's current understanding may necessitate a change to the set of national specific templates. This may extend to the exclusion of templates included here, if the information is addressed by the final harmonised templates, as well as the inclusion of new templates where information is not covered in the final harmonised templates.

12.3 The PRA may consult on further national specific templates in future, if deemed necessary.

General approach to national specific templates

12.4 The PRA has reviewed the need for additional data requirements in conjunction with its approach to insurance supervision. The templates are intended to be proportionate, taking into account the burden on firms and the effective use of the PRA's own resources. All templates will be collected annually to minimise the burden on firms, and the same submission deadlines as those for the annual reporting templates, as set out in the Directive, are expected. The PRA proposes to collect the national specific templates via the same system which will be implemented to collect the harmonised templates. The proposed format for the national specific templates is an Excel spreadsheet. This approach will ensure that any incremental costs over and above those associated with the wider changes for Solvency II reporting are of minimal significance.

12.5 The templates should be completed in accordance with the LOG files. The LOG files include the definition of the data items to be reported and instructions on how to complete the templates. The draft templates and accompanying LOG files are provided in Appendix 3.1.

12.6 The data in all templates should be submitted in the pounds sterling (£) format unless otherwise instructed by the relevant LOG file. All national specific templates should be submitted to the PRA in electronic format via Excel files. Any future changes to the format of collection for the national specific templates will be consulted on prior to their implementation.

Scope of national specific templates

12.7 In accordance with its risk based approach to supervision, the PRA has also considered the potential risks arising out of a failure to collect this data. The PRA's consideration of these risks has influenced the scoping of the proposed national specific templates.

12.8 Some templates seek to capture information where legislative requirements have resulted in a market specific to the United Kingdom. This includes employers' liability business (required by the Employers' Liability (Compulsory Insurance) Act 1969 and various related regulations) and bodily injury claims which UK courts can order to be settled by periodic payments (periodic payment order (PPO) claims). The PRA proposes to capture this information in template NS.10 which contains best-estimate future cash flow projections for employers' liability business; large bodily injury claims (which have the potential to be settled by PPO) and very long tail claims (such as latent diseases).

12.9 The United Kingdom also has legislative requirements specific to the regulation of with-profits business. These requirements relate to NS.01 with-profits value of bonus and NS.02 with-profits assets and liabilities.

12.10 Some templates seek to capture information where the firms have a non-standard capital structure which is specific to or significantly concentrated in the United Kingdom. This includes protection and indemnity (P&I) clubs, where there are some types of information required in the supervision of these firms that will not be collected through the harmonised templates. The information collected will be of benefit for the following reasons:

- information on the accounting for significant pooling arrangements will allow the identification of the performance of a pool member's own business and the effect of risk transfer to and from the pool; and

- enable the PRA to identify changes in call patterns that mask profitability.

This relates to NS.03 Pools and NS.04 Assessable Mutuals.

12.11 Some templates seek to capture important information to support the PRA's approach to supervision by requesting information on revenue account and business model analysis data. Current revenue account information for life firms is collected on a UK GAAP basis in NS.05 Revenue Account (Life).

12.12 Templates NS.06 Business Model Analysis (Life) and NS.07 Business Model Analysis (Non-life) will collect forward-looking data for the current year and a projection for three years from the current reporting year against Solvency II lines of business. The PRA believes that three years is consistent with the planning horizon of the majority of firms.

12.13 The NS.08 Business Model Analysis — Financial Guarantee Insurers template seeks to capture information from financial guarantee insurers. A significant number of these firms exist in the UK market and therefore, given the specialist nature of these firms, the PRA proposes to collect information in this area in order to support the supervision of the relevant firms.

12.14 In addition, the PRA proposes a template to collect information on life best-estimate assumptions in order to give an indication of changes in the valuation basis; how the basis compares with experience; and the variability of the firms' recent experience.

12.15 For specific non-life sub-classes where the long duration of the claim run-off make the best estimate particularly uncertain, the PRA proposes template NS.11 Non-Life Insurance Claims Information (General Liability sub-classes) to support the ongoing supervision of the appropriateness of the best estimate. Collecting this more granular data will be of benefit to the PRA's supervision by facilitating the analysis of data where the risk of inadequate claims provision is most material.

Cost benefit analysis

12.16 The national specific templates contribute to the effective implementation of Solvency II overall, allowing the United Kingdom to adopt a standardised, Europe-wide regime while allowing for specificities in its own market.

12.17 The information collected by the national specific templates will allow the PRA to conduct supervision in line with its objectives by requiring data that would not be received otherwise in the harmonised templates. Further details of the benefits associated with the templates are included in the section above.

12.18 While the national specific templates represent further reporting in addition to a large set of harmonised reporting templates, they are not expected to impose material one-off or ongoing incremental costs on firms. This is because in most cases the information required is already produced and used by firms for other purposes. Where this is not the case, the PRA has designed the proposals in order to ensure that any costs associated with the collection, preparation and submission of the required information are likely to be minimal. Examples of information which is already produced and used by firms for other purposes include:

- performance data which would be used within the firm for business planning purposes;

- forward-looking information, including capital projections, which will be produced by the firm for its ORSA;

- existing returns;

- EIOPA harmonised templates; and

- *ad hoc* requests for information

The PRA expects that where a national specific template is developed from *ad hoc* requests, this data will no longer be required through separate *ad hoc* information requests.

12.19 **Table A** demonstrates for each template why the PRA believes the incremental compliance costs, both one-off and ongoing, are expected to be of minimal materiality and sets out for each template where the information is otherwise collected.

12.20 The PRA believes that the proposed national specific template requirements will have no material impact on competition as it expects that the proposals will not impose material compliance costs on firms. One of the national specific templates, NS.04 Assessable Mutuals, applies only to mutuals. The PRA does not anticipate any different impact on mutuals in terms of the preparation, completion and submission of the data required for the national specific templates.

Table A National specific templates

Number	Template name	
NS.01	With-profits value of bonus	The information requested in this template is largely consistent with the information collected for each ring-fenced fund in Form 58 of the current PRA annual returns.
NS.02	With-profits assets and liabilities	Some information in this template is collected through current PRA annual returns, including the information collected for each ring-fenced fund in Form 19 and the investment return numbers from Form 48.
NS.03	Pools	Some pooling information is currently collected by the PRA through pool accounts and in separate *ad hoc* collections where required.
NS.04	Assessable Mutuals	This information is currently collected by the PRA in annual returns and P&I club accounts.
NS.05	Revenue account (Life)	This template requires UK GAAP revenue account information, and it is expected that this information forms part of the firms' own record keeping and reporting.
NS.06	Business model analysis (Life)	The PRA believes that most of this information will be produced as part of a firm's ORSA and that the forward looking horizon is consistent with a firm's business planning.
NS.07	Business model analysis (Non-Life)	This type of data is currently collected as part of *ad hoc* requests from supervisors, either as regular information or as part of strategy and business model analysis reviews. Some information is also currently collected through Form 22 of the PRA annual returns and should also be produced as part of the firm's ORSA. The PRA believes that the forward-looking horizon is consistent with firms' business planning.
NS.08	Business Model Analysis — financial guarantee insurers	Some of this information is currently collected in the financial guarantee insurer 'benchmarker' template, and other elements of this template are collected on an *ad hoc* basis.
NS.09	Best-estimate assumptions for life insurance risks	Best estimate assumptions will be produced by the firm as a requirement of Solvency II.
NS.10	Projection of future cash flows (best-estimate — non-life: sub-classes)	This template is based on the equivalent general liability EIOPA harmonised template.
NS.11	Non-life insurance claims information (general liability sub-classes)	This information is currently received on an *ad hoc* basis from relevant firms and is based on the equivalent EIOPA harmonised template.

Section III:
Responses to feedback on CP12/13

13 Approach to Lloyd's

13.1 Feedback was received on proposals for applying the Solvency II regime to the Lloyd's market. There have been no subsequent changes to the policy consulted on in CP12/13.

13.2 In general, respondents were in favour of the manner in which the PRA proposed to apply these various requirements to the Society of Lloyd's or managing agents (syndicate level) or both.

13.3 Respondents focused on the question of whether, and if so how, the existing requirement in respect of the provision of statements of actuarial opinion (SAO) should be replaced.

13.4 The majority of respondents felt that the responsibility for obtaining a SAO at syndicate level should rest with the Society of Lloyd's. They recommended that there should be a rule specifying a requirement for the Society to operate an appropriate process to satisfy itself as to the accuracy of syndicate technical provisions.

13.5 The PRA has considered whether responsibility should rest with the Society in the manner suggested by respondents and has decided to retain its current approach. This is to ensure that the PRA has a full range of tools to deploy in its supervision of managing agents. Therefore, the PRA will maintain a rule which requires the actuarial function of each managing agent carrying out general insurance business to review and provide an SAO to both the managing agent and the Society of Lloyd's regarding the technical provisions held in respect of each syndicate.

13.6 The PRA will also retain its general power to request a copy of the SAO from managing agents or from the Society of Lloyd's.

13.7 As the PRA is retaining its existing approach with regard to the provision of SAO it does not consider there to be any changes to the costs or benefits resulting from the proposed rules.

13.8 The PRA considers that the clarification regarding the treatment of the Society of Lloyd's as a mixed-activity insurance holding company does not change the costs or benefits resulting from the proposed rules compared to that contemplated in CP11/22 and CP12/13 as it does not imply any change in supervisory approach.

14 Public disclosure of capital add-ons and undertaking specific parameters

14.1 CP12/13 set out the proposed approach to requiring public disclosure of the application of capital add-ons and the use of undertaking specific parameters (USPs).

14.2 Feedback was received from several respondents on the proposal to exercise the option of non-separate disclosure of any capital add-ons or the required use of USPs, as contemplated in Article 51(2), by providing firms with a transitional period of non-disclosure.

14.3 A slight majority of respondents were in favour of the United Kingdom applying the option over the maximum period allowed for under Article 51(2), namely five years, rather than the two years proposed, on the grounds that any lesser period would place the UK industry at a competitive disadvantage with other Member States.

14.4 The PRA acknowledges that there are reasonable arguments both for a two-year or the full five-year transitional period. However it is the PRA's judgement that the original position of allowing a two-year transitional should be retained.

14.5 The PRA believes that, in general, there should not be material competition issues arising from its proposed rules. In international markets in particular (typically commercial and reinsurance business) buyers tend to be more sophisticated than retail buyers and can trade off price and risk (as revealed by capital add-ons), mitigating some of the effect caused by regulators applying different approaches internationally to disclosure during the five year period.

14.6 The PRA recognises that non-disclosure may, however, carry with it associated costs from a general risk premium imposed by investors and brokers/consumers on all firms, since some information is being withheld. The PRA believes there are significant benefits of having a two-year transitional period, as opposed to a five-year transitional period. In particular, these benefits include:

- providing clearer signals to the market concerning the level of a firm's regulatory capital requirements; and
- providing firms greater incentives to address the deficiencies in risk management, governance or culture that could generate a capital add-on, rather than accepting a capital charge.

The PRA has therefore decided that a two-year transitional period is needed.

Section IV:
Economic analysis

15 Economic analysis

15.1 This cost benefit analysis is an assessment of the differences between the position if the proposed rules are made and the position if they were not. The baseline for this CBA includes the set of rules as consulted in CP11/22 and CP12/13.

15.2 The CBA relates to the proposed rules in the appendices that are required to implement the Directive, and are expected to have a large impact relative to the baseline, namely the proposed introduction of the LTG package contained in OMD II.

15.3 The economic impact of proposed rule changes to transpose the Directive will depend to some extent on how those rules are supplemented with directly applying Solvency II Regulations, once adopted by European authorities.

Affected firms and markets

15.4 OMD II amends certain provisions within Solvency II, which sets prudential requirements for around 400–450 retail and wholesale insurance firms in the United Kingdom. These include insurance and reinsurance undertakings. It does not include firms below the threshold defined in Article 4 of Directive 2009/138/EC and CP11/22 pages 12–13.

15.5 Given that CP11/22 and CP12/13 analysed in detail the quantitative impact of Solvency II on the insurance market, this analysis focuses on the changes introduced by OMD II, which affect in particular the UK life insurance market. The impact on the general insurance market is estimated to be minimal, but where there are significant changes, these are considered in the analysis below.

Baseline for calculation

15.6 In early 2013, EIOPA undertook the Long-Term Guarantees Assessment (LTGA) to investigate the impact of various possible permutations of the LTG package.

15.7 The UK life insurance market exhibits a degree of concentration. The firms that submitted data for the LTGA exercise accounted for around 38% market share of the whole UK life insurance market and around 65% market share of UK life firms for which the LTG package was, at this point, envisaged to be relevant.[1]

15.8 It is possible to approximate the impact on the market of the LTG package by using the results of the LTGA exercise and exercising judgement to estimate the likely difference in impact of the measures tested for the LTGA exercise and the ones in OMD II.

15.9 The impact of the LTG measures on a given firm's technical provisions, SCR and overall solvency position are highly dependent on:

- the nature of the firm's assets and liabilities;
- the outcome of the relevant prior supervisory approval processes;
- whether the firm calculates its SCR using an approved internal model; and
- the calculation details underlying the measures, and the input parameters, both of which are still to be published.

The uncertainty in the following analysis is thus very significant.

15.10 As a consequence, this analysis has been conducted on the basis of the high-level principles set out in OMD II. The output is preliminary and will be supplemented and quantified with greater confidence once the relevant Solvency II Regulations are adopted.

Incremental benefits, compared to the baseline

15.11 At the point of CP11/22, it was envisaged that Solvency II would increase required financial resources for insurers, as a consequence of the move from a gone to a going concern regime.[2][3] Although the Solvency II regime would have been broadly neutral for most business types, long-term insurance providers would have been affected in a more significant manner.

(1) See EIOPA's Technical Findings on the Long-Term Guarantee Assessment, page 28. https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/QIS/Preparatory_forthcoming_assessments/final/outcome/EIOPA_LTGA_Report_14_June_2013_01.pdf.
(2) Directive 2009/138/EC.
(3) See page 68 of CP11/22, chapter on Key messages from Section IV on Cost Benefit Analysis.

15.12 During the LTGA, although the change in capital surplus stemming from the introduction of the volatility adjustment was broadly neutral, the change driven by the introduction of the matching adjustment removed the need to raise additional capital (at an aggregate level) and mitigated between 50% and 60% of the shortfall in capital resources compared to the current regime.

15.13 The subsequent changes introduced within OMD II on the mechanism and design of the matching adjustment (eg the change of the cap of 75% of long-term average spread to 35%) should further mitigate the impact of the introduction of Solvency II on capital resources by another 20% to 30%.

15.14 It is estimated that following the redesign of the measures as per OMD II, and allowing for other factors, such as the approval of internal models, the change of capital on the life insurance sector induced by the introduction of Solvency II should be broadly neutral, compared to the PRA's current ICAS regime. The LTG measures are expected to absorb most of the capital compliance costs identified during the CBA for CP11/22.

15.15 The benefits of OMD II accrue largely from the increase in available capital resources within the life sector that occurs as a result of the LTG measures, such as the matching adjustment (only the measures covered in this current consultation are subject to the CBA). The PRA considers that where this reflects the beneficial liquidity risk management effects of closely matching assets and liabilities, then regulatory capital will be better aligned with economic capital, and will contribute to insurance companies with long-term liabilities being able to withstand short-term volatility in financial markets.

15.16 Given supervisory powers under Solvency II and the effect of market discipline on capital resources, the PRA does not expect the current level of capital resources to be reduced. As a result, the PRA does not expect that the capital measures in the LTG package will reduce policyholder protection.

Incremental costs compared to the baseline

15.17 The original administration cost of implementing Solvency II was estimated as significant for the industry.(1)

15.18 The costs to the UK economy of introducing OMD II arise largely as insurance companies adjust their balance sheets, if relevant rebalance their investments, and adapt risk management and governance systems to comply with the requirements of OMD II. As explained in the individual chapters covering the matching adjustment, volatility adjustment and risk management the PRA expects incremental administrative compliance costs to be of minimal significance.

15.19 The PRA expects that some firms may seek to re-balance their existing asset portfolios in order to maximise the benefit obtained from the matching adjustment, and the volatility adjustment. It is difficult to estimate the extent of these portfolio effects, as applications are required to be reviewed on a case-by-case basis by supervisory authorities, and firms may reallocate assets internally to avoid trading costs.

15.20 The PRA does not expect material impacts on competition arising from the matching adjustment and volatility adjustment, as the Directive allows firms to invest in different ways when designing their matching portfolios and hence they can adopt differing pricing strategies and product designs.

(1) See page 68 of CP1, chapter on Key message from Section IV on Cost Benefit Analysis.

Appendices

Appendix 1: PRA Rulebook

1.1 PRA Rulebook — General Application

1.2 PRA Rulebook — Valuation

1.3 PRA Rulebook — Technical Provisions

1.4 PRA Rulebook — Own funds

1.5 PRA Rulebook — Solvency Capital Requirement – General Provisions

1.6 PRA Rulebook — Solvency Capital Requirement – Standard Formula

1.7 PRA Rulebook — Solvency Capital Requirement – Internal Models

1.8 PRA Rulebook — Minimum Capital Requirement

1.9 PRA Rulebook — Undertakings in difficulty

1.10 PRA Rulebook — Investments

1.11 PRA Rulebook — Composites

1.12 PRA Rulebook — Conditions governing business

1.13 PRA Rulebook — ISPVs

1.14 PRA Rulebook — Group Supervision

1.15 PRA Rulebook — Reporting

1.16 PRA Rulebook — Lloyd's

1.17 PRA Rulebook — Third County Branch Undertakings

1.18 PRA Rulebook — Transitional Measures

1.19 PRA Rulebook — Surplus Funds

1.20 PRA Rulebook — Glossary

Appendix 2: Supervisory Statements

2.1 Supervisory Statement — General application

2.2 Supervisory Statement — Own funds

2.3 Supervisory Statement — Solvency Capital Requirement

2.4 Supervisory Statement — Minimum Capital Requirement

2.5 Supervisory Statement — Supervision of firms in difficulty or run-off

2.6 Supervisory Statement — Composites

2.7 Supervisory Statement — Conditions governing business

2.8 Supervisory Statement — Group Supervision

2.9 Supervisory Statement — Reporting

2.10 Supervisory Statement — Lloyd's

2.11 Supervisory Statement — Surplus funds

2.12 Supervisory Statement — Third country branch undertakings

Appendix 3: National Specific Templates and Log Files

3.1 National Specific Templates and LOG Files

PRA RULEBOOK: SOLVENCY II FIRMS: GENERAL APPLICATION INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: General Application Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: General Application Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

GENERAL APPLICATION

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) the *Society*; and

(3) *managing agents*.

1.2 In this Part, the following definitions shall apply:

ancillary risk

(1) subject to (2), means (in relation to an *insurer* with *Part 4A permission* to insure a principal risk belonging to one *class* of *general insurance business*) a risk included in another such *class* which is:

(a) connected with the principal risk,

(b) concerned with the object which is covered against the principal risk, and

(c) the subject of the same contract insuring the principal risk.

(2) the risks included in *classes* 14, 15 and 17 may not be treated as risks ancillary to other *classes*, except that the risk included in *class* 17 may be regarded as an ancillary risk of *class* 18 where:

(a) the conditions laid down in (1)(a) to (1)(c) are fulfilled, and

(b) the principal risk relates solely to *assistance* provided for persons who fall into difficulties while travelling, while away from home or while away from their permanent residence or where it concerns disputes or risks arising out of, or in connection with, the use of sea going vessels.

[Note: Art. 16 of the *Solvency II Directive*]

assistance

means the *class* of *contract of insurance*, specified in paragraph 18 of Part I of Schedule 1 to the *Regulated Activities Order*.

non-Solvency I firm

means a firm that immediately before the *Solvency II implementation date* fell outside the scope of *Solvency I Directive*.

requirement

means a requirement or limitation included in a *firm's Part 4A permission* under section 55F(4) of *FSMA* (Giving permission: the PRA), section 55L(3) of *FSMA* (Imposition of requirements by the FCA), section 55M(3) of *FSMA* (Imposition of

Requirements by the PRA) or section 55O of *FSMA* (Imposition of requirements on acquisition of control).

Solvency I Directive

means each of:

(1) the *Consolidated Life Directive*;

(2) the *First Non-Life Directive*;

(3) the *Second Non-Life Directive*;

(4) the *Third Non-Life Directive*; and

(5) the *Reinsurance Directive.*

Solvency I firm

means a *firm* that immediately before the *Solvency II implementation date* was an *insurer* that fell within the scope of *Solvency I Directive*.

Solvency II excluded operations

means:

(1) a *mutual* whose *insurance business* is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat- rate basis; or

(2) a *mutual* whose liabilities in respect of *contracts of general insurance* must be fully reinsured with or guaranteed by other *mutuals* (including *friendly societies*) and the *mutuals* providing the *reinsurance* or the guarantees are *Solvency II undertakings.*

Solvency II implementation date

means 1 January 2016.

syndicate liabilities

means liabilities managed by a *managing agent* in respect of *insurance business* carried on through a *syndicate*.

2 UK SOLVENCY II FIRM

2.1 A *UK Solvency II firm* means a *firm*:

(1) that satisfies the conditions set out in 2.2, or

(2) whose *Part 4A permission* includes a *requirement* that it comply with the Solvency II Firms Sector.

2.2 The conditions referred to in 2.1 are, subject to the exclusions in 2.3 – 2.6:

(1) the *firm* is an *insurer*;

(2) the *firm* has its head office is in the *United Kingdom*;

(3) the *firm's Part 4A permission* does not include a *requirement* that it must only carry on *Solvency II excluded operations*;

(4) if it is a *Solvency I firm,* the *firm* is not excluded pursuant to 2.6;

(5) if it is a *non-Solvency I firm,* the *firm* is not excluded pursuant to:

(a) 2.3 on the *Solvency II implementation date*; or

(b) 2.6;

(6) if it obtains its *Part 4A permission* to *effect contracts of insurance* and/or *carry out contracts of insurance* on or after *Solvency II implementation date*, the *firm* is not excluded pursuant to:

(a) 2.3 on the date it obtains such *Part 4A permission*; or

(b) 2.6; and

(7) the *firm* is not a *pure reinsurer* which ceased to conduct new *reinsurance contracts* before 10 December 2007.

[Note: Arts. 2(1), 4(1),(3), (4), 5(2), 7, 9(1),(2), 12(1) of the *Solvency II Directive*]

2.3 A *firm* of the kind mentioned in 2.2(5) or 2.2(6) is excluded if it fulfils all of the following conditions:

(1) the *firm's* annual gross written premium income does not exceed 5,000,000 euro;

(2) the total of the *firm's technical provisions*, gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*, as referred to in Technical Provisions 2.1 – 2.3 does not exceed 25,000,000 euro;

(3) where the *firm* belongs to a *group*, the total of the *technical provisions* of the *group* defined as gross of the amounts recoverable from *reinsurance contracts* and *ISPVs* does not exceed 25,000,000 euro;

(4) the business of the *firm* does not include insurance or *reinsurance* activities covering liability, credit and suretyship insurance risks, unless they constitute *ancillary risks*;

(5) the business of the *firm* does not include *reinsurance* operations:

(a) exceeding:

(i) 500,000 euro of its gross written premium income; or

(ii) 2,500,000 euro of its *technical provisions* gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*; or

(b) with more than 10% of its gross written premium income or more than 10% of its *technical provisions* gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*.

[Note: Art. 4(1) of the *Solvency II Directive*]

2.4 A *firm* excluded under 2.3 shall cease to be excluded under that rule from the fourth year if any of the amounts set out in 2.3(1), (2), (3) or (5) are exceeded in each of the three preceding years.

[Note: Art. 4(2) of the *Solvency II Directive*]

2.5 A *firm* of the kind mentioned in 2.2(6) is not excluded under 2.3 if any of the amounts set out in 2.3(1), (2), (3) or (5) are expected to be exceeded within five years of the date the *firm* obtained its *Part 4A permission* to *effect contracts of insurance* and/or *carry out contracts of insurance*.

[Note: Art. 4(3) of the *Solvency II Directive*]

2.6 Subject to 2.4, a *firm* of the kind mentioned in 2.2(4), (5) or (6) is excluded if:

(1) the *firm* is not exercising *EEA rights* under the *Solvency II Directive*;

(2) none of the thresholds set out in 2.3:

(a) have been exceeded for three consecutive years; and

(b) are expected to be exceeded during the following five years.

[Note: Art. 4(4) of the *Solvency II Directive*]

3 LLOYD'S

3.1 Where a provision in the Solvency II Firms Sector is expressed to apply to the *Society* "in accordance with" this Chapter, the *Society* must:

(1) manage each *member's funds at Lloyd's*;

(2) carry out any applicable calculations in respect of each *member's funds at Lloyd's*;

(3) manage its *central assets* and *central liabilities*;

(4) where the context requires, supervise the *insurance business* carried on by each *member* at Lloyd's; and

(5) take such further steps as may be required,

in order to achieve, in relation to those assets and liabilities and that *insurance business*, the same effect as the relevant Solvency II Firms Sector provision would have (that is, conforming with the requirements of any *rule*) when applied to a *firm* or to the *insurance business* of a *firm*.

3.2 Where a provision in the Solvency II Firms Sector is expressed to apply to a *managing agent* "in accordance with" this Chapter, the *managing agent* must, in relation to each *syndicate* managed by it and for each *syndicate* year:

(1) manage the *syndicate assets* and *syndicate liabilities*;

(2) manage the *insurance business* carried on by the *members* of the *syndicate* through that *syndicate*; and

(3) take such further steps as may be required,

in order to achieve, in relation to those *syndicate assets* and *syndicate liabilities* and that *insurance business*, the same effect as the relevant Solvency II Firms Sector provision would have (that is, conforming with the requirements of any *rule*) when applied to a *firm* or to the *insurance business* of a *firm*.

4 INTERPRETATION

4.1 Where a provision in the Solvency II Firms Sector makes reference to amounts in euro, the exchange rate from the euro to the pound sterling for each year with effect from 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all of the EU member states were published in the Official Journal of the European Union.

[Note: Art. 299 of the *Solvency II Directive*]

4.2 Where a provision in the Solvency II Firms Sector makes reference to amounts in euro a *firm* must interpret those amounts as being succeeded by any such amounts published in the Official Journal of the European Union reflecting the percentage change in the Harmonised Indices of Consumer Prices (comprising all EU member states, as published by Eurostat) starting from 31 December 2015 until the date of revision and rounded up to a multiple of 100,000 euro, provided that where the percentage change since the previous revision is less than 5% the amounts will not be revised.

[Note: Art. 300 of the *Solvency II Directive*]

PRA RULEBOOK: SOLVENCY II FIRMS: VALUATION INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Valuation Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Valuation Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

VALUATION

Chapter content

Links

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*; and

(3) in accordance with General Application 3, *managing agents*.

2 VALUATION OF ASSETS AND LIABILITIES

2.1 A *firm* must, except where otherwise provided, value:

(1) assets at the amount for which they could be exchanged between knowledgeable willing parties in an arms' length transaction; and

(2) liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arms' length transaction.

[Note: Art. 75(1) of the *Solvency II Directive*]

2.2 For the purposes of 2.1(2) when valuing liabilities no adjustment must be made to take account of the own credit standing of the *firm*.

[Note: Art. 75(1) of the *Solvency II Directive*]

PRA RULEBOOK: SOLVENCY II FIRMS: TECHNICAL PROVISIONS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Technical Provisions Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Technical Provisions Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

TECHNICAL PROVISIONS

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*, as modified by 12; and

(3) in accordance with General Application 3, *managing agents*, as modified by 12.

1.2 In this Part, the following definition shall apply:

basic relevant risk-free interest rate term structure

means the *relevant risk-free interest rate term structure* without:

(1) a *matching adjustment*;

(2) a *volatility adjustment*; or

(3) a *risk-free interest rate transitional measure*.

Community co-insurance operation

means a co-insurance operation which relates to one or more risks classified under *general insurance business classes* 3 to 16 and which fulfils the conditions set out in Article 190(1) (a) to (f) of the *Solvency II Directive*.

cost-of-capital rate

means the rate (above the relevant risk-free interest rate) that must be used in the determination of the cost that a *Solvency II undertaking* would incur in order to hold an amount of *eligible own funds* equal to the *SCR* necessary to support the insurance and *reinsurance* obligations over their lifetime, as specified in the *Solvency II Regulations* adopted under Article 86 of the *Solvency II Directive.*

leading insurer

means (in relation to a *Community co-insurance operation*) a *co-insurer* that assumes the leader's role in co-insurance practice and in particular determines the terms and conditions of insurance and rating.

relevant insurer

means (in relation to a *Community co-insurance operation)*, an *insurer* which is concerned in the operation but is not the *leading insurer*.

relevant portfolio of assets

means the assigned portfolio of assets, consisting of bonds and other assets with similar cash-flow characteristics, to cover the *best estimate* of the *relevant portfolio of insurance and reinsurance obligations,* referred to in [the statutory instrument made to implement the *Solvency II Directive*].

risk-free interest rate transitional measure [means the approval granted to a *firm* by the *PRA* referred to in Transitional Measures 10].

volatility adjustment approval

means the approval granted to a *firm* by the *PRA* to permit it to apply a *volatility adjustment* for the purposes of calculating the *best estimate.*

2 CALCULATION OF TECHNICAL PROVISIONS

2.1 *Firms* must establish adequate *technical provisions* with respect to all of their insurance and *reinsurance* obligations towards *policyholders*.

[Note: Art. 76(1) of the *Solvency II Directive*]

2.2 The value of *technical provisions* must correspond to the current amount that the *firm* would have to pay if it were to transfer its insurance and *reinsurance* obligations immediately to another *Solvency II undertaking*.

[Note: Art. 76(2) of the *Solvency II Directive*]

2.3 *Firms* must calculate their *technical provisions*:

(1) such that the calculation makes use of and is consistent with information provided by the financial markets and generally available data on *underwriting risks* (market consistency);

(2) in a prudent, reliable and objective manner;

(3) taking into account the principles set out in Valuation 2; and

(4) in accordance with 2.4 – 8.2.

[Note: Art. 76(3)–(5) of the *Solvency II Directive*]

2.4 The value of *technical provisions* must be equal to the sum of a *best estimate* and a *risk margin* which must be calculated in accordance with 2.5, 3 and 4.

[Note: Art. 77(1) of the *Solvency II Directive*]

2.5 (1) *Firms* must value the *best estimate* and the *risk margin* separately, except where (2) applies.

(2) Where:

(a) future cash-flows associated with insurance or *reinsurance* obligations can be replicated reliably; and

(b) that replication is provided using financial instruments; and

(c) those financial instruments have a reliable market value which is observable;

then the value of *technical provisions* associated with those future cash-flows must be determined on the basis of the market value of those financial instruments.

[Note: Art. 77(4) of the *Solvency II Directive*]

3 BEST ESTIMATE

3.1 The *best estimate* must:

(1) correspond to the probability-weighted average of future cash-flows, taking into account the time value of money (expected present value of future cash-flows) using the *relevant risk-free interest rate term structure*; and

(2) be calculated:

(a) based upon up-to-date and credible information and realistic assumptions;

(b) using adequate, applicable and relevant actuarial and statistical methods; and

(c) gross, without deduction of the amounts recoverable from *reinsurance* contracts and *ISPV*s, which *firms* must calculate separately in accordance with 7.

[Note: Art. 77(2) of the *Solvency II Directive*]

3.2 The cash-flow projection used in the calculation of the *best estimate* (whether valued separately or determined on the basis of financial instruments in accordance with 2.5) must take into account all the cash in- and out-flows required to settle the insurance and *reinsurance* obligations over their lifetime.

[Note: Art. 77(2) of the *Solvency II Directive*]

4 RISK MARGIN

4.1 Where *firms* value the *best estimate* and *risk margin* separately, the *risk margin* must be an amount equal to the cost that a *Solvency II undertaking* would incur in order to hold *eligible own funds* to cover the *SCR* necessary to support the insurance and *reinsurance* obligations over their lifetime, determined using the *cost-of-capital rate*.

[Note: Art. 77(5) of the *Solvency II Directive*]

4.2 The *risk margin* must be such as to ensure that the value of the *technical provisions* is equivalent to the amount that a *Solvency II undertaking* would be expected to require in order to take over and meet the insurance and *reinsurance* obligations over their lifetime.

[Note: Art. 77(3) of the *Solvency II Directive*]

4A RISK-FREE INTEREST RATE TERM STRUCTURE

4A.1 *Firms* must ensure that the *relevant risk-free interest rate term structure*:

(1) is determined using, and consistent with, information derived from relevant financial instruments;

(2) takes account of relevant financial instruments of those maturities where the markets for those financial instruments as well as for bonds, are deep, liquid and transparent; and

(3) is only extrapolated for maturities where the markets for the relevant financial instruments or for bonds are not deep, liquid and transparent.

4A.2 For the purpose of 4A.1, the extrapolated part of the *relevant risk-free interest rate term structure* shall be based on forward rates converging smoothly from one set of forward rates in relation to the longest maturities for which the relevant financial instrument and the bonds can be observed in a deep, liquid and transparent market to an ultimate forward rate.

[Note: Art. 77a of the *Solvency II Directive*]

4B MATCHING ADJUSTMENT TO THE RELEVANT RISK FREE INTEREST RATE TERM STRUCTURE

4B.1 A *firm* must not apply a *matching adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless it has a *matching adjustment approval*.

4B.2 *Firms* that apply the *matching adjustment* to a *relevant portfolio of insurance or reinsurance obligations* shall not revert back to the approach that does not include a *matching adjustment*.

4B.3 Where a *firm* that applies the *matching adjustment* is no longer able to comply with the conditions set out in [the statutory instrument made to implement the *Solvency II Directive*], it shall immediately:

(1) inform the *PRA*; and

(2) take the necessary measures to restore compliance with these conditions as soon as possible.

4B.4 Where a *firm* is not able to restore compliance with the conditions set out in [the statutory instrument made to implement the *Solvency II Directive*] within two *months* of the date of non-compliance, it shall cease to apply the *matching adjustment* to any of its insurance or *reinsurance* obligations

4B.5 The *matching adjustment* shall not be applied with respect to insurance or *reinsurance* obligations where the *relevant risk-free interest rate term structure* to calculate *the best estimate* for those obligations includes a *volatility adjustment* or *risk-free interest rate transitional measure*.

[Note: Art. 77b of the *Solvency II Directive*]

4C CALCULATION OF THE MATCHING ADJUSTMENT

4C.1 This Chapter applies to a *firm* that has been granted a *matching adjustment approval*.

4C.2 The *matching adjustment* shall be calculated for each currency in accordance with the following principles:

(1) the *matching adjustment* shall be equal to the difference of the following:

(a) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value (in accordance with the Valuation Part) of the *relevant portfolio of assets***;**

b) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value of the *best estimate* of the *relevant portfolio of insurance or reinsurance obligations*, where the time value is taken into account using the *basic relevant risk-free interest rate term structure*;

(2) the *matching adjustment* shall not include the fundamental spread reflecting the risks retained by the *firm*;

(3) notwithstanding (1), the fundamental spread shall be increased where necessary to ensure that the *matching adjustment* for assets with sub-investment grade credit quality does not exceed the *matching adjustment* for assets of investment grade quality, of the same duration and asset class;

(4) the use of external credit assessments in the calculation of the *matching adjustment* shall be in line with the specifications set out in the *Solvency II Regulations* adopted under Article 111(1)(n) of the *Solvency II Directive*.

4C.3 For the purposes of 4C.2(2) and subject to 4C.5, the fundamental spread shall be:

(1) equal to the sum of the following:

(a) the credit spread corresponding to the probability of default of the assets; and

(b) the credit spread corresponding to the expected loss resulting from downgrading of the assets;

(2) for exposures to *EEA States*' central governments and central banks, no lower than 30% of the long term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;

(3) for assets other than exposures to *EEA States'* central governments and central banks, no lower than 35% of the long-term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;

4C.4 The probability of default referred to in 4C.3(1)(a) shall be based on long-term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class.

4C.5 Where no reliable credit spread can be derived from the default statistics referred to in 4C.3, the fundamental spread shall be equal to the portion of the long term average of the spread over the risk-free interest rate set out in 4C.3(2) and 4C.3(3).

[Note: Arts. 77c and 77e(3) of the *Solvency II Directive*]

4D VOLATILITY ADJUSTMENT

4D.1 A *firm* must not apply a *volatility adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless:

(1) it has been granted a *volatility adjustment approval*; and

(2) the *volatility adjustment* has been set out in *Solvency II Regulations* adopted under Article 77e of the *Solvency II Directive*.

(3) the *volatility adjustment* has been set out in *Solvency II Regulations* adopted under Article 77e of the *Solvency II Directive*.

4D.2 The *volatility adjustment* must not be applied to the risk-free interest rates of the *relevant risk-free interest rate term structure* that are derived by means of extrapolation in accordance with 4A.

4D.3 Where a firm applies a *volatility adjustment* in accordance with 4D, the extrapolation of the *relevant risk-free interest rate term structure* referred to in 4A shall be based on the risk-free interest rates adjusted with the *volatility adjustment*.

[Note: Arts. 77d and 77e(3) of the *Solvency II Directive*]

5 OTHER ELEMENTS TO BE TAKEN INTO ACCOUNT

5.1 When calculating *technical provisions*, *firms* must take into account:

(a) all expenses that will be incurred in servicing insurance and *reinsurance* obligations;

(b) inflation, including expenses and claims inflation and

(c) all payments to *policyholders*, including future discretionary bonuses, which *firms* expect to make, whether or not those payments are contractually guaranteed, unless those payments fall within Surplus Funds 2.1.

[Note: Art. 78 of the *Solvency II Directive*]

5.2 (1) When calculating *technical provisions*, *firms* must take account of the value of financial guarantees and any contractual options included in *contracts of insurance* and *reinsurance contracts*.

(2) Any assumptions used by a *firm* to determine the likelihood that *policyholders* will exercise contractual options, including lapses and surrenders, must:

(a) be realistic and based on current and credible information; and

(b) take into account, either explicitly or implicitly, the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

[Note: Art. 79 of the *Solvency II Directive*]

6 SEGMENTATION

6.1 When calculating *technical provisions, firms* must segment their insurance and *reinsurance* obligations into homogenous risk groups and, as a minimum, by lines of business as contemplated by the *Solvency II Regulations*.

[Note: Art. 80 of the *Solvency II Directive*]

7 RECOVERABLES FROM REINSURANCE CONTRACTS AND ISPVS

7.1 (1) *Firms* must calculate amounts recoverable from *reinsurance contracts* and *ISPV*s in accordance with 2 – 6.

(2) For the purposes of (1), *firms* must take into account the time difference between amounts becoming recoverable and the actual receipt of those amounts.

(3) *Firms* must adjust the calculation referred to in (1) to take into account expected losses due to the default of the counterparty. That adjustment must be based on an assessment of the probability of default of the counterparty and the average loss that would result from that default (loss-given- default).

[Note: Art. 81 of the *Solvency II Directive*]

8 DATA QUALITY AND APPLICATION OF APPROXIMATIONS

8.1 *Firms* must ensure that the data used in the calculation of their *technical provisions* is appropriate, complete and accurate.

8.2 Where *firms* have insufficient data of appropriate quality to apply a reliable actuarial method to a set or subset of their insurance and *reinsurance* obligations, or amounts recoverable from their *reinsurance* contracts and *ISPVs, firms* may use appropriate approximations, including case-by-case approaches, in the calculation of the *best estimate.*

[Note: Art. 82 of the *Solvency II Directive*]

9 COMPARISON AGAINST EXPERIENCE

9.1 (1) *Firms* must ensure that the *best estimate*, and the assumptions underlying the calculation of the *best estimate*, are regularly compared against experience.

(2) Where the comparison in (1) identifies systematic deviation exists between the *firm's best estimate* calculations and experience, the *firm* must make appropriate adjustments to the actuarial methods being used and/or the assumptions being made to ensure that the *best estimate* is calculated in accordance with 2 – 8.

[Note: Art. 83 of the *Solvency II Directive*]

10 APPROPRIATENESS OF THE LEVEL OF TECHNICAL PROVISIONS

10.1 Upon request by the *PRA*, the *firm* must demonstrate to the *PRA*:

(1) the appropriateness of the level of the *firm's technical provisions*;

(2) the applicability and relevance of the methods applied; and

(3) the adequacy of the underlying statistical data used.

[Note: Art. 84 of the *Solvency II Directive*]

11 COMMUNITY CO-INSURANCE OPERATIONS

11.1 In relation to *Community co-insurance operations*, where a *firm* is a *leading insurer* or a *relevant insurer,* the amount of *technical provisions* shall be determined according to 2 – 9.

11.2 The *technical provisions* calculated by a *firm* which is a *relevant insurer* shall be at least equal to those determined by the *leading insurer.*

[Note: Art. 192 of the *Solvency II Directive*]

12 LLOYD'S

12.1 This Chapter applies to the *Society* and *managing agents.*

12.2 For the purposes of complying with 4.1*, managing agents* must construe the reference to "SCR" in 4.1 as a reference to the notional *syndicate SCR* required to be calculated pursuant to Solvency Capital Requirement – General Provisions 8.2.

12.3 For the purpose of complying with 1.1(2) the *Society* must calculate *technical provisions* in respect of the *insurance business* of each *member.*

12.4 For the purpose of complying with 1.1(3), a *managing agent* must calculate *technical provisions* in respect of each *syndicate* it manages

12.5 In respect of business that has been subject to an *approved reinsurance to close*, *managing agents* must calculate *technical provisions* (before and after deduction of *reinsurance* cessions) for the reinsuring and not for the reinsured *member*.

12.6 For the purposes of 6.1 in relation to *managing agents*, a *managing agent* must carry out the segmentation referred to in that *rule* in respect of each *syndicate* managed by the *managing agent*.

PRA RULEBOOK: SOLVENCY II FIRMS: OWN FUNDS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Own Funds Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Own Funds Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

OWN FUNDS

Chapter content

Links

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*.

2 DETERMINATION OF OWN FUNDS

2.1 A *firm's own funds* comprise the sum of its *basic own funds* and *ancillary own funds*.

[Note: Art. 87 of the *Solvency II Directive*]

2.2 The *firm's basic own funds* consist of the following items:

(1) the excess of assets over liabilities, less the amount of own *shares* held by the *firm*; and

(2) subordinated liabilities.

[Note: Art. 88 of the *Solvency II Directive*]

2.3 Subject to 2.5, the *firm's ancillary own funds* consist of items (other than items of *basic own funds*) which can be called up to absorb losses, including the following (to the extent that they are not items of *basic own funds*):

(1) unpaid share capital or initial fund that has not been called up;

(2) letters of credit and guarantees;

(3) any other legally binding commitments received by the *firm*; and

(4) for a *mutual*, any future claims which it may have against its members by way of a call for supplementary contribution within the next 12 *months*.

[Note: Art. 89(1) of the *Solvency II Directive*]

2.4 Where an item of *ancillary own funds* becomes paid in or called up, the proceeds paid in or the amount due in respect of the call must be treated as an asset and the item must cease to be treated as an item of *ancillary own funds*.

[Note: Art. 89(2) of the *Solvency II Directive*]

2.5 When determining its *own funds*, a *firm* must not take into account any item of *ancillary own funds* unless, subject to 2.6, it has received the *PRA's* approval of either:

(1) a monetary amount for the relevant item of *ancillary own funds*; or

(2) the method by which to determine the amount of the relevant item of *ancillary own funds*, together with the amount determined in accordance with that method for a specified time period.

[Note: Art. 90(1) and (3) of the *Solvency II Directive*]

2.6 Where a *firm* has received approval:

(1) under 2.5(1), it may only include in its *own funds* the item of *ancillary own funds* for an amount up to the amount approved; or

(2) under 2.5(2), it may only include in its *own funds* the item of *ancillary own funds* up to the amount determined using the method approved, and only for the time period for which approval is granted.

[Note: Art. 90(3) of the *Solvency II Directive*]

2.7 A *firm* may only attribute an amount to an item of *ancillary own funds* to the extent that it:

(1) reflects the loss-absorbency of the item; and

(2) is based upon prudent and realistic assumptions.

[Note: Art. 90(2) of the *Solvency II Directive*]

3 CLASSIFICATION OF OWN FUNDS INTO TIERS

3.1 A *firm* may only include an *own funds* item in its *Tier 1 own funds* if:

(1) it is an item of *basic own funds*; and

(2) it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

[Note: Art. 94(1) of the *Solvency II Directive*]

3.2 A *firm* may only include an *own funds* item in its *Tier 2 own funds* if:

(1) where it is an item of *basic own funds*, it substantially possesses the characteristics set out in 3.5(2), taking into consideration the features set out in 3.6; or

(2) where it is an item of *ancillary own funds*, it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

[Note: Art. 94(2) of the *Solvency II Directive*]

3.3 A *firm* may only include in its *Tier 3 own funds* an item of:

(1) *basic own funds* that does not fall within 3.1 or 3.2(1); and

(2) *ancillary own funds* that does not fall within 3.2(2).

[Note: Art. 94(3) of the *Solvency II Directive*]

3.4 (1) In classifying its *own funds* items, a *firm* must refer to the lists of *own funds* items set out in the *Solvency II Regulations*.

(2) A *firm* must not include an *own funds* item in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds* if that *own funds* item is not covered by the lists referred to in (1), unless it has received the *PRA*'s approval.

(3) When seeking approval to classify an *own funds* item referred to in (2) in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds*, a *firm* must demonstrate that the *own funds* item satisfies the criteria laid down in 3.1 – 3.3 for that classification.

[Note: Art. 95 of the *Solvency II Directive*]

3.5 The characteristics referred to in 3.1(2) and 3.2 are:

(1) the item is available, or can be called up on demand, to fully absorb losses on a going-concern basis as well as in the case of winding up (permanent availability); and

(2) in the case of winding up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and *reinsurance* obligations to *policyholders*, have been met (subordination).

[Note: Art. 93(1) of the *Solvency II Directive*]

3.6 When assessing the extent to which *own funds* items possess the characteristics set out in 3.5, currently and in the future, a *firm* must consider:

(1) the duration of the item, in particular whether the item is dated or not and, where an *own funds* item is dated, the relative duration of the item as compared to the duration of the insurance and *reinsurance* obligations of the *firm* (sufficient duration);

(2) whether the item is free from requirements or incentives to redeem the nominal sum (absence of incentives to redeem);

(3) whether the item is free from mandatory fixed charges (absence of mandatory servicing costs); and

(4) whether the item is clear of encumbrances (absence of encumbrances).

[Note: Art. 93(2) of the *Solvency II Directive*]

3.7 (1) A *firm* must not classify as *Tier 1 own funds*:

(a) paid-in ordinary share capital and related share premium account; or

(b) paid-in initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to cancel and withhold dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

(2) A *firm* must not classify as *Tier 2 basic own funds*:

(a) ordinary share capital and related share premium account; or

(b) initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to defer dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

[Note: Arts. 93 and 94 of the *Solvency II Directive*]

4 ELIGIBILITY AND LIMITS APPLICABLE TO TIERS

4.1 As far as compliance with its *SCR* is concerned at least the following conditions must be met:

(1) more than one-third of the total amount of the *firm's eligible own funds* is accounted for by *Tier 1 own funds*; and

(2) less than one-third of the *firm's eligible own funds* is accounted for by *Tier 3 own funds.*

[Note: Art. 98(1) of the *Solvency II Directive*]

4.2 As far as compliance with its *MCR* is concerned, as a minimum more than 50% of the *firm's eligible own funds* must be accounted for by *Tier 1 own funds*.

[Note: Art. 98(2) of the *Solvency II Directive*]

5 NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS

5.1 5.2 – 5.6 do not apply in respect of the following:

(1) any item which a *firm* intends to include within its *basic own funds* that is not covered by the lists of *own funds* items set out in the *Solvency II Regulations*, but which may be included in its *basic own funds* only if the *firm* has received the *PRA's* approval; and

(2) any item which a *firm* intends to include within its *ancillary own funds*.

5.2 (1) A *firm* must notify the *PRA* in writing of its intention to issue an item which it intends to include within its *basic own funds* at least one *month* before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the *firm* must give as much notice as is practicable in those circumstances.

(2) When giving notice, a *firm* must:

(a) provide details of the amount of *basic own funds* the *firm* is seeking to raise through the intended issue and whether the *own funds* is intended to be issued to external investors or within its *group*;

(b) identify the classification of *basic own funds* the item is intended to fall within;

(c) include confirmation from the *governing body* of the *firm* that the item complies with the *rules* applicable to items of *basic own funds* included in the classification of the item identified in (b); and

(d) provide a copy of the term sheet and details of any features of the item it intends to include within its *basic own funds* which are novel, unusual or different from an item of *basic own funds* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by the Solvency II Firms Sector or the *Solvency II Regulations*.

5.3 A *firm* must provide a further written notification to the *PRA* including all the information required in 5.2(2) as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.

5.4 If a *firm* proposes to establish a debt securities program for the issue of an item for inclusion within its *basic own funds*, it must:

(1) notify the *PRA* of the establishment of the program; and

(2) provide the information required by 5.2(2)

at least one *month* before the first proposed drawdown. The *PRA* must be notified of any changes in accordance with 5.3.

5.5 The items of *basic own funds* to which 5.2 does not apply are:

(1) ordinary *shares* which:

(a) meet the classification criteria for ordinary share capital in *Tier 1 own funds*; and

(b) are the same as ordinary *shares* previously issued by the *firm*;

(2) debt instruments issued from a debt securities program, provided that program was notified to the *PRA* prior to its first drawdown, in accordance with 5.4; and

(3) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *firm* and included in *basic own funds.*

5.6 A *firm* must notify the *PRA* in writing, no later than the date of issue, of its intention to issue an item listed in 5.5 which it intends to include within its *basic own funds*. When giving notice, a *firm* must:

(1) provide the information set out at 5.2(2)(a), (b) and (c) and

(2) confirm that the terms of the item have not changed since the previous issue by the *firm* of that type of item of *basic own funds*.

6 LLOYD'S

6.1 This Chapter applies to the *Society.*

6.2 For the purposes of complying with the *SCR Rules,* the *Society* must categorise *own funds* at Lloyd's as between:

(1) *own funds* attributable to the *Society*; and

(2) *own funds* attributable to *members* which are available to support *members' insurance business* at Lloyd's, including *funds at Lloyd's*.

6.3 The *Society* must notify the *PRA* in writing, within 14 days, in the event the *Council* makes a determination pursuant to paragraph 8(1A) or varies a determination pursuant to paragraph 8(1B)(a) of the New Central Fund Byelaw (No 23 of 1996) as amended, that the *Central Fund* or a part of the *Central Fund* is to constitute *own funds* attributable to the *Society* for the purposes of covering the *SCR* for Lloyd's.

6.4 In determining *own funds* at Lloyd's in accordance with 2, the *Society* shall have regard to:

(1) the *Society's central assets* and *central liabilities*; and

(2) the assets and liabilities of *members,* including assets which are available to support *members' insurance business* at Lloyd's, such assets including a *member's funds at Lloyd's.*

PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT - GENERAL PROVISIONS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Solvency Capital Requirement - General Provisions [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Solvency Capital Requirement - General Provisions Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

SOLVENCY CAPITAL REQUIREMENT – GENERAL PROVISIONS

Chapter content

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*, as modified by 6 – 8*;* and

(3) in accordance with General Application 3, *managing agents*, as modified by 8.

2 REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS COVERING THE SCR

2.1 A *firm* must hold *eligible own funds* covering its *SCR*.

[Note: Art. 100 of the *Solvency II Directive*]

3 GENERAL PROVISIONS FOR THE CALCULATION OF THE SCR

3.1 A *firm* must calculate its *SCR* either in accordance with the *standard formula* or using an *internal model* for which *internal model approval* has been granted.

[Note: Art. 100 of the *Solvency II Directive*]

3.2 A *firm* must calculate its *SCR* on the presumption that it will pursue its business as a going concern.

[Note: Art. 101(2) of the *Solvency II Directive*]

3.3 A *firm's SCR*:

(1) must be calibrated to ensure that all quantifiable risks to which the *firm* is exposed are taken into account, including at least the non-life *underwriting risk*, life *underwriting risk*, health *underwriting risk*, *market risk*, *credit risk*, and *operational risk*;

(2) must cover existing business, as well as the new business expected to be written over the following 12 *months*; and

(3) with respect to existing business, must cover only unexpected losses.

[Note: Art. 101(3)–(4) of the *Solvency II Directive*]

3.4 A *firm's SCR* must correspond to the value-at-risk of its *basic own funds* subject to a confidence level of 99.5% over a one-year period.

[Note: Art. 101(3) of the *Solvency II Directive*]

3.5 When calculating the *SCR*, *firms* must take account of the effect of *risk-mitigation techniques*, provided that *credit risk* and other risks arising from the use of *risk-mitigation techniques* are properly reflected in the *SCR*.

[Note: Art. 101(5) of the *Solvency II Directive*]

3.6 Notwithstanding 3.2 – 3.5, a *firm's SCR* shall not cover the risk of loss of *basic own funds* resulting from changes to the *volatility adjustment*.

[Note: Art. 77d(6) of the *Solvency II Directive*]

4 FREQUENCY OF CALCULATION OF THE SCR

4.1 A *firm* must calculate its *SCR* and report the result of that calculation to the *PRA* at least once a year.

[Note: Art. 102(1) of the *Solvency II Directive*]

4.2 For the purposes of 2.1, a *firm* must hold *eligible own funds* which cover its last reported *SCR*.

[Note: Art. 102(1) of the *Solvency II Directive*]

4.3 A *firm* must monitor the amount of its *eligible own funds* and its *SCR* on an ongoing basis.

[Note: Art. 102(1) of the *Solvency II Directive*]

4.4 If a *firm's* risk profile deviates significantly from the assumptions underlying its last reported *SCR*, the *firm* must recalculate its *SCR* without delay and report it to the *PRA*.

[Note: Art. 102(1) of the *Solvency II Directive*]

4.5 Where there is evidence to suggest that the risk profile of a *firm* has altered significantly since the date on which the *SCR* was last reported by it, if so requested by the *PRA*, the *firm* must recalculate its *SCR*.

[Note: Art. 102(2) of the *Solvency II Directive*]

5 CAPITAL ADD-ON

5.1 A *firm* must make every effort to remedy the deficiencies that led to the imposition of a *capital add-on* arising as a result of an *internal model significant risk profile deviation* or a *significant system of governance deviation*.

[Note: Art. 37(3) of the *Solvency II Directive*]

5.2 Except as provided in 5.3, the *SCR* prior to the imposition of the *capital add-on*, together with the amount of the *capital add-on* imposed by the *PRA*, will constitute the *firm's SCR*.

[Note: Art. 37(5) of the *Solvency II Directive*]

5.3 For the purposes of calculating the *risk margin*, the *SCR* of a *firm* must not include any *capital add-on* imposed as a result of a *significant system of governance deviation*.

[Note: Art. 37(5) of the *Solvency II Directive*]

6 REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS: LLOYD'S

6.1 This Chapter applies to the *Society*.

6.2 The *Society* must ensure that *eligible own funds* are held at Lloyd's covering its *SCR.*

6.3 *Eligible own funds* covering the *central requirement* must be *eligible own funds* attributable to the *Society*.

6.4 Where the *standard formula* is used by the *Society* to calculate the *SCR* for Lloyd's, the *Society* must carry out the following process before it will be taken to have demonstrated that 6.2 is met:

(1) *own funds* attributable to a *member* are to be compared with the *member's* notional *SCR* derived pursuant to 8.4;

(2) where the *own funds* attributable to the *member* are less than or equal to that *member's* notional *SCR*, such *own funds* (but no additional *own funds* attributable to that *member,* including any *own funds* which are greater than the *member's* notional *SCR*) are to be taken into account for the purposes of establishing compliance with 6.2; and

(3) to the extent the *own funds* attributable to the *member* are less than that *member's* notional *SCR* derived pursuant to 8.4, the *Society* must hold *own funds* in respect of the difference.

6.5 Where the *Society* uses an approved *internal model*, the *Society* must also ensure that *eligible own funds* are held at Lloyd's covering, for at least 99.5% of the scenarios taken into account in the *internal model* for the purposes of meeting Solvency Capital Requirement - Internal Models 12.2, any diminution in *own funds* at Lloyd's arising from the impact of those scenarios.

6.6 Where an approved *internal model* is used by the *Society* to calculate the SCR, for the purpose of meeting the requirement set out in 6.2, the *Society* may take account of *own funds* attributable to a *member* only to the extent of the diminution, if any, to those *own funds* resulting from the application of risk scenarios taken into account in the *internal model*.

7 GENERAL PROVISIONS FOR CALCULATION OF THE SCR: LLOYD'S

7.1 This Chapter applies to the *Society*.

7.2 In calculating the *SCR* for Lloyd's, the *Society* must ensure that the *SCR* is calibrated so as to include:

(1) all quantifiable risks to which *members* are exposed as a consequence of those *members* carrying on *insurance business* at Lloyd's; and

(2) all quantifiable risks to which the *Society* is exposed, including risks to the *central assets* and *central liabilities*,

in the manner required by 3 (and, where an *internal model* is used, in accordance with the Solvency Capital Requirement - Internal Models Part and where the *standard formula* is used, in accordance with the Solvency Capital Requirement - Standard Formula Part).

7.3 The *Society* must calculate a *central requirement* for Lloyd's which meets 7.2(2).

7.4 The *central requirement* must take account of the risk that the *central assets* may be used to meet deficiencies (as to amount or quality) in *own funds* attributable to *members*, such *own funds* supporting *members' insurance business* at Lloyd's.

8 SYNDICATE NOTIONAL SCR AND MEMBER NOTIONAL SCR: LLOYD'S

8.1 This Chapter applies to *managing agents* and, where specified, the *Society.*

8.2 A *managing agent* must calculate a notional *SCR* for each *syndicate* which it manages.

8.3 The notional *SCR* for each *syndicate* referred to in 8.2 must be calculated using a methodology which is consistent with the method used by the *Society* to derive the *SCR* for Lloyd's for the purposes of enabling the *Society* to comply with the relevant provisions of this Chapter.

8.4 The *Society* must calculate a notional *SCR* for each *member* using the method of calculation chosen to calculate the *SCR* for Lloyd's for the purpose of 3.1.

8.5 Where a *managing agent* manages risks which are included in the Lloyd's *SCR* calculation, the *managing agent* must promptly assist and provide all relevant information to the *Society* for the purposes of the *Society* complying with relevant provisions of *SCR Rules*.

PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT STANDARD FORMULA INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137G (the PRA’s general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Solvency Capital Requirement Standard Formula [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook Solvency II Firms: Solvency Capital Requirement Standard Formula Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

SOLVENCY CAPITAL REQUIREMENT – STANDARD FORMULA

Chapter content

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*, as modified by 8**.**

(3) [Drafting note: placeholder to consider application of this Part to managing agents further in the light of the arrangements the Society makes to review the notional SCR of each syndicate].

1.2 In this Part, the following definitions shall apply:

standard equity capital charge

means the standard capital requirement for equity risk calculated in accordance with the *Solvency II Regulations* before any *symmetric adjustment* is applied.

symmetric adjustment

means the symmetric adjustment that may be applied to the *standard equity capital charge* in accordance with the *Solvency II Regulations.*

2 STRUCTURE OF THE SCR STANDARD FORMULA

2.1 For a *firm* calculating its *SCR* on the basis of the *standard formula*, its *SCR* is the sum of the following items:

(1) the *basic SCR*;

(2) the capital requirement for *operational risk*, as set out in 5; and

(3) the adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes, as set out in 6.

[Note: Art. 103 of the *Solvency II Directive*]

3 THE BASIC SCR

3.1 For the purposes of calculating its *basic SCR,* a *firm* must:

(1) calculate the capital requirements for:

(a) the non-life *underwriting risk* module;

(b) the life underwriting risk module;

(c) the health underwriting risk module;

(d) the market risk module; and

(e) the counterparty default risk module; and

(2) aggregate the capital requirements referred to in (1) in accordance with the following formula:

$$\text{basic SCR} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where:

(a) 'SCR_i' and 'SCR_j' denote the non-life *underwriting risk* module, the life *underwriting risk* module, the health *underwriting risk* module, the *market risk* module and the counterparty default risk module;

(b) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j';

(b) the factor '$Corr_{i,j}$' denotes the item set out in row 'i' and column 'j' of the correlation matrix in (d); and

(d)

i \ j	Market	Default	Life	Health	Non-life
Market	1	0,25	0,25	0,25	0,25
Default	0,25	1	0,25	0,25	0,5
Life	0,25	0,25	1	0,25	0
Health	0,25	0,25	0,25	1	0
Non-life	0,25	0,5	0	0	1

[Note: Art. 104(1) and Annex IV point (1) of the *Solvency II Directive*]

3.2 For the purposes of calculating the capital requirements in 3.1(1) for non-life *underwriting risk*, life *underwriting risk* and health *underwriting risk*, a *firm* must allocate its insurance and *reinsurance* operations to the *underwriting risk* that best reflects the technical nature of the underlying risks.

[Note: Art. 104(2) of the *Solvency II Directive*]

3.3 Each of the risk modules referred to in 3.1(1) must be calibrated using a Value-at-Risk measure, with a 99.5% confidence level over a one-year period.

3.4. Where appropriate, *diversification effects* must be taken into account in the design of each risk module.

[Note: Art. 104(4) of the *Solvency II Directive*]

3.5 For the purposes of the *basic SCR*, a *firm* must calculate the capital requirement for the non-life *underwriting risk* module so that it:

(1) reflects the risk arising from its non-life insurance obligations, in relation to the perils covered and the processes used in the conduct of business; and

(2) takes account of the uncertainty in its results related to existing insurance and *reinsurance* obligations, as well as to new business expected to be written within the following 12 *months*.

[Note: Art. 105(2) of the *Solvency II Directive*]

3.6 For the purposes of 3.1(1)(a), the capital requirement for the non-life *underwriting risk* module is a combination of the capital requirements for at least the following sub-modules:

(1) a non-life premium and reserve risk sub-module covering the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of *claim* settlements; and

(2) a non-life catastrophe risk sub-module covering the risk of loss, or of adverse change in the value of insurance liabilities, resulting from significant uncertainty of pricing and provisioning assumptions related to extreme or exceptional events.

[Note: Art. 105(2) of the *Solvency II Directive*]

3.7 For the purposes of 3.1(1)(b) a *firm* must calculate the capital requirement for the life *underwriting risk* module so as to reflect the risk arising from its life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.

[Note: Art. 105(3) of the *Solvency II Directive*]

3.8 The life *underwriting risk* module must be calculated as:

(1) a combination of the capital requirements for the following sub-modules:

(a) mortality risk;

(b) longevity risk;

(c) disability-morbidity risk;

(d) life expense risk;

(e) revision risk;

(f) lapse risk; and

(g) life catastrophe risk;

(2) aggregated in accordance with the following formula:

$$SCR_{\text{life}} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where: 'SCR_i' and 'SCR_j' denote the mortality risk sub-module, the longevity risk sub-module, the disability-morbidity risk sub-module, the life expense risk sub-module, the revision risk sub-module, the lapse risk sub-module and the life catastrophe risk sub-module; and

'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'.

[Note: Art. 105(3) and Annex IV point (3) *Solvency II Directive*]

3.9 For the purposes of 3.8:

(1) the mortality risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of

mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities;

(2) the longevity risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities;

(3) the disability-morbidity risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of disability, sickness and morbidity rates;

(4) the life-expense risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of the expenses incurred in servicing *contracts of insurance* or *reinsurance contracts*;

(5) the revision risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured;

(6) the lapse risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level or volatility of the rates of *policy* lapses, terminations, renewals and surrenders; and

(7) the life-catastrophe risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from the significant uncertainty of pricing and provisioning assumptions related to extreme or irregular events.

[Note: Art. 105(3) of the *Solvency II Directive*)]

3.10 For the purposes of 3.1(1)(c):

(1) a *firm* must calculate the capital requirement for the health *underwriting risk* module to reflect the risk arising from its underwriting of health insurance obligations, whether it is pursued on a similar technical basis to that of life insurance or not, following from both the perils covered and the processes used in the conduct of business; and

(2) the health *underwriting risk* module must cover at least the risk of loss, or of adverse change, in the value of insurance liabilities resulting from:

(a) changes in the level, trend, or volatility of the expenses incurred in servicing *contracts of insurance* or *reinsurance contracts*;

(b) fluctuations in the timing and amount of *claim* settlements at the time of provisioning; and

(c) the significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances.

[Note: Art. 105(4) of the *Solvency II Directive*]

3.11 For the purposes of 3.1(1)(d):

(1) a *firm* must calculate the capital requirement for the *market risk* module so that it:

(a) reflects the risk arising from the level or volatility of market prices of financial instruments which have an impact upon the value of the assets and liabilities of the *firm*;

(b) properly reflects the structural mismatch between assets and liabilities, in particular with respect to the duration of assets and liabilities; and

(2) the capital requirement for the *market risk* module is a combination of the capital requirements for at least the following sub-modules:

(a) an interest-rate risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the term structure of interest rates, or in the volatility of interest rates;

(b) an equity risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of equities;

(c) a property risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of real estate;

(d) a spread risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over the risk-free interest-rate term structure;

(e) a currency risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of currency exchange rates; and

(f) a *market risk* concentrations sub-module covering additional risks to a *firm* stemming either from lack of diversification in the asset portfolio or from large exposure to default risk by a single issuer of securities or a *group* of related issuers.

[Note: Art. 105(5) of the *Solvency II Directive*]

3.12 For the purposes of 3.1(1)(e), the counterparty default risk module:

(1) must reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of the *firm* over the following 12 *months*;

(2) must cover risk-mitigating contracts, such as *reinsurance* arrangements, securitisations and *derivatives*, and receivables from intermediaries, as well as any other credit exposures which are not covered in the spread risk sub-module;

(3) must take appropriate account of collateral or other security held by, or for the account of, the *firm* and the associated risks;

(4) for each counterparty, must take account of the overall counterparty risk exposure of the *firm* to that counterparty, irrespective of the legal form of the counterparty's contractual obligations to the *firm*.

[Note: Art. 105(6) of the *Solvency II Directive*]

4 CALCULATION OF THE EQUITY RISK SUB-MODULE AND APPLICATION OF THE SYMMETRIC ADJUSTMENT MECHANISM

4.1 For the purposes of calculating the equity risk sub-module referred to in 3.11(2)(b), a *firm* must apply a *symmetric adjustment* to the *standard equity capital charge* to cover the risk arising from changes in the level of equity prices.

[Note: Art. 106(1) of the *Solvency II Directive*]

5 CAPITAL REQUIREMENT FOR OPERATIONAL RISK

5.1 A *firm's* capital requirement for *operational risk* must:

(1) reflect its operational risks to the extent that they are not already reflected in the risk modules used to calculate its *basic SCR*; and

(2) be calibrated in accordance with Solvency Capital Requirement – General Provisions 3.3 – 3.4.

[Note: Art. 107(1) of the *Solvency II Directive*]

5.2 With respect to *linked long-term contracts of insurance*, the calculation of the capital requirement for *operational risk* must take into account the amount of annual expenses incurred in respect of those insurance obligations.

[Note: Art. 107(2) of the *Solvency II Directive*]

5.3 With respect to *insurance business* operations other than those referred to in 5.2, the capital requirement for *operational risk* must:

(1) take into account the volume of those operations, in terms of earned *premiums* and *technical provisions* which are held in respect of that *insurance business;* and

(2) not exceed 30% of the *basic SCR* relating to those operations.

[Note: Art. 107(3) of the *Solvency II Directive*]

6 ADJUSTMENT FOR LOSS-ABSORBING CAPACITY OF TECHNICAL PROVISIONS AND DEFERRED TAXES

6.1 The adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes as referred to in 2.1(3):

(1) must reflect potential compensation of unexpected losses through a simultaneous decrease in *technical provisions* or deferred taxes, or a combination of the two; and

(2) must take account of the risk-mitigating effect provided by future discretionary benefits of *contracts of insurance*.

[Note: Art. 108 of the *Solvency II Directive*]

6.2 For the purposes of 6.1(2):

(1) a *firm* must take account of the risk-mitigating effect provided by future discretionary benefits to the extent that it can establish that a reduction in future discretionary benefits may be used to cover unexpected losses when they arise;

(2) the risk-mitigating effect provided by future discretionary benefits must be no higher than the sum of *technical provisions* and deferred taxes relating to those future discretionary benefits; and

(3) the value of future discretionary benefits under adverse circumstances must be compared to the value of those benefits under the underlying assumptions of the *best estimate* calculation.

[Note: Art. 108 of the *Solvency II Directive*]

7 SIMPLIFICATION IN THE STANDARD FORMULA

7.1 (1) A *firm* may use a simplified calculation for a specific sub-module or risk module where the nature, scale and complexity of the risks it faces justifies it.

(2) A *firm* must calibrate its simplified calculation in accordance with Solvency Capital Requirement – General Provisions 3.3 – 3.4.

[Note: Art. 109 of the *Solvency II Directive*]

8 LLOYD'S

8.1 This Chapter applies to the *Society* in relation to the use of the *standard formula* for the purpose of Solvency Capital Requirement – General Provisions 3.1.

8.2 The *Society* must aggregate the results of each notional *SCR* referred to in Solvency Capital Requirement – General Provisions 8.4 together with the *central requirement*, in order to obtain the *SCR* for Lloyd's.

PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT – INTERNAL MODELS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Solvency Capital Requirement - Internal Models [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Solvency Capital Requirement - Internal Models Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

SOLVENCY CAPITAL REQUIREMENT – INTERNAL MODELS

Chapter content

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*.

(3) [Drafting note: placeholder to consider application of this Part to managing agents further in the light of the arrangements the Society makes to review the notional SCR of each syndicate]

1.2 In this Part, the following definitions shall apply:

internal model approval application

means an application by a *firm* for *internal model approval.*

internal model change policy

means a *firm's* policy for making minor and major changes to its *internal model.*

internal model requirements

means the requirements set out in Solvency Capital Requirement – Internal Models 10 – 15.

2 APPROVAL OF FULL AND PARTIAL INTERNAL MODELS

2.1 A *firm* may calculate its *SCR* using an *internal model* that is either a full *internal model* or a *partial internal model* only:

(1) if it has been granted *internal model approval* in respect of its *internal model*; and

(2) to the extent of its *internal model approval.*

2.2 A *firm* that has been granted *internal model approval* must calculate its *SCR* using the *internal model* for which *internal model approval* has been granted.

[Note: Arts. 112(1) and 112(2) of the *Solvency II Directive*]

3 APPLICATIONS FOR APPROVAL OF FULL AND PARTIAL INTERNAL MODELS

3.1 A *firm* making an *internal model approval application* must submit, as a minimum, documentary evidence that demonstrates to the *PRA's* satisfaction that the *internal model* and, if the context requires, the *firm* satisfies the *internal model requirements.*

[Note: Art. 112(3) of the *Solvency II Directive*]

3.2 A *firm* making an *internal model approval application* must demonstrate to the *PRA's* satisfaction that its systems for identifying, measuring, monitoring, managing and reporting risk are adequate.

[Note: Art. 112(5) of the *Solvency II Directive*]

3.3 When making an *internal model approval application*, a *firm* must submit its *internal model change policy* to the *PRA* for approval.

[Note: Art. 115 of the *Solvency II Directive*]

3.4 Upon request by the *PRA*, a *firm* with an *internal model approval* must provide the *PRA* with an estimate of the *SCR* determined in accordance with the *standard formula*.

[Note: Art. 112(7) of the *Solvency II Directive*]

4 APPLICATIONS FOR APPROVAL OF PARTIAL INTERNAL MODELS

4.1 Where an *internal model approval application* relates to the use of a *partial internal model,* the *internal model requirements* apply with any changes that are necessary to take account of the limited scope of the application of the *internal model*.

[Note: Art. 112(3) of the *Solvency II Directive*]

4.2 A *firm* making an *internal model approval application* to use a *partial internal model* must:

(1) explain, and properly justify, the reason for the limited scope of application of the *internal model*;

(2) explain how the resulting *SCR* reflects more appropriately the risk profile of the *firm* and complies with 2.3 and Solvency Capital Requirement - General Provisions 2 – 4; and

(3) demonstrate that the design of its *partial internal model* is consistent with the principles in 2.3 and Solvency Capital Requirement - General Provisions 2 – 4 so as to allow the *partial internal model* to be fully integrated into the *standard formula*.

[Note: Art. 113(1) of the *Solvency II Directive*]

5 TRANSITIONAL PLAN TO EXTEND THE SCOPE OF THE MODEL

5.1 Upon request by the *PRA*, a *firm* which has made an *internal model approval application* in respect of a *partial internal model* that only covers certain sub-modules of a specific risk module, or some of the business units of the *firm* with respect to a specific risk module, or parts of both, must submit a realistic transitional plan to extend the scope of the proposed *partial internal model*.

[Note: Art. 113(2) of the *Solvency II Directive*]

5.2 The realistic transitional plan referred to in 5.1 must set out the manner in which the *firm* plans to extend the scope of the proposed *partial internal model* to other sub-modules or business units of the *firm*, in order to ensure that the *internal model* covers a predominant part of the *firm's insurance business* with respect to that specific risk module.

[Note: Art. 113(2) of the *Solvency II Directive*]

6 CHANGES TO AN INTERNAL MODEL OR INTERNAL MODEL CHANGE POLICY

6.1 A *firm* with *internal model approval* must not change its *internal model* otherwise than in accordance with the *firm's internal model change policy* as approved by the *PRA*.

[Note: Art. 115 of the *Solvency II Directive*]

6.2 A *firm's internal model change policy* must include a specification of minor and major changes to the *internal model*.

[Note: Art. 115 of the *Solvency II Directive*]

6.3 A firm with *internal model approval* must not:

(1) make any major change to its *internal model*; or

(2) make any change to its *internal model change policy;*

without obtaining the prior approval of the *PRA* in accordance with the procedures set out in 3 – 5 for obtaining *internal model approval*.

[Note: Art. 115 of the *Solvency II Directive*]

7 RESPONSIBILITIES OF THE FIRM'S GOVERNING BODY

7.1 A *firm's*:

(1) *internal model approval application*; and

(2) application to the *PRA* for approval to make a major change to its *internal model* for which it has received *internal model approval*;

must be approved by the *firm's governing body*.

[Note: Art. 116 of the *Solvency II Directive*]

7.2 A *firm* must have in place systems which ensure that its *internal model* operates properly on a continuous basis.

[Note: Art. 116 of the *Solvency II Directive*]

8 REVERSION TO THE STANDARD FORMULA

8.1 A *firm* with an *internal model approval* must not, in respect of the *internal model* for which that *internal model approval* has been granted, revert to calculating the whole or any part of the *SCR* in accordance with the *standard formula.*

[Note: Art. 117 of the *Solvency II Directive*]

9 NON-COMPLIANCE OF THE INTERNAL MODEL

9.1 If a *firm* with *internal model approval* ceases to comply with the *internal model requirements*, the *firm* must, without delay, either present to the *PRA* a plan to restore compliance within a reasonable period of time, or demonstrate to the *PRA* that the effect of non-compliance is immaterial.

[Note: Art. 118(1) of the *Solvency II Directive*]

10 USE TEST

10.1 A *firm* must demonstrate to the *PRA* that its *internal model* is widely used, and plays an important role in its system of governance (referred to in Conditions Governing Business 2 – 8) and particularly in its:

(1) risk-management system, as set out in Conditions Governing Business 3.1 – 3.4, and decision-making processes; and

(2) economic and solvency capital assessment and allocation processes, including its *ORSA,* as set out in Conditions Governing Business 3.5 – 3.8.

[Note: Art. 120 of the *Solvency II Directive*]

10.2 A *firm* must also demonstrate to the *PRA* that the frequency of calculation of its *SCR* using the *internal model* is consistent with the frequency with which it uses its *internal model* for the purposes set out in 10.1.

[Note: Art. 120 of the *Solvency II Directive*]

10.3 A *firm* must ensure the ongoing appropriateness of the design and operations of its *internal model*, and that the *internal model* continues to appropriately reflect the risk profile of the *firm*.

[Note: Art. 120 of the *Solvency II Directive*]

11 STATISTICAL QUALITY STANDARDS

11.1 A *firm* must ensure that its *internal model* and, in particular, the calculation of the *probability distribution forecast* underlying it, complies with 11.2 – 11.8.

[Note: Art. 121(1) of the *Solvency II Directive*]

11.2 The methods used to calculate the *probability distribution forecast* must be:

(1) based on adequate, applicable and relevant actuarial and statistical techniques;

(2) based upon current and credible information and realistic assumptions; and

(3) consistent with the methods used to calculate *technical provisions*.

[Note: Art. 121(2) of the *Solvency II Directive*]

11.3 A *firm* must be able to justify the assumptions underlying its *internal model* to the *PRA*.

[Note: Art. 121(2) of the *Solvency II Directive*]

11.4 (1) Data used for the *internal model* must be accurate, complete and appropriate.

(2) A *firm* must update the data sets used in the calculation of the *probability distribution forecast* at least annually.

[Note: Art. 121(3) of the *Solvency II Directive*]

11.5 Without limiting the operation of 11.2, irrespective of the method chosen to calculate the *probability distribution forecast*, the ability of the *internal model* to rank risk must be sufficient to ensure that it is widely used and plays an important role in the system of governance of the *firm*, in particular in its risk-management system and decision-making processes, and capital allocation in accordance with 10.1.

[Note: Art. 121(4) of the *Solvency II Directive*]

11.6 The *internal model* must cover all of the material risks to which the *firm* is exposed, including at least the risks set out in Solvency Capital Requirement – General Provisions 3.3(1).

[Note: Art. 121(4) of the *Solvency II Directive*]

11.7 In its *internal model*, a *firm* must:

(1) accurately assess:

(a) the particular risks associated with financial guarantees and any contractual options, where material; and

(b) the risks associated with both *policyholder* options and the *firm's* contractual options,

taking into account the impact that future changes in financial and non-financial conditions may have on the exercise of those options; and

(2) take account of all payments to *policyholders* which it expects to make, whether or not those payments are contractually guaranteed.

[Note: Art. 121(7) and (9) of the *Solvency II Directive*]

11.8 A *firm's internal model* must only take into account:

(1) as regards *diversification effects*, dependencies within and across risk categories, if the *PRA* is satisfied, as part of the *internal model approval*, that the *firm's* system for measuring those *diversification effects* is adequate;

(2) the effect of *risk-mitigation techniques*, if and to the extent that *credit risk* and other risks arising from the use of *risk-mitigation techniques* are properly reflected in the *internal model*; and

(3) future management actions, if and to the extent that:

(a) they are future management actions that the *firm* would reasonably expect to carry out in specific circumstances; and

(b) the *firm* makes allowance in its *internal model* for the time necessary to implement those actions.

[Note: Art. 121(5), (6) and (8) of the *Solvency II Directive*]

12 CALIBRATION STANDARDS

12.1 *A firm* may use, for internal modelling purposes, a different time period or *risk measure* than that set out in Solvency Capital Requirement – General Provisions 3.4 only where the outputs of the *internal model* can be used by the *firm* to calculate the *SCR* in a manner that provides *policyholders* with a level of protection equivalent to that set out in Solvency Capital Requirement – General Provisions 3.2 – 3.5.

[Note: Art. 122(1) of the *Solvency II Directive*]

12.2 A *firm* must derive the *SCR* directly from the *probability distribution forecast* generated by its *internal model*, using the Value-at-Risk *risk measure* set out in Solvency Capital Requirement – General Provisions 3.4.

[Note: Art. 122(2) of the *Solvency II Directive*]

12.3 When required to do so by the *PRA*, a *firm* must run its *internal model* on relevant benchmark portfolios, using assumptions based on external rather than internal data in order to verify the calibration of the *internal model* and to check that its specification is in line with generally accepted market practice.

[Note: Art. 122(4) of the *Solvency II Directive*]

13 PROFIT AND LOSS ATTRIBUTION

13.1 A *firm* with *internal model approval* must review, at least annually, the causes and sources of profits and losses for each *major business unit*.

[Note: Art. 123 of the *Solvency II Directive*]

13.2 A *firm* must demonstrate how the categorisation of risk chosen in its *internal model* explains the causes and sources of profits and losses.

[Note: Art. 123 of the *Solvency II Directive*]

13.3 A *firm* must ensure that its categorisation of risk and attribution of profits and losses reflects its risk profile.

[Note: Art. 123 of the *Solvency II Directive*]

14 VALIDATION STANDARDS

14.1 (1) A *firm* must have in place a regular cycle of *internal model* validation which includes:

(a) monitoring the performance of the *internal model*, reviewing the ongoing appropriateness of its specification and testing its results against experience;

(b) an effective statistical process for validating the *internal model* which enables the *firm* to demonstrate to the *PRA* that the resulting capital requirements are appropriate;

(c) an analysis of the stability of the *internal model* and, in particular, the testing of the sensitivity of the results of the *internal model* to changes in key underlying assumptions; and

(d) an assessment of the accuracy, completeness and appropriateness of the data used by the *internal model*.

(2) The statistical methods applied for the purposes of (1)(b) must test the appropriateness of the *probability distribution forecast* compared to loss experience, all material new data and information relating thereto.

[Note: Art. 124 of the *Solvency II Directive*]

15 DOCUMENTATION STANDARDS

15.1 A *firm* must document the design and operational details of its *internal model*.

[Note: Art. 125 of the *Solvency II Directive*]

15.2 The documentation referred to in 15.1 must:

(1) demonstrate compliance with 10 – 14:

(2) provide a detailed outline of the theory, assumptions, and mathematical and empirical bases underlying the *internal model*;

(3) indicate any circumstances under which the *internal model* does not work effectively; and

(4) include all major changes to the *internal model*, as referred to in 6.

[Note: Art. 125 of the *Solvency II Directive*]

16 EXTERNAL MODELS AND DATA

16.1 The *internal model requirements* apply regardless whether a *firm* uses, in its *internal model*, a model or data obtained from a third party.

[Note: Art. 126 of the *Solvency II Directive*]

17 LLOYD'S

17.1 This Chapter applies to the *Society* in relation to the use of an *internal model* for the purpose of Solvency Capital Requirement – General Provisions 3.1.

17.2 The *internal model* must:

(1) separately identify and aggregate any diminution in *basic own funds* arising as a result of the application of risk scenarios taken into account in the *internal model* to:

(a) the *insurance business* of *members*; and

(b) the *central assets* and *central liabilities*; and

(2) where the risk scenarios taken into account in the *internal model* result in the *own funds* attributable to a particular *member* being exhausted, identify the consequent impact upon *own funds* attributable to the *Society*.

PRA RULEBOOK: SOLVENCY II FIRMS: MINIMUM CAPITAL REQUIREMENT INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137G (the PRA’s general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Minimum Capital Requirement Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Minimum Capital Requirement Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

MINIMUM CAPITAL REQUIREMENT

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*, as modified by 5.

1.2 In this Part, the following definitions shall apply;

captive insurer

means a *Solvency II undertaking* owned by:

(1) a financial *undertaking* other than a *Solvency II undertaking*; or

(2) a *group* of *Solvency II undertakings*; or

(3) a non-financial *undertaking*;

the purpose of which is to provide insurance cover exclusively for the risks of the undertaking or undertakings to which it belongs, or of an *undertaking*, or *undertakings*, of the *group* of which that *Solvency II undertaking* is a member.

[Note: Art. 13(2) of the *Solvency II Directive*]

captive reinsurer

means a *Solvency II undertaking* that is a *pure reinsurer* owned by:

(1) a financial *undertaking* other than a *Solvency II undertaking*; or

(2) a *group* of *Solvency II undertakings;* or

(3) a non-financial *undertaking*;

the purpose of which is to provide *reinsurance* cover exclusively for the risks of the *undertaking* or *undertakings* to which it belongs or of an *undertaking* or *undertakings* of the *group* of which that *pure reinsurer* is a member.

[Note: Art.13(5) of the *Solvency II Directive*]

2 GENERAL PROVISIONS

2.1 A *firm* must hold *eligible own funds* covering the *MCR.*

[Note: Art. 128 of the *Solvency II Directive*]

3 CALCULATION OF THE MINIMUM CAPITAL REQUIREMENT

3.1 The function used to calculate the *firm's MCR* must be calibrated to the value-at-risk of its *basic own funds* subject to a confidence level of 85% over a one-year period.

[Note: Art. 129(1)(c) of the *Solvency II Directive*]

3.2 The *MCR* must have an absolute floor of:

(1) 2,500,000 euro for *firms*, including *captive insurers*, which have *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of general insurance*, except in the case where all or some of the *general insurance business classes* 10 to 15 are covered, in which case it must be no less than 3,700,000 euro;

(2) 3,700,000 euro for *firms*, including *captive insurers*, which have *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of long term insurance*;

(3) 3,600,000 euro for *pure reinsurers*, except in the case of *captive reinsurers* that are *pure reinsurers*, in which case the *MCR* must be no less than 1,200,000 euro;

(4) the sum of the amounts set out in (1) and (2) for *firms* other than *pure reinsurers* which as of 15 March 1979 carried on both *long-term insurance business* and *general insurance business*.

[Note: Art. 129(1)(d) of the *Solvency II Directive*]

3.3 Without prejudice to the requirements on the absolute floor in 3.2, the *MCR* must neither fall below 25% nor exceed 45% of the *firm's SCR*, calculated in accordance with *SCR Rules*, and including any *capital add-on* which has been imposed.

[Note: Art. 129(3) of the *Solvency II Directive*]

4 FREQUENCY AND REPORTING IN RELATION TO THE MINIMUM CAPITAL REQUIREMENT

4.1 A *firm* must calculate the *MCR* and report the results of that calculation to the *PRA* at least quarterly.

[Note: Art. 129(4) of the *Solvency II Directive*]

4.2 Where either of the limits referred to in 3.3 determines a *firm's MCR* the *firm* must provide the *PRA* information allowing a proper understanding of the reasons therefor.

[Note: Art. 129(4) of the *Solvency II Directive*]

5 LLOYD'S

5.1 This Chapter applies to the *Society.*

5.2 In calculating the *MCR* for Lloyd's, in the manner required by 3, the *Society* must ensure that the *MCR* is calibrated so as to include all quantifiable risks to which:

(1) *members* are exposed as a consequence of those *members* carrying on *insurance business* at Lloyd's; and

(2) the *Society* is exposed, including risks to the *central assets* and *central liabilities*.

5.3 The *Society* must determine, at least quarterly, the ratio of the Lloyd's *MCR* to the Lloyd's *SCR* and notify the *PRA* of the result at the same time it reports the quarterly *MCR* calculation required by 4.1.

5.4 The *Society* must calculate a reporting point for each *underwriting member*, in accordance with 5.5.

5.5 The reporting point for each *underwriting member* must be calculated using the ratio referred to in 5.3, expressed as a percentage of the *member's* notional *SCR* referred to in Solvency Capital Requirement – General Provisions 8.4.

5.6 The *Society* must notify the *PRA* if *own funds* attributable to a *member* fall below the reporting point determined in accordance with 5.5 as soon as it is observed by the *Society*.

PRA RULEBOOK: SOLVENCY II FIRMS: UNDERTAKINGS IN DIFFICULTY INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Undertakings in Difficulty Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Undertakings in Difficulty Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

UNDERTAKINGS IN DIFFICULTY

Chapter content

Links

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*, as modified by 6.

2 IDENTIFICATION AND NOTIFICATION OF DETERIORATING FINANCIAL CONDITIONS

2.1 A *firm* must have procedures in place to identify deteriorating financial conditions and must immediately notify the *PRA* when such deterioration occurs.

[Note: Art. 136 of the *Solvency II Directive*]

3 NON-COMPLIANCE WITH THE SCR

3.1 A *firm* must:

(1) immediately inform the *PRA* as soon as it observes that the *SCR* is no longer complied with, or where there is a risk of non-compliance within the next three *months*;

(2) within two *months* from the observation of non-compliance with the *SCR*, submit a realistic *recovery plan* for approval by the *PRA*; and

(3) take the measures necessary to achieve, within six *months* (or such longer period as the *PRA* may determine) from the observation of non-compliance with the *SCR*, the re-establishment of the level of *eligible own funds* covering the *SCR* or the reduction of its risk profile to ensure compliance with the *SCR*.

[Note: Art. 138(1)–(3) of the *Solvency II Directive*]

3.2 If the *PRA* has extended the period referred to in 3.1(3), by reason of the declaration by *EIOPA* of *exceptional adverse situations* affecting the *firm*, the *firm* must submit a progress report to the *PRA* every three *months* setting out the measures taken and the progress made to re-establish the level of *eligible own funds* covering the *SCR* or to reduce its risk profile to ensure compliance with the *SCR*.

[Note: Art. 138(4) of the *Solvency II Directive*]

4 NON-COMPLIANCE WITH THE MCR

4.1 A *firm* must:

(1) inform the *PRA* immediately where it observes that the *MCR* is no longer complied with or where there is a risk of non-compliance within the next three *months*; and

(2) within one *month* from the observation of non-compliance with the *MCR*, submit, for approval by the *PRA,* a short-term realistic *finance scheme* to restore, within three *months* of that observation, the reestablishment of *eligible own funds* at least to the level of the *MCR* or to reduce its risk profile to ensure compliance with the *MCR*.

5 RECOVERY PLAN AND FINANCE SCHEME

5.1 Any *recovery plan* or *finance scheme* must at least include particulars or evidence concerning the following:

(1) estimates of management expenses, in particular current general expenses and commissions;

(2) estimates of income and expenditure in respect of direct business, *reinsurance* acceptances and *reinsurance* cessions;

(3) a forecast balance sheet;

(4) estimates of the financial resources intended to cover the *technical provisions* and the *SCR* and the *MCR*; and

(5) the *firm's* overall *reinsurance* policy.

[Note: Art. 142(1) of the *Solvency II Directive*]

6 LLOYD'S

6.1 For the purposes of this Part, 3 and 5 shall apply to the *Society* such that a breach of the *central requirement* shall be treated as a breach of the *SCR*.

PRA RULEBOOK: SOLVENCY II FIRMS: INVESTMENTS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Investments Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Investments Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

INVESTMENTS

Chapter content

1. **APPLICATION AND DEFINITIONS**
2. **PRUDENT PERSON PRINCIPLE: GENERAL PRINCPLES**
3. **PRUDENT PERSON PRINCIPLE: ASSETS COVERING TECHNICAL PROVISIONS**
4. **PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS FOR ASSETS COVERING LINKED LONG-TERM LIABILITIES**
5. **PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS WHERE THE INVESTMENT RISK IS NOT BORNE BY THE POLICYHOLDER**
6. **REPACKAGED LOANS**

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*; and

(3) in accordance with General Application 3, *managing agents*.

1.2 In this Part, the following definitions shall apply:

alternative investment fund

means (in accordance with Article 4(1)(a) of Directive 2011/61/EU) a collective investment undertaking, including investment compartments thereof, which:

(1) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and

(2) does not require authorisation pursuant to Article 5 of the Directive 2009/65/EC.

authorised contractual scheme

means a *co-ownership scheme* or a *partnership scheme*.

collective investment scheme

means a collective investment scheme, as defined in section 235 of *FSMA.*

ICVC

means a body incorporated under the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

linked benefit

means a benefit payable under a *linked long-term contract of insurance* or a *regulated collective investment scheme* the amount of which is determined by reference to:

(1) the value of the property of any description (whether specified or not); or

(2) fluctuations in the value of any such property; or

(3) income from such property; or

(4) fluctuations in an index of the value of such property.

linked long-term liabilities

means the insurance obligations in respect of *linked benefits* under a *linked long-term contract of insurance*.

recognised scheme

means a scheme recognised under:

(1) section 264 of *FSMA* (Schemes constituted in other EEA States); or

(2) section 270 of *FSMA* (Schemes authorised in designated countries or territories); or

(3) section 272 of *FSMA* (Individually recognised overseas schemes).

regulated collective investment scheme

means:

(1) an *ICVC*; or

(2) an *authorised unit trust scheme*; or

(3) an *authorised contractual scheme*; or

(4) a *recognised scheme*;

regulated market

means:

(1) a regulated market as defined in point (14) of Article 4 of Directive 2004/39/EC; or

(2) a market situated outside the *EEA States* which is characterised by the fact that:

(a) it meets comparable requirements to those set out in (1); and

(b) the financial instruments dealt in are of a quality comparable to those in a regulated market in the *United Kingdom*.

unit

means:

(1) (in relation to a *collective investment scheme*) the investment, specified in article 81 of the *Regulated Activities Order* (Units in a collective investment scheme) and defined in section 237(2) of *FSMA* (Other definitions); and

(2) (in relation to an *alternative investment fund*) the right or interest (however described) of an investor in an *alternative investment fund*.

2 PRUDENT PERSON PRINCIPLE: GENERAL PRINCIPLES

2.1 A *firm* must invest its assets in accordance with the following requirements:

(1) the *firm* must only invest in assets and instruments the risks of which it can properly identify, measure, monitor, manage, control and report and appropriately take into account in the assessment of its overall solvency needs in accordance with Conditions Governing Business 3.5(2)(a);

(2) all the assets of the *firm* must be:

(a) invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio of assets of the *firm* as a whole; and

(b) localised such as to ensure their availability; and

(3) in the case of a conflict of interest, the *firm* must, or must procure that any third party which manages its assets will ensure that the investment of assets is made in the best interest of *policyholders*.

[Note: Art. 132(1) – (2) of the *Solvency II Directive*]

3 PRUDENT PERSON PRINCIPLE: ASSETS COVERING TECHNICAL PROVISIONS

3.1 In addition to meeting the requirements set out in 2.1, a *firm* must ensure that assets held to cover its *technical provisions* are invested in a manner appropriate to the nature and duration of the *firm's* insurance and *reinsurance* liabilities and in the best interests of all *policyholders*, taking into account any disclosed *policy* objectives.

[Note: Art. 132(2) of the *Solvency II Directive*]

4 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS FOR ASSETS COVERING LINKED LONG-TERM LIABILITIES

4.1 This Chapter does not apply to a *pure reinsurer.*

4.2 In addition to the requirements set out in 2.1 and 3.1, where a *firm* carries out *linked long-term contracts of insurance*, it must also satisfy the requirements in 4.3.

4.3 Where 4.2 applies, the *firm* must cover its *technical provisions* in respect of its *linked long-term liabilities* as closely as possible with:

(1) where the *linked benefits* are linked to the value of *units*, those *units*;

(2) where the *linked benefits* are linked to the value of assets contained in an internal fund of the *firm*:

(a) in a case where the internal fund is divided into notional units, the assets represented by those notional units; or

(b) in a case where notional units are not established, those assets; and

(3) where the *linked benefits* are linked to a *share* index or other reference value not mentioned in (1) or (2), assets of appropriate security and marketability which correspond as closely as possible to the assets on which the reference value is based.

[Note: Art. 132(3) of the *Solvency II Directive*]

5 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS WHERE THE INVESTMENT RISK IS NOT BORNE BY THE POLICYHOLDER

5.1 This Chapter does not apply in respect of assets covering *technical provisions* for *linked long-term contracts of insurance* unless, and to the extent that, the assets are held to cover the *technical provisions* in respect of any guarantee of investment performance or other guaranteed benefit provided under those *linked long-term contracts of insurance*.

[Note: Art. 132(3) – (4) of the *Solvency II Directive*]

5.2 Subject to 5.1, and without prejudice to 2, 3 and 4, a *firm* must invest its assets in accordance with the following requirements

(1) the *firm* must not invest in a *derivative* or *quasi-derivative* unless, and to the extent that, it contributes to a reduction of risks or facilitates efficient portfolio management;

(2) investments and assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;

(3) assets must be properly diversified in such a way as to avoid:

(a) excessive reliance on any particular asset, issuer, *group* of *undertakings* or geographical area; and

(b) excessive accumulation of risk in the portfolio as a whole;

(4) investments in assets issued by the same issuer, or issuers belonging to the same *group*, must not expose the *firm* to excessive risk concentration.

[Note: Art. 132(4) of the *Solvency II Directive*]

6 REPACKAGED LOANS

6.1 A *firm* must ensure that the requirements set out in the *Solvency II Regulations,* that need to be met by *undertakings* that repackage loans into tradable securities and other financial instruments in order for a *firm* to be allowed to invest in such securities or instruments, are met in respect of securities or instruments held by the *firm* that were:

(1) issued after 1 January 2011; or

(2) issued before 1 January 2011 where new underlying exposures were added or substituted after 31 December 2014.

[Note: Arts. 135(2)(a) and 308b (11) of the *Solvency II Directive*]

PRA RULEBOOK: SOLVENCY II FIRMS: COMPOSITES INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137G (the PRA’s general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook Solvency II Firms: Composites Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Composites Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

COMPOSITES

Chapter content

Links

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*; and

(3) in accordance with General Application 3, *managing agents*.

2 LONG-TERM AND GENERAL INSURANCE ACTIVITIES TO BE SEPARATELY MANAGED

2.1 This Chapter:

(1) applies to a *composite firm* other than a *pure reinsurer*; and

(2) does not apply to a *managing agent* which manages one or more *syndicates*, all of which carry on *reinsurance* exclusively.

2.2 A *composite firm* must separately manage the activities relating to its *general insurance business* and the activities relating to its *long-term insurance business* in such a way that:

(1) its *long-term insurance business* and its *general insurance business* are distinct from one another;

(2) the interests of *policyholders* of *contracts of long-term insurance* are not prejudiced by activities relating to the *firm's general insurance business* and the interests of *policyholders* of *contracts of general insurance* are not prejudiced by activities relating to the *firm's long-term insurance business*; and

(3) profits from the activities relating to the *composite firm's long-term insurance business* benefit *policyholders* of *contracts of long-term insurance* as if the *composite firm* was engaged only in *long-term insurance business*.

[Note: Art. 74(1) of the *Solvency II Directive*]

3 MINIMUM FINANCIAL OBLIGATIONS: GENERAL PROVISIONS

3.1 This Chapter:

(1) applies to a *composite firm*, other than a *pure reinsurer*; and

(2) does not apply to a *managing agent* which manages one or more *syndicates*, all of which carry on *reinsurance* exclusively.

3.2 A *composite firm* must maintain separate accounts for each of its *long-term insurance business* and its *general insurance business* to show the sources of the results for each activity separately.

3.3 For the purposes of 3.2, the *firm* must:

(1) break down, according to origin, all income (including *premiums*, recoverables from *reinsurance contracts* and investment income) and all expenditure (including insurance settlements, additions to *technical provisions*, *reinsurance premiums* and

operating expenses) in respect of its *general insurance business* and its *long-term insurance business*, respectively; and

(2) if items are shared between the *firm's long-term insurance business* and its *general insurance business*, apportion those items appropriately between the two activities and enter them into the accounts on the basis of that apportionment.

[Note: Art. 74(6) of the *Solvency II Directive*]

3.4 The *firm* must record the methods on the basis of which the apportionment referred to in 3.3(2) has been made and be able to demonstrate to the *PRA* the appropriateness of those methods of apportionment.

4 MINIMUM FINANCIAL OBLIGATIONS: CALCULATION OF NOTIONAL MINIMUM CAPITAL REQUIREMENT

4.1 This Chapter:

(1) applies to a *composite firm*, other than a *pure reinsurer*; and

(2) does not apply to *managing agents.*

4.2 Without prejudice to the *SCR rules* and the Minimum Capital Requirement Part, the *firm* must calculate a notional minimum capital requirement on the basis of the accounts referred to in 3.2:

(1) with respect to its *long-term insurance business*, calculated as if the *firm* carried on *long-term insurance business* only; and

(2) with respect to its *general insurance business*, calculated as if the *firm* carried on *general insurance business* only.

[Note: Art. 74(2) of the *Solvency II Directive*]

4.3 The *firm* must cover:

(1) its *notional life MCR* with *eligible own funds* attributable to its *long-term insurance business*, as identified on the basis of the accounts referred to in 3.2; and

(2) its *notional non-life MCR* with *eligible own funds* attributable to its *general insurance business*, as identified on the basis of the accounts referred to in 3.2.

[Note: Art. 74(3) of the *Solvency II Directive*]

4.4 For the purposes of 4.3, the *firm* must not cover:

(1) its *notional life MCR* with *eligible own funds* attributable to its *general insurance business*; and

(2) its *notional non-life MCR* with *eligible own funds* attributable to its *long-term insurance business*.

[Note: Art. 74(3) of the *Solvency II Directive*]

4.5 The *firm* must prepare a statement on the basis of the accounts referred to in 3.2 identifying the *eligible own funds* covering the *notional life MCR* and the *notional non-life MCR*, respectively.

[Note: Art. 74(6) of the *Solvency II Directive*]

4.6 Provided the *firm* satisfies the requirements in 4.3 and 4.4, and subject to the requirement in 4.7, a *firm* may use:

(1) *eligible own funds* attributable to its *general insurance business* that are in excess of its *notional non-life MCR*; and

(2) *eligible own funds* attributable to its *long-term insurance business* that are in excess of its *notional life MCR;*

to cover part or all of the difference between the *firm's SCR* and the sum of its *notional non-life MCR* and *notional life MCR*.

[Note: Art. 74(4) of the *Solvency II Directive*]

4.7 For the purposes of 4.6, a *firm* must notify the *PRA* before using:

(1) *eligible own funds* referred to in 4.6(1) to cover the portion of the difference referred to in 4.6 that relates to the difference between the *notional life SCR* and the *notional life MCR*; or

(2) *eligible own funds* referred to in 4.6(2) to cover the portion of the difference referred to in 4.6 that relates to the difference between the *notional non-life SCR* and the *notional non-life MCR*.

[Note: Art. 74(4) of the *Solvency II Directive*]

4.8 If a *composite firm* is in breach of either 4.3(1) or 4.3(2), the provisions of Minimum Capital Requirement 4.1 apply to the activity in respect of which the breach has occurred, as if the words "*MCR*" in Minimum Capital Requirement 4.1 were substituted with the words "*notional life MCR*" or "*notional non-life MCR*", as applicable, regardless of whether any breach has occurred in respect of the other activity.

[Note: Art. 74(7) of the *Solvency II Directive*]

5 LINKS BETWEEN GENERAL INSURERS AND LONG-TERM INSURERS

5.1 If a *general insurer* and a *long-term insurer* have financial, commercial or administrative links with each other, each of those *firms* must ensure that its accounts are not distorted by an agreement between them or by any arrangement which could affect the apportionment of expenses and income.

[Note: Art. 73(4) of the *Solvency II Directive*]

6 LLOYD'S

6.1 This Chapter applies to *managing agents*.

6.2 A *managing agent* must not permit both *general insurance business* and *long-term insurance business* to be carried on together through any *syndicate* managed by it, except where:

(1) the *long-term insurance business* to be carried on by that *syndicate* is or is to be restricted to *reinsurance;* or

(2) the *general insurance business* to be carried on by that *syndicate* is or is to be restricted to *effect contracts of insurance* or *carry out contracts of insurance* in *general insurance business class* 1 (accident) or *class* 2 (sickness).

[Note: Art. 73(2) of the *Solvency II Directive*]

PRA RULEBOOK: SOLVENCY II FIRMS: CONDITIONS GOVERNING BUSINESS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Conditions Governing Business Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA: Rulebook Solvency II Firms: Conditions Governing Business Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

CONDITIONS GOVERNING BUSINESS

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with General Application 3, the *Society*, as modified by 12; and

(3) in accordance with General Application 3, *managing agents*, as modified by 12.

1.2 In this Part, the following definitions shall apply:

closed year

means a *syndicate year* closed by *reinsurance to close,* either into another *syndicate year* or into an *insurer* approved by the *Council* for that purpose.

concentration risk

means all risk exposures with a loss potential which is large enough to threaten the solvency or the financial position of a *Solvency II undertaking*.

[Note: Art. 13(35) of the *Solvency II Directive*]

corporate member

means a *member* that is a *body corporate* or a Scottish Limited partnership.

explicit maximum loss potential

means the maximum economic risk transferred by the ceding undertaking to the *reinsurer* under a contract of *reinsurance.*

external credit assessment institution

means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009.

[Note: Art. 13(40) of the *Solvency II Directive*]

finite reinsurance

means *reinsurance*:

(1) under which the *explicit maximum loss potential* arising from a significant transfer of both *underwriting risk* and timing risk exceeds the premium payable by the ceding *undertaking* over the duration of the contract by a limited but significant amount; and

(2) which possesses at least one of the following characteristics:

(a) explicit and material consideration of the time value of money; and

(b) contractual provisions to moderate the balance of economic experience between the parties to the *reinsurance* over time to achieve the target risk transfer.

[Note: Art. 210(3) of the *Solvency II Directive*]

former member

means a *person* who has ceased to be a *member*, whether by resignation or otherwise, in accordance with the Lloyd's Act 1982 and any *byelaw* made under it.

individual member

means a *member,* or *former member*, who is a natural *person*.

liquidity risk

means the risk that a *firm* is unable to realise investments and other assets in order to settle its financial obligations when they fall due.

[Note: Art. 13(34) of the *Solvency II Directive*]

quasi-derivative

means a contract or asset having the effect of a *derivative* contract.

reinsurer

means an *insurance undertaking* whose business includes effecting or carrying out contracts of *reinsurance*; includes a retrocessionaire.

technical provisions transitional measure

[means the approval granted to a *firm* by the *PRA* referred to in Transitional Measures 11].

2 GENERAL GOVERNANCE REQUIREMENTS

2.1 A *firm* must ensure its *governing body* is ultimately responsible for the *firm's* compliance with the *rules* and all applicable laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*.

[Note: Art. 40 of the *Solvency II Directive*]

2.2 (1) A *firm* must have in place an effective system of governance which provides for sound and prudent management of its business.

(2) The system of governance must include at least:

(a) an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities; and

(b) an effective system for ensuring the transmission of information.

(3) The system of governance must include compliance with the requirements laid down in 2.5 and 3 – 8.

(4) The system of governance must be subject to regular internal review.

[Note: Art. 41(1) of the *Solvency II Directive*]

2.3 A *firm's* system of governance must be proportionate to the nature, scale and complexity of its operations.

[Note: Art. 41(2) of the *Solvency II Directive*]

2.4 A *firm* must:

(1) have written policies in relation to at least risk management, internal control, internal audit and, where relevant, *outsourcing*;

(2) make those policies subject to prior approval of its *governing body*;

(3) ensure those policies are implemented;

(4) review those policies at least annually; and

(5) adapt those policies in view of any significant change in the system or area concerned.

[Note: Art. 41(3) of the *Solvency II Directive*]

2.5 The written policy on risk management referred to in 2.4(1) must comprise:

(1) policies relating to points (i) – (vi) in 3.1(2)(c); and

(2) where the *volatility adjustment* is applied, a policy on the criteria for the application of the *volatility adjustment.*

[Note: Art. 44(2) and (2a) of the *Solvency II Directive*]

2.6 A *firm* must take reasonable steps to ensure continuity and regularity in the performance of its activities, including the development of contingency plans. To that end, the *firm* must employ appropriate and proportionate systems, resources and procedures.

[Note: Art. 41(4) of the *Solvency II Directive*]

3 RISK MANAGEMENT

3.1 (1) A *firm* must have in place an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies.

(2) That risk management system must:

(a) be effective and well integrated into the organisational structure and decision-making processes of the *firm* with proper consideration of the *persons* who effectively run the *firm* or have other key *functions*;

(b) cover the risks to be included in the calculation of the *SCR* as set out in Solvency Capital Requirement - General Provisions 3.3(1), as well as the risks which are not, or not fully, included in the calculation thereof;

(c) cover at least the following areas:

(i) underwriting and reserving;

(ii) asset–liability management;

(iii) investment, in particular *derivatives*, *quasi-derivatives* and similar commitments;

(iv) *liquidity risk* and *concentration risk* management;

(v) *operational risk* management;

(vi) *reinsurance* and other *risk-mitigation techniques*.

(3) Where a *firm* applies the *matching adjustment* or the *volatility adjustment* it must set up a liquidity plan projecting the incoming and outgoing cash-flows in relation to the assets and liabilities subject to those adjustments.

[Note: Art. 44(1)–(2) of the *Solvency II Directive*]

3.2 As regards asset-liability management, a *firm* must:

(1) regularly assess the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the extrapolation of the *relevant risk-free interest rate term structure* referred to in Technical Provisions 4A;

(2) where the *matching adjustment* is applied, regularly assess:

(a) the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the calculation of the *matching adjustment*, including the calculation of the fundamental spread referred to in Technical Provisions 4C.2(2), and the possible effect of a forced sale of assets on its *eligible own funds*;

(b) the sensitivity of its *technical provisions* and *eligible own funds* to changes in the composition of the assigned portfolio of assets;

(c) the impact of a reduction of the *matching adjustment* to zero;

(3) where the *volatility adjustment* is applied, regularly assess:

(a) the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the calculation of the *volatility adjustment* and the possible effect of a forced sale of assets on its *eligible own funds*;

(b) the impact of a reduction of the volatility to zero.

[Note: Art. 44(2a) of the *Solvency II Directive*]

3.3 A *firm* must submit the assessments referred to in 3.2 as part of the information reported annually in accordance with Reporting 2. Where the reduction of the *matching adjustment* or the *volatility adjustment* to zero would result in non-compliance with the *SCR*, the *firm* must also submit an analysis of the measures it could apply in such a situation to re-establish the level of the *eligible own funds* covering the *SCR* or to reduce its risk profile to restore compliance with the *SCR*.

[Note: Art. 44(2a) of the *Solvency II Directive*]

3.4 As regards investment risk, a *firm* must demonstrate that it complies with the Investments Part.

[Note: Art. 44(3) of the *Solvency II Directive*]

3.5 A *firm* must provide for a risk management *function* that is structured in such a way as to facilitate the implementation of the risk management system.

[Note: Art. 44(4) of the *Solvency II Directive*]

3.6 In order to avoid overreliance on *external credit assessment institutions* when it uses external credit rating assessments in the calculation of *technical provisions* and the *SCR*, a *firm* must assess the appropriateness of those external credit rating assessments as part of its risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments.

[Note: Art. 44(4a) of the *Solvency II Directive*]

3.7 A *firm* that has received *internal model approval* must ensure that its risk management *function* covers the following additional tasks:

(1) to design and implement the *internal model*;

(2) to test and validate the *internal model*;

(3) to document the *internal model* and any subsequent changes made to it;

(4) to analyse the performance of the *internal model* and to produce summary reports thereof; and

(5) to inform the *governing body* about the performance of the *internal model*, suggesting areas needing improvement, and updating that body on the status of efforts to improve previously identified weaknesses.

[Note: Art. 44(5) of the *Solvency II Directive*]

3.8 (1) A *firm* must conduct an *ORSA* as part of its risk management system.

(2) The *ORSA* must include at least the following:

(a) the *firm's* overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the *firm*;

(b) the compliance, on a continuous basis, with:

(i) the *SCR* and *MCR*; and

(ii) the requirements regarding *technical provisions*, as set out in Technical Provisions; and

(c) the significance with which the risk profile of the *firm* deviates from the assumptions underlying the *SCR*.

(3) For the purposes of 3.8(2)(a), the *firm* must:

(a) have in place processes which are proportionate to the nature, scale and complexity of the risks inherent in its business and which enable it to properly identify and assess the risks it faces in the short and long term and to which it is, or could be, exposed; and

(b) demonstrate the methods used in that assessment.

(4) Where a *firm* applies the *matching adjustment*, the *volatility adjustment*, the *risk-free interest rate transitional measure* or the *technical provisions transitional measure*, it must perform the assessment of compliance with the capital requirements referred to in 3.8(2)(b) with and without taking into account those adjustments and transitional measures.

(5) In the case referred to in 3.8(2)(c), when an *internal model* is used, the assessment must be performed together with the recalibration that transforms the internal risk numbers into the *SCR risk measure* and calibration.

[Note: Arts. 45(1), (2), (2a), (3) of the *Solvency II Directive*]

3.9 A *firm* must make the *ORSA* an integral part of its business strategy and take the *ORSA* into account on an ongoing basis in its strategic decisions.

[Note: Art. 45(4) of the *Solvency II Directive*]

3.10 A *firm* must perform the *ORSA* regularly and without delay following any significant change in its risk profile.

[Note: Art. 45(5) of the *Solvency II Directive*]

3.11 A *firm* must inform the *PRA* of the results of each *ORSA* as part of the information reported under Reporting 2.

[Note: Art. 45(6) of the *Solvency II Directive*]

4 INTERNAL CONTROL

4.1 (1) A *firm* must have in place an effective internal control system.

(2) That system must include administrative and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels of the *firm* and a compliance *function*.

[Note: Art. 46(1) of the *Solvency II Directive*]

4.2 The compliance *function* referred to in 4.1(2) must include:

(1) advising the *governing body* on compliance with the *rules* and other laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*; and

(2) an assessment of the possible impact of any changes in the legal environment on the operations of the *firm* concerned and the identification and assessment of compliance risk.

[Note: Art. 46(2) of the *Solvency II Directive*]

4.3 A *firm* must have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of its *technical provisions*.

[Note: Art. 82 of the *Solvency II Directive*]

4.4 A *firm* must have processes and procedures in place to ensure that the *best estimate*, and the assumptions underlying the calculation of the *best estimate*, are regularly compared against experience.

[Note: Art. 83 of the *Solvency II Directive*]

5 INTERNAL AUDIT

5.1 (1) A *firm* must provide for an effective internal audit *function*.

(2) The internal audit *function* must:

(a) include an evaluation of the adequacy and effectiveness of the internal control system and other elements of the system of governance; and

(b) be objective and independent from the operational *functions*.

(3) A *firm* must ensure that any findings and recommendations of the internal audit *function* are reported to the *firm's governing body* which must:

(a) determine what actions are to be taken with respect to each of the internal audit findings and recommendations; and

(b) ensure that those actions are carried out.

[Note: Art. 47 of the *Solvency II Directive*]

6 ACTUARIAL FUNCTION

6.1 (1) A *firm* must provide for an effective actuarial *function* to:

(a) coordinate the calculation of *technical provisions*;

(b) ensure the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of *technical provisions*;

(c) assess the sufficiency and quality of the data used in the calculation of *technical provisions*;

(d) compare *best estimates* against experience;

(e) inform the *governing body* of the reliability and adequacy of the calculation of *technical provisions*;

(f) oversee the calculation of *technical provisions* in the cases set out in Technical Provisions 8;

(g) express an opinion on the overall underwriting policy;

(h) express an opinion on the adequacy of *reinsurance* arrangements; and

(i) contribute to the effective implementation of the risk management system referred to in 3, in particular with respect to the risk modelling underlying the calculation of the *SCR* and *MCR* and to the *firm's ORSA*.

(2) The actuarial *function* must be carried out by *persons* who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the *firm's* business, and who are able to demonstrate their relevant experience with applicable professional and other standards.

[Note: Art. 48 of the *Solvency II Directive*]

7 OUTSOURCING

7.1 If a *firm outsources* a *function* or any insurance or *reinsurance* activity, it remains fully responsible for discharging all of its obligations under the *rules* and other laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*.

[Note: Art. 49(1) of the *Solvency II Directive*]

7.2 A *firm* must not *outsource* a critical or important operational *function* or activity in such a way as to lead to any of the following:

(1) materially impairing the quality of the *firm's* system of governance;

(2) unduly increasing the *operational risk*;

(3) impairing the ability of the *supervisory authorities* to monitor the *firm's* compliance with its obligations;

(4) undermining continuous and satisfactory service to *policyholders*.

[Note: Art. 49(2) of the *Solvency II Directive*]

7.3 A *firm* must, in a timely manner, notify the *PRA* prior to the *outsourcing* of critical or important *functions* or activities as well as of any subsequent material developments with respect to those *functions* or activities.

[Note: Art. 49(3) of the *Solvency II Directive*]

7.4 Without prejudice to 7.1 – 7.3, a *firm outsourcing* a *function* or an insurance or *reinsurance* activity must take the necessary steps to ensure that the following conditions are satisfied:

(1) the service provider must co-operate with the *PRA* and, where relevant, any other *supervisory authority* of the *firm* in connection with the *function* or activity that is the subject of the *outsourcing*;

(2) the *firm*, its auditors, the *PRA* and, where relevant, any other *supervisory authority* of the *firm* must have effective access to data related to the *functions* or activities that are the subject of the *outsourcing*; and

(3) the *PRA* and, where relevant, any other *supervisory authority* of the *firm* must have effective access to the business premises of the service provider and must be able to exercise those rights of access.

[Note: Art. 38(1) of the *Solvency II Directive*]

8 FIT AND PROPER REQUIREMENTS FOR PERSONS WHO EFFECTIVELY RUN THE UNDERTAKING OR HAVE OTHER KEY FUNCTIONS

[Drafting Note: Placeholder for rules in relation to Article 42 of the Solvency II Directive]

9 FINITE REINSURANCE

9.1 A *firm* must not enter into a contract of *finite reinsurance* (either as a cedant or a *reinsurer*) or pursue *finite reinsurance* activities unless it is able to properly identify, measure, monitor, manage, control and report the risks arising from that contract or those activities.

[Note: Art. 210 of the *Solvency II Directive*]

10 RESTRICTION OF BUSINESS

10.1 (1) A *firm,* other than a *pure reinsurer,* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

(2) (1) does not prevent a *friendly society* that was on 15 March 1979 carrying on *long-term insurance business* and savings business from continuing to carry on savings business.

[Note: Articles 18(1)(a) and 305(3) of the *Solvency II Directive*]

10.2 A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

[Note: Art. 18(1)(b) of the *Solvency II Directive*]

11 PREMIUMS FOR NEW BUSINESS

11.1 A *firm* must not enter into a *contract of long-term insurance* unless it is satisfied, on reasonable actuarial assumptions, that the *premiums* receivable shall be sufficient:

(1) to enable the *firm* to meet all of its commitments*;* and

(2) in particular, to establish adequate *technical provisions* as required in the Technical Provisions Part.

[Note: Art. 209 of the *Solvency II Directive*]

11.2 For the purposes of 11.1, all aspects of the financial situation of the *firm* may be taken into account, provided that input from resources other than *premiums* and investment income expected to be earned from *premiums* is not systematic and permanent in a way that may jeopardise the long-term solvency of the *firm*.

[Note: Art. 209 of the *Solvency II Directive*]

12 LLOYD’S

12.1 This Chapter applies to the *Society* and *managing agents*.

12.2 For the purpose of;

(1) 3.1(2)(b), 3.8(2)(c) and 6.1(1)(i), as applied to *managing agents*, the reference to “*SCR*” is to be interpreted as a reference to the notional *syndicate SCR* calculated by *managing agents* as required by Solvency Capital Requirement - General Provisions 8.2.

(2) 3.7 and 3.8(5), as applied to *managing agents*, the reference to “internal model” is to be interpreted as a reference to any *internal model* used by a *managing agent* to

calculate the notional *syndicate SCR* as required by Solvency Capital Requirement – General Provisions 8.2; and

(3) 3.10, as applied to *managing agents*, the reference to “risk profile” is to be interpreted as a reference to the risk profile of any *syndicate* managed by the *managing agent.*

12.3 For the purpose of 3.8 – 3.11, as applied to *managing agents, managing agents* must conduct an *ORSA* for each *syndicate* which they manage.

12.4 Where a provision of this Part requires that a *function* be established, the *Society* and *managing agents* must each separately establish that *function*.

12.5 The actuarial *function* of a *managing agent* must, in respect of each *syndicate* managed by the *managing agent*, carrying out *general insurance business*;

(1) review the *technical provisions* of each *syndicate year* (other than a *closed year)*; and

(2) provide an opinion to the *managing agent* and the *Society* confirming that the *technical provisions* (before addition of the *risk margin*) for each *syndicate year* are no less prudent than the *best estimate* of the amounts required to be held (before addition of the *risk margin*) in accordance with Technical Provisions 2 – 8.

12.6 The *PRA* must be informed by the *managing agent* promptly if the *managing agent* becomes aware that the actuarial *function* of the *managing agent* will or may be unable to produce an unqualified opinion under 12.5(2).

12.7 8 applies separately to *managing agents* and the *Society*.

12.8 For the purpose of 10.1, the *Society* and *managing agents* must take all reasonable steps to ensure that:

(1) a *corporate member* does not carry on any commercial business other than *insurance business* and activities arising directly from that business; and

(2) *individual members* do not, in their capacity as *underwriting members*, carry on any commercial business other than *insurance business* and activities arising directly from that business.

PRA RULEBOOK: SOLVENCY II FIRMS: INSURANCE SPECIAL PURPOSE VEHICLES INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Insurance Special Purpose Vehicles Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook Solvency II Firms: Insurance Special Purpose Vehicles Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

INSURANCE SPECIAL PURPOSE VEHICLES

Chapter content

Links

1 APPLICATION

1.1 Unless otherwise stated, this Part applies to a *UK ISPV*.

2 GENERAL PROVISIONS

2.1 A *UK ISPV* must ensure that at all times it is fully funded.

3 UK ISPVS WITH PART 4A PERMISSION

3.1 Where a *UK ISPV* has a *Part 4A permission* in force prior to 1 January 2016, that *Part 4A permission* shall continue to have effect thereafter provided that the *UK ISPV* satisfies the requirements of the *Solvency II Regulations* on that date.

PRA RULEBOOK: SOLVENCY II FIRMS: GROUP SUPERVISION INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules);
(2) section 137T (general supplementary powers); and
(3) section 192J (rules requiring provision of information by parent undertakings).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Group Supervision Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Group Supervision Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

GROUP SUPERVISION

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) every *UK Solvency II firm*:

(a) that is a member of a *group* for which the *PRA* is the *group supervisor*;

(b) that is a member of a *group* for which a *supervisory authority* (other than the *PRA*) is the *group supervisor*, subject to (c) and to the extent this Part gives effect to the *Solvency II EEA implementing measures* in the *EEA State* of its *group supervisor*; and

(c) where the *group supervisor* of a *group* of which a *firm* is a member is a *supervisory authority* in an *EEA State* other than the *United Kingdom*, the requirements of the *Solvency II EEA implementing measures* in that *EEA State* apply to the *firm* in relation to its capacity as a member of that *group*;

(2) in accordance with General Application 3, the *Society* as a *mixed activity insurance holding company*, as modified by 21; and;

(3) a *UK holding company*

1.2 In this Part, the following definitions shall apply:

close links

means a situation in which two or more *persons* are linked by *control* or *participation*, or a situation in which two or more *persons* are permanently linked to one and the same person by a *control* relationship.

[Note: Art. 13(17) of the *Solvency II Directive*]

financial institution

has the meaning given in point (26) of Article 4(1) of the *CRR*.

group supervisor

means (in relation to a *group*) the authority designated as group supervisor in relation to that *group*, in accordance with Article 247 of the *Solvency II Directive*.

intermediate holding company

means an *insurance holding company* or a *mixed financial holding company* through which a *Solvency II undertaking* in a *group* holds a *participation* in a *related Solvency II undertaking*, a *third country insurance undertaking* or a *third country reinsurance undertaking.*

method 1

means the method for calculating group solvency described in 11.1.

method 2

means the method for calculating group solvency described in 12.1.

mixed activity insurance holding company

means a *parent undertaking*, other than a *Solvency II undertaking*, a *third-country insurance undertaking*, a *third-country reinsurance undertaking*, an *insurance holding company* or a *mixed financial holding company*, the *subsidiary undertakings* of which include at least one *Solvency II undertaking*.

[Note: Art. 212(1)(g) of the *Solvency II Directive*]

own funds eligible for the group SCR

means:

(1) in relation to *method 1*, the *own funds eligible for the group SCR* in accordance with 11.1(3); and

(2) in relation to *method 2,* the aggregate *eligible own funds* of the *group* referred to in 12.2.

own funds eligible for the SCR

means the aggregate of the *firm's*:

(a) *Tier 1 own funds*; and

(b) *eligible Tier 2 own funds*; and

(c) *eligible Tier 3 own funds*.

related Solvency II undertaking

means a *Solvency II undertaking* that is a *related undertaking* of another *undertaking*.

related undertaking

means, in relation to an *undertaking* ("U"):

(1) any *subsidiary undertaking* of U; or

(2) any *undertaking* in which U or any of U's *subsidiary undertakings* holds a *participation*; or

(3) any *undertaking* linked to U by an *Article 12(1) relationship*; or

(4) any *undertaking* linked by an *Article 12(1) relationship* to an *undertaking* in (1), (2) or (3).

solvency deficit

means the amount (if any) by which the *related undertaking's eligible own funds* fall short of its solvency capital requirement under the *SCR Rules* or the relevant *Solvency II implementing measures* as appropriate.

UK holding company

means an *insurance holding company* or *mixed financial holding company* that:

(1) is incorporated in the *United Kingdom*; or

(2) has a place of business in the *United Kingdom.*

2 CASES OF APPLICATION AND SCOPE OF GROUP SUPERVISION

2.1 This Part applies at the level of the *group* to types of *groups* where:

(1) either:

(a) a *UK Solvency II firm* is a *participating undertaking* in at least one other *Solvency II undertaking*, *third country insurance undertaking* or *third country reinsurance undertaking*; or

(b) a *Solvency II undertaking* (other than a *UK Solvency II firm*) is a *participating undertaking* in a *UK Solvency II firm*; or

(2) the *parent undertaking* of a *UK Solvency II firm* is an *insurance holding company* or a *mixed financial holding company* which has its head office in an *EEA State*; or

(3) the *parent undertaking* of a *UK Solvency II firm* is an *insurance holding company* or a *mixed financial holding company* which does not have its head office in an *EEA State* or is a *third country insurance undertaking* or a *third country reinsurance undertaking*; or

(4) the *parent undertaking* of a *UK Solvency II firm* is a *mixed activity insurance holding company*.

[Note: Art. 213(2) of the *Solvency II Directive*]

2.2 Where, in accordance with 2.1, this Part applies at the level of a *group*, that *group* consists of all *undertakings* within the relevant *group*, subject to 2.3 and 3 and provided that:

(1) where 2.1(1) applies, the definition of a *group* must be applied to the *participating Solvency II undertaking*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*;

(2) where 2.1(2) applies, the definition of a *group* must be applied to the *insurance holding company* or *mixed financial holding company*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*;

(3) where 2.1(3) applies, the definition of a *group* must be applied to the *insurance holding company* or *mixed financial holding company*, *third country insurance undertaking* or *third country reinsurance undertaking* (as applicable), its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*; and

(4) where 2.1(4) applies, the definition of a *group* must be applied to the *mixed activity insurance holding company*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*.

[Note: Art. 213(2) of the *Solvency II Directive*]

2.3 Where the *PRA* as *group supervisor* has granted a *waiver* or where a *supervisory authority* which is the *group supervisor* has decided, in accordance with Article 214 of the *Solvency II Directive*, not to include an *undertaking* in the group supervision referred to in 2.1:

(1) that *undertaking* must be excluded from the *group* for the purposes of 2.1; and

(2) if that *undertaking* is a *firm* and is excluded because:

(a) it is of negligible interest with respect to the objectives of group supervision; or

(b) its inclusion would be inappropriate or misleading with respect to the objectives of group supervision,

the *firm* which is at the head of the *group* of which that *firm* would otherwise be a part, or any other *firm* which is a member of the *group* must provide any information in relation to the excluded *firm* that the *PRA* may require to facilitate the supervision of the excluded *firm*.

[Note: Art. 214(2) of the *Solvency II Directive*]

2.4 The provisions of the Solvency II Firms Sector concerning the supervision of *firms* (or the *Solvency II EEA implementing measures* in relation to *Solvency II undertakings* which are members of a *group* for which the *PRA* is the *group supervisor*) taken individually continue to apply to those *undertakings*, except where otherwise provided under this Part.

[Note: Art. 213(1) of the *Solvency II Directive*]

3 LEVELS

3.1 If the *participating Solvency II undertaking* or the *insurance holding company* or *mixed financial holding company* referred to in 2.1(1) or 2.1(2) is itself a *subsidiary undertaking* of another *Solvency II undertaking* or of another *insurance holding company* or *mixed financial holding company* which has its head office in an *EEA State*, then 4 – 19 apply only at the level of the ultimate *Solvency II undertaking*, *insurance holding company*, or *mixed financial holding company* in the *group* which has its head office in an *EEA State*.

[Note: Art. 215(1) of the *Solvency II Directive*]

3.2 If the *PRA* makes the decision referred to in Article 216(1) of the *Solvency II Directive* (group supervision at national level) then 4 – 19 apply with any necessary changes, subject to Articles 216(6) and 217 of the *Solvency II Directive* and the following:

(1) group supervision of the ultimate *parent undertaking* at national level is restricted to those *rules* of 4 – 19 if the *firm* is granted a *waiver* of such other sections as would otherwise apply to a *group*; and

(2) no *firm* in the *group* may introduce, in accordance with 15.1(5), an application for permission to subject any *subsidiary undertakings* in the *group* to 15.3.

[Note: Art. 216(2) and (5) of the *Solvency II Directive*]

4 GROUP SOLVENCY: GENERAL PROVISIONS

4.1 Where 2.1(1) applies, each *participating Solvency II undertaking* that is a *firm* in the *group* and each *relevant insurance group undertaking* must ensure that *eligible own funds* are available in the *group* which are always at least equal to the *group SCR* as calculated in accordance with 7 – 12.

[Note: Art. 218(2) of the *Solvency II Directive*]

4.2 Where 2.1(2) applies, each *relevant insurance group undertaking* must ensure that *eligible own funds* are available in the *group* which are always at least equal to the *group SCR* as calculated in accordance with 14.

[Note: Art. 218(3) of the *Solvency II Directive*]

4.3 *Relevant insurance group undertakings* must have procedures in place to identify deteriorating financial conditions within the *groups* of which they are members and must immediately notify the *group supervisor* when that deterioration occurs.

[Note: Arts. 218(4) and 136 of the *Solvency II Directive*]

4.4 *Relevant insurance group undertakings* must:

(1) immediately inform the *PRA* as soon as they observe that the *group SCR* is no longer complied with, or where there is a risk of non-compliance within the next three *months*;

(2) within two *months* from the observation of non-compliance with the *group SCR*, submit a realistic *recovery plan* in accordance with Undertakings In Difficulty 5.1 for approval by the *PRA*;

(3) take the measures necessary to achieve, within six *months* (or such longer period as the *PRA* may determine) from the observation of non-compliance with the *group SCR*, the re-establishment of the level of *eligible own funds* covering the *group SCR* or the reduction of the risk profile to ensure compliance with the *group SCR*; and

(4) if the *PRA* has extended the period referred to (3) by reason of the declaration by *EIOPA* of an *exceptional adverse situation* affecting the *group*, submit a progress report to the *PRA* every three *months* setting out the measures taken and the progress made to re-establish the level of *own funds* covering the *group SCR* or to reduce the risk profile to ensure compliance with the *group SCR*.

[Note: Arts. 218(4) and 138(1)–(4) of the *Solvency II Directive*]

5 GROUP SOLVENCY: FREQUENCY OF CALCULATIONS

5.1 The calculations referred to in 4.1 and 4.2 must be carried out at least annually by the *relevant insurance group undertakings*.

[Note: Art. 219(1) of the *Solvency II Directive*]

5.2 The relevant data for, and the results of, the calculations referred to in 4.1 and 4.2 must be submitted to the *group supervisor* by:

(1) the *participating Solvency II undertakings* referred to in 4.1, or by any one of them, in the case of the calculations referred to in 4.1; or

(2) *UK holding company* or such other *undertaking* in the *group* as may be determined by the *group supervisor* in accordance with Article 219(1) of the *Solvency II Directive*, in the case of the calculations referred to in 4.2.

[Note: Art. 219(1) of the *Solvency II Directive*]

5.3 (1) The *relevant insurance group undertakings* must monitor the *group SCR* on an ongoing basis.

(2) Where the risk profile of the *group* deviates significantly from the assumptions underlying the last reported *group SCR*, the *group SCR* must be recalculated without delay and reported to the *group supervisor*.

(3) Upon request by the *group supervisor*, in accordance with Article 219(2) of the *Solvency II Directive*, the *group SCR* must be recalculated without delay and reported to the *group supervisor*.

[Note: Art. 219(2) of the *Solvency II Directive*]

6 GROUP SOLVENCY: NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS BY GROUP MEMBER

6.1 This section applies to a *firm* if another member of its *group* intends to issue an item for inclusion within the *basic own funds* forming the *own funds eligible for the group SCR* of the *firm*'s *group*.

6.2 A *firm* must notify the *PRA* in writing of the intention of another member of its *group* which is not a *firm* to issue an item which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, as soon as it becomes aware of the intention of the issuing *undertaking*. When giving notice, a *firm* must:

(1) provide details of the amount of *basic own funds* to be raised through the intended issue and whether the item is intended to be issued to external investors or within its *group*;

(2) identify the classification of *basic own funds* the item is intended to fall within;

(3) include confirmation from the *governing body* of the *firm* that the item complies with the *rules* applicable to items of *basic own funds* included in the classification of the item identified in (2); and

(4) provide a copy of the term sheet and details of any features of the item it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR* which are novel, unusual or different from an item of *own funds* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by the Solvency II Firms Sector or the *Solvency II Regulations*.

6.3 A *firm* must provide a further written notification to the *PRA* including all the information required in 6.2 as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.

6.4 If an *undertaking* proposes to establish a debt securities program for the issue of an item which the *firm* intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, the *firm* must:

(1) notify the *PRA* of the establishment of the program; and

(2) provide the information required by 6.2

as soon it becomes aware of the proposed establishment. The *PRA* must be notified of any changes in accordance with 6.3.

6.5 The items of *basic own funds* to which 6.2 does not apply are:

(1) ordinary *shares* issued by an *undertaking* in the *group* which are:

(a) classified as *Tier 1 own funds* or *Tier 2 basic own funds*; and

(b) the same as ordinary *shares* previously issued by that *undertaking*;

(2) debt instruments issued from a debt securities program established by an *undertaking* in the *group*, provided that program was notified to the *PRA* prior to its first drawdown in accordance with 6.4; and

(3) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *group undertaking* and included in the *basic own funds* forming the *own funds eligible for the group SCR*.

6.6 A *firm* must notify the *PRA* in writing, no later than the date of issue, of the intention of the *undertaking* in the *group* to issue an item listed in 6.5 which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*. When giving notice, a *firm* must:

(1) provide the information set out at 6.2(1) – (3); and

(2) confirm that the terms of the item have not changed since the previous issue of that type of item of *basic own funds* by that *undertaking*.

7 GROUP SOLVENCY: BASIC PRINCIPLES

7.1 The calculation of the solvency at the level of the *group* of the *Solvency II undertakings* referred to in 2.1(1) must be carried out:

(1) in accordance with the technical principles in 8 – 10; and

[Note: Art. 220(1) of the *Solvency II Directive*]

(2) in accordance with *method 1*, unless the *group supervisor* has determined under Article 220(2) of the *Solvency II Directive* that *method 2* or a combination of *method 1* and *method 2* must be applied.

[Note: Art. 220(2) of the *Solvency II Directive*]

8 GROUP SOLVENCY: PROPORTIONAL SHARES

8.1 The calculation of the solvency of a *group* must take account of the proportional share held by the *participating undertaking* in its *related undertakings*.

[Note: Art. 221(1) of the *Solvency II Directive*]

8.2 For the purposes of 8.1, the proportional share must comprise either of the following, subject to 8.3:

(1) where *method 1* is used, the percentages used for the establishment of the consolidated accounts; or

(2) where *method 2* is used, the proportion of the subscribed capital that is held, directly or indirectly, by the *participating undertaking*.

[Note: Art. 221(1) of the *Solvency II Directive*]

8.3 Notwithstanding 8.2:

(1) where the *related undertaking* is a *subsidiary undertaking* and does not have sufficient *eligible own funds* to cover its *SCR*, the total *solvency deficit* of the *subsidiary undertaking* must be taken into account (or a proportional share of that *solvency deficit*, if the *group supervisor* so determines under Article 221(1) of the *Solvency II Directive*); and

[Note: Art. 221(1) of the *Solvency II Directive*]

(2) the proportional share must be as determined by the *group supervisor* if such a determination is made under Article 221(2) of the *Solvency II Directive*.

[Note: Art. 221(2) of the *Solvency II Directive*]

9 GROUP SOLVENCY: ELIMINATION OF DOUBLE USE OF ELIGIBLE OWN FUNDS AND INTRA-GROUP CREATION OF CAPITAL AND VALUATION

9.1 *Own funds eligible for the SCR* must not be taken into account more than once among the different *Solvency II undertakings* taken into account in the calculation of the solvency of a *group*. For that purpose, when calculating the solvency of a *group* and where *method 1* and *method 2* do not provide for it, the following amounts must be excluded:

(1) the value of any asset of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of one of its *related Solvency II undertakings*;

(2) the value of any asset of a *related Solvency II undertaking* of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of that *participating Solvency II undertaking*; and

(3) the value of any asset of a *related Solvency II undertaking* of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of any other *related Solvency II undertaking* of that *participating Solvency II undertaking*.

[Note: Art. 222(1) of the *Solvency II Directive*]

9.2 Without prejudice to 9.1 or 9.3, the following must be excluded in the calculation of the solvency of a *group* unless they are, and only insofar as they are, eligible for covering the *SCR* of the *related undertaking* concerned:

(1) surplus funds falling under Article 91(2) of the *Solvency II Directive* arising in a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated; and

(2) any subscribed but not paid-up capital of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated.

[Note: Art. 222(2) of the *Solvency II Directive*]

9.3 Without prejudice to 9.1, the following must, in any event, be excluded from the calculation:

(1) subscribed but not paid-up capital which represents a potential obligation on the part of the *participating undertaking*;

(2) subscribed but not paid-up capital of the *participating Solvency II undertaking* which represents a potential obligation on the part of a *related Solvency II undertaking*; and

(3) subscribed but not paid-up capital of a *related Solvency II undertaking* which represents a potential obligation on the part of another *related Solvency II undertaking* of the same *participating Solvency II undertaking*.

[Note: Art. 222(2) of the *Solvency II Directive*]

9.4 Where the *PRA* considers that certain *own funds eligible for the SCR* of a *related Solvency II undertaking* (other than those referred to in 9.2 and 9.3) cannot effectively be made available to cover the *SCR* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated, those *own funds* must not be included in the calculation of the group solvency of the *group* unless they are, and only in so far as they are, eligible for covering the *SCR* of the *related undertaking*.

[Note: Art. 222(3) of the *Solvency II Directive*]

9.5 The sum of the *own funds* included under 9.2 and 9.4 must not exceed the *SCR* of the *related Solvency II undertaking*.

[Note: Art. 222(4) of the *Solvency II Directive*]

9.6 Any *eligible own funds* of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated that are subject to prior authorisation from the *supervisory authority* of the *related Solvency II undertaking*, in accordance with Article 90 of the *Solvency II Directive*, must be included in the calculation of the group solvency only in so far as they have been duly authorised by that *supervisory authority*.

[Note: Art. 222(5) of the *Solvency II Directive*]

9.7 When calculating the solvency of a *group*, no account must be taken of any *own funds eligible for the SCR* arising out of reciprocal financing between the *participating Solvency II undertaking* and any of the following:

(1) a *related undertaking*;

(2) a *participating undertaking*; and

(3) another *related undertaking* of any of its *participating undertakings*.

[Note: Art. 223(1) of the *Solvency II Directive*]

9.8 When calculating the solvency of a *group*, no account must be taken of any *own funds eligible for the SCR* of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the group solvency of the *group* is calculated where the *own funds* concerned arise out of reciprocal financing with any other *related undertaking* of that *participating Solvency II undertaking*. Reciprocal financing exists at least where a *Solvency II undertaking*, or any of its *related undertakings*, holds shares in, or makes loans to, another *undertaking* which, directly or indirectly, holds *eligible own funds* of the first *undertaking*.

[Note: Art. 223(2), (3) of the *Solvency II Directive*]

9.9 The value of the assets and liabilities of a *group* must be assessed in accordance with Valuation 2.

[Note: Art. 224 of the *Solvency II Directive*]

10 GROUP SOLVENCY: APPLICATION OF THE CALCULATION METHODS

10.1 Where a *Solvency II undertaking* has more than one *related Solvency II undertaking*, the group solvency calculation of the *group* must be carried out by including each of those *related Solvency II undertakings*.

[Note: Art. 225 of the *Solvency II Directive*]

10.2 In respect of a *related Solvency II undertaking* with its head office in an *EEA State* other than that of the *Solvency II undertaking* for which the group solvency calculation of the *group* is carried out, the group solvency calculation must take account of the *SCR* and the *own funds eligible for the SCR* as laid down in the *Solvency II EEA implementing measures* of that other *EEA State*.

[Note: Art. 225 of the *Solvency II Directive*]

10.3 (1) When calculating the group solvency of a *Solvency II undertaking* in a *group*, the situation of each *intermediate holding company* must be taken into account.

(2) For the sole purpose of that calculation, the *intermediate holding company* must be treated as if it were a *Solvency II undertaking* subject to the *SCR Rules* in respect of the *SCR* and were subject to the same conditions as are laid down in the Own Funds Part in respect of *own funds eligible for the SCR*.

(3) In cases where an *intermediate holding company* holds subordinated debt or other *eligible own funds* subject to limitation in accordance with Own Funds 5 or any applicable *Solvency II Regulations*, they must be recognised as *eligible own funds* up to the amounts calculated by application of the limits in Own Funds 5 or any applicable *Solvency II Regulations* to the total *eligible own funds* outstanding at group level of the *group* as compared to the *group SCR*.

(4) Any *eligible own funds* of an *intermediate holding company*, which would require prior authorisation from a *supervisory authority* in accordance with Article 90 of the *Solvency II Directive*, may be included in the calculation of the group solvency of the *group* only in so far as they have been duly authorised by the *group supervisor*.

[Note: Art. 226 of the *Solvency II Directive*]

10.4 (1) Subject to (2), when calculating, in accordance with *method 2*, the group solvency of a *Solvency II undertaking* in a *group* which is a *participating undertaking* in a *third country insurance undertaking* or *third country reinsurance undertaking*, that *third country insurance undertaking* or *third country reinsurance undertaking* must, solely for the purposes of that calculation, be treated as a *related Solvency II undertaking*.

(2) If the third country in which that *third country insurance undertaking* or *third country reinsurance undertaking* has its head office makes it subject to authorisation and imposes on it a solvency regime that is assessed to be equivalent under Article 227 of the *Solvency II Directive*, the calculation in (1) must take into account, as regards

that *undertaking*, the requirement equivalent to the *SCR* and the capital items eligible to satisfy that requirement as laid down by that third country.

[Note: Art. 227 of the *Solvency II Directive*]

10.5 When calculating the group solvency of a *Solvency II undertaking* in a *group* which is a *participating undertaking* in a *credit institution*, *investment firm* or *financial institution*, the *participating Solvency II undertaking* must either:

(1) apply *method 1* or *method 2* in Annex I to Directive 2002/87/EC with any necessary changes, provided that *method 1* in that Annex must be applied only where the *group supervisor* is satisfied as to the level of integrated management and internal control regarding the *undertakings* which would be included in the scope of consolidation and provided always that the method chosen must be applied in a consistent manner over time; or

(2) if the *group supervisor* so determines (either at the request of the *participating undertaking* or on its own initiative), deduct any such *participation* from the *own funds eligible for the group SCR* of the *participating undertaking*.

[Note: Art. 228 of the *Solvency II Directive*]

10.6 Where the information necessary for calculating the group solvency of a *Solvency II undertaking* in a *group*, concerning a *related undertaking* with its head office in an *EEA State* or a third country, is not available to the *group supervisor* then:

(1) the book value of that *related undertaking* in the *participating Solvency II undertaking* must be deducted from the *own funds eligible for the group SCR*; and

(2) the unrealised gains connected with that *participation* must not be recognised as *own funds eligible for the group SCR*.

[Note: Art. 229 of the *Solvency II Directive*]

11 CALCULATION METHODS: METHOD 1

11.1 (1) The calculation of the group solvency of the *participating Solvency II undertaking* in a *group* must be carried out on the basis of the consolidated accounts.

(2) The group solvency of the *participating Solvency II undertaking* in a *group* is the difference between the following:

(a) the *own funds eligible for the group SCR*, calculated on the basis of consolidated data; and

(b) the *group SCR* calculated on the basis of consolidated data.

(3) Own Funds and the *SCR Rules* apply to the calculation of the *own funds eligible for the group SCR* and of the *group SCR* based on consolidated data.

[Note: Art. 230(1) of the *Solvency II Directive*]

11.2 The *group SCR* of a *group* based on consolidated data (consolidated *group SCR*) must be calculated on the basis of either the *standard formula* or an approved *internal model*, in a manner consistent with the general principles contained in the *SCR Rules*

[Note: Art. 230(2) of the *Solvency II Directive*]

11.3 (1) The consolidated *group SCR* of a *group* must have as a minimum the sum of the following:

(a) the *MCR* of the *participating Solvency II undertaking*; and

(b) the proportional share of the *MCR* of the *related Solvency II undertakings*.

(2) That minimum must be covered by *eligible own funds* within paragraph 2 of the definition of "*eligible own funds*".

(3) For the purposes of determining whether those *eligible own funds* qualify to cover the minimum consolidated *group SCR* of a *group*, the principles in 8 – 10 apply with any necessary changes. Undertakings In Difficulty 3 also applies with any necessary changes.

[Note: Art. 230(2) of the *Solvency II Directive*]

11.4 Any application for permission to calculate the consolidated *group SCR*, as well as the *SCR* of *Solvency II undertakings* in the *group*, on the basis of an *internal model*, submitted by a *Solvency II undertaking* and its *related undertakings*, or jointly by the *related Solvency II undertakings* of an *insurance holding company* or a *mixed financial holding company*, must be submitted to the *group supervisor*.

[Note: Art. 231(1) of the *Solvency II Directive*]

12 CALCULATION METHODS: METHOD 2

12.1 The group solvency of the *participating Solvency II undertaking* in a *group* is the difference between the following:

(1) the aggregated group *eligible own funds*, as provided for in 12.2; and

(2) the value in the *participating Solvency II undertaking* of the *related Solvency II undertakings* and the aggregated *group SCR*, as provided for in 12.3.

[Note: Art. 233(1) of the *Solvency II Directive*]

12.2 The aggregated group *eligible own funds* of a *group* is the sum of the following:

(1) the *own funds eligible for the SCR* of the *participating Solvency II undertaking*; and

(2) the proportional share of the *participating Solvency II undertaking* in the *own funds eligible for the SCR* of the *related Solvency II undertakings.*

[Note: Art. 233(2) of the *Solvency II Directive*]

12.3 The aggregated *group SCR* of a *group* is the sum of the following:

(1) the *SCR* of the *participating Solvency II undertakings*; and

(2) the proportional share of the *SCR* of the *related Solvency II undertakings*.

[Note: Art. 233(3) of the *Solvency II Directive*]

12.4 Where, in a *group*, the *participation* in the *related Solvency II undertaking* consists, wholly or in part, of an indirect ownership, the value in the *participating Solvency II undertaking* of the *related Solvency II undertaking* must incorporate the value of that indirect ownership. The value of that indirect ownership must take into account the relevant successive interests, and the items referred to in 12.2(2) and 12.3(2) must include the corresponding proportional shares, respectively, of the *own funds eligible for the SCR* of the *related Solvency II undertaking* and of the *SCR* of the *related Solvency II undertakings*.

[Note: Art. 233(4) of the *Solvency II Directive*]

12.5 Any application for permission to calculate the *SCR* of *Solvency II undertakings* in the *group*, on the basis of an *internal model*, submitted by a *Solvency II undertaking* and its *related undertakings*, or jointly by the *related undertakings* of an *insurance holding company* or a *mixed financial holding company*, must be submitted to the *group supervisor*.

[Note: Art. 233(5) of the *Solvency II Directive*]

13 CALCULATION METHODS: CAPITAL ADD-ONS

13.1 The *relevant insurance group undertakings* must make every effort to remedy the deficiencies that led to the imposition of a *capital add-on* arising as a result of an *internal model significant risk profile deviation* or a *significant system of governance deviation* at group level.

[Note: Arts. 232 and 37(3) of the *Solvency II Directive*]

13.2 The *group SCR* prior to the imposition of the *capital add-on*, together with the amount of the *capital add-on* imposed at group level, will constitute the *group's group SCR*.

[Note: Arts. 232 and 37(5) of the *Solvency II Directive*]

14 SUPERVISIONS OF GROUP SOLVENCY FOR SOLVENCY II FIRMS THAT ARE SUBSIDIARIES OF AN INSURANCE HOLDING COMPANY OR A MIXED FINANCIAL HOLDING COMPANY

14.1 (1) Where *Solvency II undertakings* in a *group* are *subsidiary undertakings* of an *insurance holding company* or a *mixed financial holding company*, the calculation of the solvency of the *group* must be carried out at the level of the *insurance holding company* or *mixed financial holding company* applying 7.1(2) – 12.

(2) For the purpose of that calculation, the *insurance holding company* or *mixed financial holding company* must be treated as if it were a *Solvency II undertaking* subject to the *SCR Rules* as regards the *SCR* and the Own Funds Part as regards the *own funds eligible for the SCR*, provided that the *relevant insurance group undertakings* remain responsible for discharging any obligations arising from the application of this sub-paragraph.

[Note: Art. 235 of the *Solvency II Directive*]

15 GROUPS WITH CENTRALISED RISK MANAGEMENT

15.1 15.3 applies to any *Solvency II undertaking* in a *group* which is a *subsidiary undertaking* of another *Solvency II undertaking* or of an *insurance holding company* where all of the following conditions are satisfied:

(1) the *subsidiary undertaking*, in relation to which the *group supervisor* has not made a decision under Article 214(2) of the *Solvency II Directive*, is included in the *group supervision* carried out by the *group supervisor* at the level of the *parent undertaking* in accordance with this Part;

(2) the risk-management processes and internal control mechanisms of the *parent undertaking* cover the *subsidiary undertaking* and the *parent undertaking* satisfies the *PRA* regarding the prudent management of the *subsidiary undertaking*;

(3) (a) the *parent undertaking*; or

(b) one or more *relevant insurance group undertakings*,

is permitted, under 17.2(3), to produce a single document covering all relevant *ORSAs*;

(4) (a) the *parent undertaking*; or

(b) one or more *relevant insurance group undertaking,*

is permitted, under 18.1(2), to produce a single *SFCR* covering all relevant *Solvency II undertakings* and *insurance holding companies* and *mixed financial holding companies*; and

(5) an application for permission to be subject to 15.3 has been submitted by the *parent undertaking* or one or more *relevant insurance group undertakings* and a favourable decision has been made on that application in accordance with the procedure in Article 237 of the *Solvency II Directive*.

[Note: Art. 236 of the *Solvency II Directive*]

15.2 An application for permission to be subject to 15.3 must be made to the *PRA* if the *subsidiary undertaking* is a *UK Solvency II firm*.

[Note: Art. 237(1) of the *Solvency II Directive*]

15.3 Without prejudice to 11.4 and subject to 15.4, if the conditions referred to in 15.1 are satisfied, the *SCR* of the *subsidiary undertaking* in the *group* must be calculated in accordance with any decisions taken in accordance with Article 238 of the *Solvency II Directive*.

[Note: Art. 238 of the *Solvency II Directive*]

15.4 (1) 15.3 ceases to apply where:

(a) the condition referred to in 15.1(1) is no longer complied with;

(b) the condition referred to in 15.1(2) is no longer complied with and the *group* does not restore compliance with this condition in an appropriate period of time.

(2) The *parent undertaking* or *relevant insurance group undertakings* of a *group* to which 15.3 applies must ensure that the conditions referred to in 15.1(2) – (4) are complied with on an ongoing basis and in the event of non-compliance must:

(a) inform the *group supervisor* and the *supervisory authority* of the *subsidiary undertaking* concerned without delay; and

(b) present a plan to the *supervisory authorities* to restore compliance within an appropriate period of time.

[Note: Art. 240 of the *Solvency II Directive*]

16 RISK CONCENTRATION AND INTRA-GROUP TRANSACTIONS

16.1 (1) Where 2.1(1) or 2.1(2) apply, the *relevant insurance group undertakings* or any *UK holding company* must report on a regular basis and at least annually to the *group supervisor* any significant risk concentration at the level of the *group*.

(2) The necessary information must be submitted to the *group supervisor* by the *relevant insurance group undertaking* which is at the head of the *group* or, where the *group* is not headed by a *relevant insurance group undertaking*, by the *UK holding company* or such other *Solvency II undertaking* in the *group* as the *group supervisor* may specify.

[Note: Art. 244 of the *Solvency II Directive*]

16.2 (1) Where 2.1(1) or 2.1(2) applies, the *relevant insurance group undertakings* or any *UK holding company* must report on a regular basis, and at least annually, to the *group supervisor* all significant intra-group transactions by *Solvency II undertakings* within a *group*, including those performed with a natural person with *close links* to an *undertaking* in the *group*.

(2) Where an intra-group transaction falling within (1) is very significant, it must be reported to the *group supervisor* as soon as practicable.

(3) The necessary information must be submitted to the *group supervisor* by the *relevant insurance group undertaking* which is at the head of the *group* or, where the *group* is not headed by a *Solvency II undertaking*, by the *UK holding company* or such other *Solvency II undertaking* in the *group* as the *group supervisor* may specify.

[Note: Art. 245 of the *Solvency II Directive*]

17 RISK MANAGEMENT AND INTERNAL CONTROL

17.1 (1) Where 2.1(1) or 2.1(2) applies, the following requirements in the Conditions Governing Business Part apply with any necessary changes at the level of the *group*:

(a) 2.2 – 2.6;

(b) 3

(c) 4.1 – 4.2

(d) 5

(e) 6

(f) 7.1 – 7.3; and

(g) 8

(2) Without prejudice to (1), the risk management and internal control systems and reporting procedures must be implemented consistently in all the *undertakings* included in the scope of *group* supervision under 2.2(1) and 2.2(2) so that those systems and reporting procedures can be controlled at the level of the *group*.

(3) Without prejudice to (1), the internal control mechanisms must include at least the following:

(a) adequate mechanisms as regards group solvency to identify and measure all material risks incurred and to appropriately relate *eligible own funds* to risks; and

(b) sound reporting and accounting procedures to monitor and manage the intra-group transactions and the risk concentration.

17.2 (1) Where 2.1(1) or 2.1(2) applies, a *participating Solvency II undertaking* that is a *firm*, or if there is none, the *UK holding company* or the *relevant insurance group undertakings*, must undertake at the level of the *group* the assessment required by Conditions Governing Business 3.8 – 3.11.

(2) Where the calculation of the solvency at the level of the *group* is carried out in accordance with *method 1*, the *participating Solvency II undertaking*, the *UK holding company* or the *relevant insurance group undertakings* (as appropriate) must provide to the *group supervisor* a proper understanding of the difference between the sum of the *SCR* of all the *related Solvency II undertakings* in the *group* and the consolidated *SCR* of the *group*.

(3) Where the *participating Solvency II undertaking*, the *UK holding company* or the *relevant insurance group undertakings* (as appropriate) so decide, and subject to the agreement of the *group supervisor*, they may undertake any assessments required by Conditions Governing Business 3.8 – 3.11 at the level of the *group* and at the level of any *subsidiary undertaking* in the *group* at the same time, and may produce a single document covering all the assessments.

(4) Where the *group* exercises the option provided in (3), it must submit the document to all *supervisory authorities* concerned at the same time.

(5) The exercise of the option provided in (3) does not exempt the *subsidiary undertakings* concerned from the obligation to ensure that the requirements of Conditions Governing Business 3.8 – 3.11 are met.

[Note: Art. 246(1) to (4) of the Solvency II Directive]

17.3 Reporting 2.1 – 2.4 apply with any necessary changes.

[Note: Art. 254(2) of the *Solvency II Directive*]

18 GROUP SFCR

18.1 (1) When 2.1(1) or 2.1(2) applies, *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* must disclose publicly, on an annual basis, a report on the solvency and financial condition at the level of the *group*. Reporting 3 – 6 apply with any necessary changes.

(2) Where a *participating Solvency II undertaking* that is a *firm* or the *relevant insurance group undertakings* (as appropriate) so decide, and subject to the agreement of the *group supervisor*, they may provide a single *SFCR* which must comprise the following:

(a) the information at the level of the *group* which must be disclosed in accordance with (1); and

(b) the information for any of the subsidiaries within the *group* which must be individually identifiable and disclosed in accordance with Reporting 3 – 6.

[Note: Art. 256 of the *Solvency II Directive*]

19 GROUP STRUCTURE

19.1 When 2.1(1) or 2.1(2) applies, *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* must disclose publicly, at the level of the *group*, on an annual basis, the legal structure and the governance and organisational structure, including a description of all *subsidiaries*, material *related undertakings*, and significant branches belonging to the *group*.

[Note: Art. 256a of the *Solvency II Directive*]

20 THIRD COUNTRIES

20.1 When 2.1(3) applies, 4 – 14 and 16 – 19 apply with any necessary changes at the level of the *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State*, *third country insurance undertaking* or *third country reinsurance undertaking* unless:

(1) subject to 20.2, the third country in which that *undertaking* has its head office is assessed to be equivalent under Article 260 of the *Solvency II Directive*; or

(2) in the absence of equivalent group supervision referred to in Article 260 of the *Solvency II Directive*, the *PRA* has specified other methods in accordance with Article 262 of the *Solvency II Directive*.

[Note: Art. 262 of the *Solvency II Directive*]

20.2 20.1(1) does not apply where, in the case of temporary equivalence under Article 260(5) of the *Solvency II Directive*, there is a *Solvency II undertaking* in the *group* that has a balance sheet total that exceeds the balance sheet total of the *parent undertaking* situated outside of the *EEA*.

[Note: Art. 260(7) of the *Solvency II Directive*]

20.3 When calculating the solvency of a *group* falling within 2.1(3) for the purpose of 20.1, a *relevant insurance group undertaking* must treat the *parent undertaking* (being an *insurance holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*), solely for the purposes of that calculation, as a *UK Solvency II firm* to which 2.1(1)(a) applies.

[Note: Art. 262 of the *Solvency II Directive*]

20.4 Where the *parent undertaking* referred to in 2.1(3) is itself a *subsidiary undertaking* of an *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*, 20.1 applies at the level of either:

(1) the ultimate *parent undertaking* which is an *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*; or

(2) such other *parent undertaking* as the *PRA* may determine in accordance with Article 263 of the *Solvency II Directive*.

[Note: Art. 263 of the *Solvency II Directive*]

21 MIXED-ACTIVITY INSURANCE HOLDING COMPANIES

21.1 16.2 and 17.3 apply, with any necessary changes, to *groups* falling within 2.1(4).

[Note: Art. 265 of the *Solvency II Directive*]

Appendix 1.15

PRA RULEBOOK: SOLVENCY II FIRMS: REPORTING INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

   (1) section 137G (the PRA's general rules); and
   (2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook Solvency II Firms: Reporting Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Reporting Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

REPORTING

Chapter content

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) in accordance with General Application 3, the *Society*.

(3) in accordance with General Application 3, *managing agents*, for the purposes of 7.

1.2 In this part, the following definitions shall apply:

aircraft

means the *class* of *contract of insurance*, specified in paragraph 5 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

aircraft liability

means the *class* of *contract of insurance*, specified in paragraph 11 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

assessable mutual

means a *mutual* whose articles of association, rules or bye-laws provide for the calling of additional contributions from members.

general insurer

means an *insurer* with *permission* to *effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of general insurance.*

general liability

means the *class* of *contract of insurance*, specified in paragraph 13 of Part I of Schedule 1 to the *Regulated Activities Order.*

goods in transit

means the *class* of *contract of insurance*, specified in paragraph 7 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

liability of ships

means the *class* of *contract of insurance*, specified in paragraph 12 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

long-term insurer

means an *insurer* with *permission* to *effect contract of insurance* or *carry out contracts of insurance* that are *contracts of long-term insurance*.

material pooling agreement

means an arrangement in which:

(1) insurance or *reinsurance undertakings* only are members;

(2) the members have assumed joint liability between themselves for a portfolio of insurance or *reinsurance* obligations in defined proportions (which are adjustable should one of the members default to ensure that any claim is fully met); and

(3) the members have the capacity to accept pooled insurance risks with a gross exposure to any one loss exceeding USD 1 Billion.

mixed commercial package

means *contracts of insurance* (other than *treaty reinsurance* contracts) against more than one of:

(1) loss or damage to property; or

(2) risks to the *person* insured incurring liabilities to third parties; or

(3) risks of loss to the *persons* insured arising from the failure of debtors of theirs to pay their debts when due; or

(4) risks of loss to the *persons* insured attributable to interruptions of business carried on by them; or

(5) risks of loss to the *persons* insured attributable to their incurring unforeseen expenses; or

(6) any other risk of loss to a commercial operation;

where the risks and losses covered in the contract are rated on a single package basis and no separately identifiable *premium* is charged or recorded for internal management purposes for any one group of risks or losses specified in the contract.

motor vehicle liability

means the *class* of *contract of insurance*, specified in paragraph 10 of Part I of Schedule 1 to the *Regulated Activities Order.*

professional indemnity

means *contracts of insurance* (other than *treaty reinsurance* contracts), including directors' and officers' liability and error and omissions liability, against the risks of the *persons* insured incurring liabilities to third parties arising from wrongful acts (such as breach of duty, breach of trust, negligence, error or omissions) by professionals, named individuals or businesses occurring in the course of the insured's professional activities.

public and products liability

means *contracts of insurance* (other than *treaty reinsurance* contracts) against the risks of *persons* insured incurring liabilities to third parties for damage to property, injury, illness or death, arising in the course of the insured's business.

ships

means the *class* of *contract of insurance*, specified in paragraph 6 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

suretyship

means the *class* of *contract of insurance*, specified in paragraph 15 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

Railway rolling stock

means the *class* of *contract of insurance*, specified in paragraph 4 of Part 1 of Schedule 1 to the *Regulated Activities Order.*

2 REPORTING TO THE *PRA*

2.1 A *firm* must submit to the *PRA* information which is necessary for the purposes of the *PRA's* supervision of the *firm.*

[Note: Art. 35(1) of the *Solvency II Directive*]

2.2 The information referred to in 2.1 must:

(1) be submitted in the applicable format or template (if any) provided in the *Solvency II Regulations* or in the form of any *national specific template* where applicable; and

(2) include at least the information necessary to enable the *PRA* to assess the matters set out below when performing the supervisory review process:

(a) the *firm's* system of governance;

(b) the business pursued by the *firm*;

(c) the valuation principles applied by the *firm* for solvency purposes;

(d) the risks faced by the *firm*;

(e) the risk management systems of the *firm*; and

(f) the capital structure, capital needs and capital management of the *firm*, and

(3) enable the *PRA* to make any appropriate decisions resulting from the exercise of their supervisory rights and duties.

[Note: Art. 35(1) of the *Solvency II Directive*]

2.3 The information referred to in 2.1 and 2.2 must comprise the following:

(1) qualitative or quantitative elements, or any appropriate combination thereof;

(2) historic, current or prospective elements, or any appropriate combination thereof; and

(3) data from internal or external sources, or any appropriate combination thereof.

[Note: Art. 35(3) of the *Solvency II Directive*]

2.4 The information which a *firm* submits to the *PRA* in accordance with 2.1 and 2.2 must comply with the following principles:

(1) it must reflect the nature, scale and complexity of the business of the *firm*, and in particular the risks inherent in that business;

(2) it must be accessible, complete in all material respects, comparable and consistent over time; and

(3) it must be relevant, reliable and comprehensive.

[Note: Art. 35(4) of the *Solvency II Directive*]

2.5 A *firm* must have in place appropriate systems and structures to fulfil the requirements set out in 2.1 – 2.4, as well as a written policy approved by its *governing body* ensuring the ongoing appropriateness of the information submitted by the *firm* to the *PRA*.

[Note: Art. 35(5) of the *Solvency II Directive*]

2.6 Subject to 2.7, a *firm* falling within categories (1) – (7) must submit to the *PRA* the corresponding *national specific templates* on an annual basis:

(1) a *firm* carrying on *with-profits insurance business* must submit template NS1: With-Profits Value of Bonus and template NS2: With-Profits Assets and Liabilities;

(2) a *firm* which manages a *material pooling agreement* must submit template NS3: Pools;

(3) an *assessable mutual* which:

(a) has called for an additional contribution after 1 January 2006; or

(b) has received approval for *ancillary own funds* as contemplated in Own Funds 2.3(4)

must submit template NS4: Assessable Mutuals;

(4) a *firm* writing *suretyship* business the effect of which is to improve the credit rating of the underlying *security* must submit template NS8: Business Model Analysis – Financial Guarantee Insurers;

(5) a *long term insurer* must submit:

(a) NS5: Revenue Account (Life);

(b) NS9: Best Estimate Assumptions for Life Insurance Risks; and

(c) NS6: Business Model Analysis (Life);

(6) a *general insurer* must submit NS7: Business Model Analysis (Non-life);

(7) a *general insurer* carrying on *insurance business a*nd proportional and non-proportional *reinsurance* obligations relating to:

(a) *railway rolling stock;* or

(b) *aircraft;* or

(c) *ships;* or

(d) *goods in transit;* or

(e) *motor vehicle liability;* or

(f) *aircraft liability;* or

(g) liability of ships; or

(h) *general liability;*

must submit NS10: Projection of Future Cash Flows (Best Estimate - Non Life: Sub-classes);

(8) A *general insurer* carrying on *insurance business* relating to:

(a) *employers' liability* (including as part of a *mixed commercial package);* or

(b) *public and products liability* (including as part of a mixed commercial package; or

(c) *professional indemnity;*

must submit NS11: Non-life Insurance Claims Information (General Liability Sub-classes).

2.7 A *firm* falling within 2.6(2), 2.6(3)(a) or 2(6) that does not have a *Part 4A permission* to *effect contracts of insurance* is not subject to the obligation to complete the corresponding *national specific template*.

2.8 A *firm* falling within categories [x] must submit to the *PRA* the corresponding *national specific template* on a quarterly basis. [*placeholder for templates e.g. Lloyds*]

2.9 For the purposes of 2.6 and 2.8, all amounts shown in Units must be reported in *United Kingdom* sterling unless the *national specific template* expressly states otherwise.

2.10 A *firm* shall submit the annual *national specific templates* referred to in 2.6, after the end of the transitional period set out in Transitional Measures 3.1, no later than 14 weeks after the *firm's* financial year end.

2.11 A *firm* shall submit the quarterly *national specific templates* referred to in 2.8 after the end of the transitional period set out in Transitional Measures 3.3, no later than 5 weeks related to any quarter ending.

2.12 If the due date for the *national specific template* falls on a day which is not a *business day*, the documents must be submitted no later than the next *business day* after the due date.

2.13 A *firm* shall submit to the *PRA*, the *national specific templates* referred to in 2.6 and 2.8 in electronic format.

2.14 Where a *firm* notifies the *PRA* that any of its submissions of *national specific template* submissions under 2.6 or 2.8 is incorrect, or where the *PRA* notifies a *firm* that any part of the *national specific template* appears to it to be inaccurate or incomplete, the *firm* must promptly make any appropriate corrections or adjustments and if necessary re-submit the *national specific template* (or relevant part of it).

3 PUBLIC DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT

3.1 A *firm* must disclose publicly, on an annual basis, a *SFCR*.

[Note: Art. 51(1) of the *Solvency II Directive*]

3.2 The information which a *firm* discloses in its *SFCR* must include the information required in 2.3 and must comply with the principles in 2.4.

[Note: Art. 51(1) of the *Solvency II Directive* and the *Solvency II Regulations*]

3.3 A *firm's SFCR* must contain the following information, either in full or by way of reference to equivalent information, both in nature and scope, disclosed publicly under other legal or regulatory requirements:

(1) a description of the business and performance of the *firm*;

(2) a description of the system of governance of the *firm* and an assessment of its adequacy for the risk profile of the *firm*;

(3) a description of the risk exposure, risk concentration, risk mitigation and risk sensitivity separately for each category of risk of the *firm*;

(4) a description, separately for assets, *technical provisions* and other liabilities, of the bases and methods used for their valuation, together with an explanation of any major differences in the bases and methods used for the valuation of those assets, *technical provisions* and other liabilities in financial statements of the *firm*; and

(5) a description of the capital management of the *firm*, including at least the following:

(a) the structure, amount and quality of *own funds* of the *firm*, together with the information specified in 3.5;

(b) the amount of the *MCR* and *SCR* of the *firm,* together with the information specified in 3.6;

(c) information showing and explaining the main differences between the underlying assumptions of the *standard formula* and the underlying assumptions of any *internal model* for which the *firm* has received *internal model approval*; and

(d) the amount of any non-compliance with the *MCR* or any significant non-compliance with the *SCR* during the reporting period, even if subsequently resolved, with an explanation of the origin of that non-compliance and its consequences, as well as any remedial measures taken in respect of that non-compliance.

[Note: Art. 51(1)(a)–(e) of the *Solvency II Directive*]

3.4 For the purposes of 3.3(4), where a *firm* applies:

(1) a *matching adjustment* in accordance with Technical Provisions 4B, the firm must include in the description;

(a) a description of the matching adjustment and of the portfolio of obligations and assigned assets to which the *matching adjustment* is applied; and

(b) a quantification of the impact of a change to zero of the *matching adjustment* on the *firm's* financial position;

(2) a *volatility adjustment* in accordance with Technical Provisions 4D, the firm must include in the description:

(a) a statement on whether the volatility adjustment referred to in Technical Provisions 4D is used by the *firm*;

(b) quantification of the impact of a change to zero of the volatility adjustment on the *firm's* financial position.

[Note: Art. 51(1a) of the *Solvency II Directive* [and the *Solvency II Regulations*]]

3.5 The disclosure required by 3.3(5)(a) must include the following:

(1) an analysis of any significant change in the structure, amount and quality of *own funds* of the *firm* as compared to the previous reporting period of the *firm*;

(2) an explanation of any major differences in relation to the value of elements of *own funds* items in the financial statements of the *firm*; and

(3) a brief description of the capital transferability of the *own funds* of the *firm*.

[Note: Art. 51(2) of the *Solvency II Directive*]

3.6 The disclosure required by 3.3(5)(b) must include the following:

(1) the amount of the *SCR* calculated by the *firm* using the *standard formula* or, where the *firm* has received *internal model approval*, the amount of the *SCR* calculated using its *internal model* and, where applicable in the case of a *partial internal model*, the *standard formula*;

(2) the amount of any *capital add-on* imposed upon the *firm* in accordance with Article 37 of the *Solvency II Directive*, together with concise information on the justification given by the *PRA* for its imposition; and

(3) the impact of any *undertaking specific parameters* the *firm* is required to use in calculating the *standard formula* in accordance with Article 110 of the *Solvency II Directive,* together with concise information on the justification given by the *PRA* for requiring the use of those *undertaking specific parameters*.

[Note: Art. 51(2) of the *Solvency II Directive*]

3.7 The disclosure of the *SCR* required by 3.3(5)(b) must be accompanied, where applicable, with a statement indicating that the final amount of the *SCR* is subject to supervisory assessment.

[Note: Art. 51(2) of the *Solvency II Directive*]

3.8 Where a *firm*, in its *SFCR*, makes use of, or refers to, public disclosures made by the *firm* under other legal or regulatory requirements, those disclosures must be equivalent to the information required to be disclosed under 3.3 – 3.7, in both their nature and scope.

[Note: Art. 53(3) of the *Solvency II Directive*]

4 PERMITTED NON-DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT

4.1 Where a *firm* is granted a *waiver* by the *PRA* permitting the *firm* not to disclose information otherwise required to be disclosed pursuant to 3.3(1) – (4) and 3.4 in its *SFCR*, the *firm* must make a statement to this effect in its *SFCR* and state whether the non-disclosure is permitted because:

(1) the disclosure of that information would enable competitors of the *firm* to gain a significant, undue advantage; or

(2) the *firm* has obligations to *policyholders* or other counterparty relationships which bind the *firm* to secrecy or confidentiality.

[Note: Arts. 53(1) and 53(2) of the *Solvency II Directive*]

5 UPDATES AND ADDITIONAL VOLUNTARY INFORMATION: SOLVENCY AND FINANCIAL CONDITION REPORT

5.1 In the event of any major development affecting significantly the relevance of the information disclosed in accordance with:

(1) 3.3 – 3.8; or

(2) 4;

a *firm* must disclose publicly appropriate information on the nature and effects of that major development.

[Note: Art. 54(1) of the *Solvency II Directive*]

5.2 Without limiting the general application of 5.1, for the purposes of that *rule* the following will be regarded as a major development:

(1) non-compliance with the *MCR* by the *firm* and either the *PRA* considers that the *firm* will not be able to submit, or the *PRA* does not receive within one month of the date of observation by the *firm* of non-compliance with the *MCR*, a *finance scheme* in accordance with Undertakings in Difficulty 4.1; and/or

(2) significant non-compliance with the *SCR* by the *firm* and the *PRA* does not receive, within two *months* from the date when non-compliance with the *SCR* was first observed by the *firm*, a *recovery plan* as required by Undertakings in Difficulty 3.1(2).

[Note: Art. 54(1) of the *Solvency II Directive*]

5.3 Where the circumstances described in 5.2(1) or 5.2(2) arise, the *firm* must immediately publicly disclose the amount of non-compliance with the *MCR* or *SCR* as the case may be, together with an explanation of the origin and consequences of that non-compliance, and a description of any remedial measures taken.

[Note: Art. 54(1) of the *Solvency II Directive*]

5.4 Where compliance with the *MCR* has not been restored by a *firm* within three *months* after the first observation of non-compliance by the *firm*, then the *firm* must publicly disclose at the end of that three-*month* period the non-compliance with the *MCR*, together with an explanation of the origin and consequences of that non-compliance, a description of any remedial measures taken and of any further remedial measures planned.

[Note: Art. 54(1) of the *Solvency II Directive*]

5.5 Where compliance with the *SCR* has not been restored by a *firm* within six *months* after the first observation of non-compliance by the *firm*, then the *firm* must publicly disclose at the end of that six-*month* period the non-compliance with the *SCR*, together with an explanation of the origin and consequences of that non-compliance, a description of any remedial measures taken and of any further remedial measures planned.

[Note: Art. 54(1) of the *Solvency II Directive*]

6 POLICY AND APPROVAL: SOLVENCY AND FINANCIAL CONDITION REPORT

6.1 A *firm* must have in place:

(1) appropriate systems and structures to fulfil the requirements of 3 – 5; and

(2) a written policy ensuring the ongoing appropriateness of any information disclosed:

(a) in accordance with the requirements referred to in (1); and

(b) on a voluntary basis as further information or explanation related to the *SFCR* which is not already required to be disclosed.

[Note: Art. 55(1) of the *Solvency II Directive*]

6.2 A *firm* must ensure that its *SFCR* is:

(1) subject to approval by its *governing body*; and

(2) not publicly disclosed until the approval referred to in (1) is received.

[Note: Art. 55(2) of the *Solvency II Directive*]

7 LLOYDS: PROVISION OF INFORMATION BY MANAGING AGENTS

7.1 A *managing agen*t must, as promptly as possible, submit any information to the *Society* that is necessary for the *Society* to comply with its obligations in this Part or under the *Solvency II Regulations*.

7.2 The information in 7.1 must be submitted in the form that the *Society* requires.

PRA RULEBOOK: SOLVENCY II FIRMS: LLOYD'S INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules);
(2) section 137T (general supplementary powers); and
(3) section 318 (exercise of powers through Council).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Lloyd's Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Lloyd's Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

LLOYD'S

Chapter content

1. **APPLICATION AND DEFINITIONS**
2. **SPECIAL PROVISIONS FOR LLOYD'S**
3. **APPROVED REINSURANCE TO CLOSE**
4. **PROVISION OF INFORMATION BY MANAGING AGENTS**
5. **INSURANCE RECEIVABLES TO BE CARRIED TO TRUST FUNDS**
6. **AMENDMENTS TO BYELAWS, TRUST DEEDS AND STANDARD FORM LETTERS OF CREDIT AND GUARANTEES**
7. **THE CENTRAL FUND**
8. **CAPACITY TRANSFER MARKET**
9. **FORMER UNDERWRITING MEMBERS**

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) in accordance with General Application 3, the *Society*; and

(2) in accordance with General Application 3, *managing agents,* where specified*.*

1.2 In this Part, the following definitions shall apply:

capacity transfer market

means any method of transferring capacity in *syndicates,* including capacity auctions, bilateral arrangements, capacity offers, minority buy-outs and conversion schemes**.**

compensation scheme

means the Financial Services Compensation Scheme established under section 213 of *FSMA*.

Lloyd's member's contribution

means assets:

(1) provided to a *managing agent* in response to a cash call; or

(2) held by the *Society* as *funds at Lloyds*.

protected claim

means a *claim* which is covered by the *compensation scheme*, as defined in *rule* COMP 5.2.1 R of the *PRA Handbook*.

2 SPECIAL PROVISIONS FOR LLOYD'S

2.1 Neither the *Society* nor *managing agents* may permit a *member* to carry on any *insurance business*, except as a participant on one or more *syndicates*.

2.2 The *Society* must ensure that all participants in the Lloyd's market are made aware of their obligations under the Solvency II Firms Sector.

2.3 The *Society* must establish and maintain effective arrangements to monitor and manage risk arising from:

(1) conflicts of interest (including in relation to (2) – (4));

(2) inter-*syndicate* transactions, including *reinsurance to close* and *approved reinsurance to close*;

(3) related party transactions;

(4) transactions between *members* and itself.

3 APPROVED REINSURANCE TO CLOSE

3.1 Notwithstanding that the liability of a reinsured *member* to a *policyholder* is unaffected by an *approved reinsurance to close* for the purposes of the Solvency II Firms Sector:

(1) for an *approved reinsurance to close* which is not to a *subsidiary undertaking* of the *Society*:

(a) a *contract of insurance* reinsured under an *approved reinsurance to close* must be treated as if the reinsuring *member* and not the reinsured *member* had effected the original *contract of insurance*; and

(b) any payment received by a *member* as consideration for or in connection with an *approved reinsurance to close* must be treated as a *Lloyd's member's contribution* and not as *premium* or as a *reinsurance* recovery

(2) for an *approved reinsurance to close* to a *subsidiary undertaking* of the *Society*, a *contract of insurance* reinsured under that *approved reinsurance to close* must be treated as if the reinsured *member* had not effected the original *contract of insurance* but:

(a) for the purposes of the calculation of the Lloyd's *SCR*, *general insurance business* carried on by *members* and *former underwriting members* which has been reinsured to a *subsidiary undertaking* of the *Society* under an *approved reinsurance to close* must be treated as reinsured to a third party; and

(b) for the purposes of calculating the *SCR* of any *subsidiary undertaking* of the *Society* which is a *UK Solvency II firm*, the *approved reinsurance to close* must be treated as a *reinsurance*.

4 PROVISION OF INFORMATION BY MANAGING AGENTS

4.1 A *managing agent* must, as soon as possible, give the *Society* any information the *managing agent* has concerning material risks to *funds at Lloyd's* or *central assets*.

4.2 A *managing agent* need not comply with 4.1 if the *managing agent* knows that the *Society* already has the relevant information.

5 INSURANCE RECEIVABLES TO BE CARRIED TO TRUST FUNDS

5.1 The *Society* must take all reasonable steps to ensure that each *member*:

(1) executes the appropriate *Lloyd's trust deeds*; and

(2) carries to the appropriate *Lloyd's trust fund* all amounts received or receivable by the *member*, or on its behalf, in respect of any *insurance business* carried on by it.

5.2 The *Society* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.

5.3 A *managing agent* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.

5.4 In complying with 5.1 to 5.3, the *Society* and *managing agents* must take all reasonable steps to ensure that amounts received or receivable by a *member* in respect of *general insurance business* and *long-term insurance business* are carried to separate *Lloyd's trust funds*.

6 AMENDMENTS TO BYELAWS, TRUST DEEDS AND STANDARD FORM LETTERS OF CREDIT AND GUARANTEES

6.1 The *Society* must, as soon as it is practical to do so, notify the *PRA* of its intention to approve the form of any new *Lloyd's trust deed*.

6.2 The *Society* must, as soon as it is practical to do so, notify the *PRA* of its intention to make any amendment which may alter the meaning or effect of any *byelaw*, including:

(1) any *Lloyd's trust deed*;

(2) any standard form letter of credit prescribed by the *Society* from time to time; or

(3) any standard form guarantee agreement prescribed by the *Society* from time to time.

6.3 The *Society* must provide the *PRA* with full details of:

(1) the form of any new *Lloyd's trust deed* it intends to approve, as described in 6.1; and

(2) any amendments falling within 6.2.

6.4 The *Society* must consult interested parties in relation to any new *Lloyd's trust deed* and in relation to any amendment falling within 6.2.

6.5 The information provided to the *PRA* by the *Society* under 6.3 must include:

(1) a statement of the purpose of any proposed amendment or new *Lloyd's trust deed* and the expected impact, if any, on *policyholders*, *managing agents*, *members*, and potential *members*; and

(2) a description of the consultation undertaken under 6.4 including a summary of any significant responses to that consultation.

7 THE CENTRAL FUND

7.1 The directions in this Chapter are given under section 318 of *FSMA* (Exercise of powers through Council) for the purpose of achieving the objective specified, as required by section 318(2) of *FSMA*.

7.2 The directions given in this Chapter are given in relation to the exercise of the powers by the *Society* in respect of the *Central Fund* and are given with a view to achieving the objective of ensuring that the *Society* in making payments, or in providing any other financial assistance from the *Central Fund*, does so on a basis which does not take into account the amounts of compensation which *policyholders* may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

7.3 The *Society* must, in the exercise of its powers to make payments from the *Central Fund* or to provide other forms of financial assistance from the *Central Fund*, ensure that in calculating and determining the amount of any such payment or the amount of any other financial assistance, it does not take into account the amounts of compensation which *policyholders* may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

8 CAPACITY TRANSFER MARKET

8.1 The *Society* must make appropriate *byelaws* governing conduct in the *capacity transfer market*.

9 FORMER UNDERWRITING MEMBERS

9.1 The *Society* must ensure that sections 320 to 322 of *FSMA* (Former underwriting members, Requirements imposed under section 320, Rules applicable to former underwriting members) are drawn to the attention of any *person* ceasing to be an *underwriting member* on or after 1 December 2001.

9.2 The *Society* must require any *person*, other than a *body corporate*, ceasing to be an *underwriting member* on or after 1 December 2001 to:

(1) notify the *Society* of any change in his address within one *month* of the change; and

(2) in the case of a natural *person*, to make arrangements for the *Society* to be notified in the event of his death.

PRA RULEBOOK: SOLVENCY II FIRMS: THIRD COUNTRY BRANCHES INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137G (the PRA’s general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Third Country Branches Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Third Country Branches Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

THIRD COUNTRY BRANCHES

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to *third country branch undertakings,* except *Swiss general insurers*.

1.2 In this Part, the following definitions shall apply:

authorised UK representative

means a *person* resident in the *United Kingdom* who is authorised to act generally, and to accept service of any *document*, on behalf of the *firm*.

branch MCR

means a capital requirement calculated in accordance with the Minimum Capital Requirement Part but taking account only of the operations effected by the *third country branch.*

branch scheme of operations

means a scheme containing the information required in 5.1.

branch SCR

means a capital requirement calculated in accordance with the *SCR Rules* but taking account only of the operations effected by the *third country branch.*

branch technical provisions

means the technical provisions established in accordance with the Technical Provisions Part to cover the insurance and *reinsurance* obligations assumed by a *third country branch undertaking* in the *United Kingdom.*

composite third country branch

means a *third country branch* (except a *third country pure reinsurance branch*) that carries on both *long-term insurance business* and *general insurance business* in the *United Kingdom.*

EEA MCR

means a capital requirement calculated in accordance with the Minimum Capital Requirement Part but taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches.*

EEA SCR

means a capital requirement calculated in accordance with the *SCR Rules* but taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches.*

EEA technical provisions

means the technical provisions established in accordance with the Technical Provisions Part to cover the insurance and *reinsurance* obligations assumed by a *UK-deposit insurer* in the *EEA*.

EEA-deposit insurer

means a *third country branch undertaking* that has made a deposit in an *EEA State* (other than the *United Kingdom*) under Article 162(2)(e) of the *Solvency II Directive* in accordance with Article 167 of the *Solvency II Directive.*

pre-Solvency II branch MCR

means the minimum capital requirement that applied to the *third country branch undertaking* under *PRA rules* as at 31 December 2015.

Swiss general insurance company

has the meaning given in article 1(2) of the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507).

Swiss general insurer

means a *Swiss general insurance company* which has *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance* of a kind which is subject to the *Swiss Treaty Agreement*.

Swiss Treaty Agreement

means the agreement of 10 October 1989 between the European Economic Community and the Swiss Confederation on direct insurance other than life insurance, approved on behalf of the European Economic Community by the Council Decision of 20 June 1991 (No 91/370/EEC).

third country branch

means a *third country insurance branch* or a *third country pure reinsurance branch.*

third country branch undertaking eligible own funds

(1) as to compliance with the *branch SCR*, means the aggregate of the *third country branch undertaking'*s:

(a) *Tier 1 own funds*; and

(b) (i) *Tier 2 own funds*; and

(ii) *Tier 3 own funds*

that satisfy the limits in Own Funds 4.1, as if references to the "*SCR*" in those provisions were references to the *branch SCR*; and the limits in the *Solvency II Regulations*.

(2) as to compliance with the *branch MCR*, means the aggregate of the *third country branch undertaking'*s:

(a) *Tier 1 own funds*; and

(b) *Tier 2 basic own funds* that satisfy the limits in Own Funds 4.2 as if references to the "*MCR*" in those provisions were references to the *branch MCR;* and the limits in the *Solvency II Regulations*.

(3) as to compliance with the *EEA SCR*, means the aggregate of the *third country branch undertaking'*s:

(a) *Tier 1 own funds*; and

(b) (i) *Tier 2 own funds*; and

(ii) *Tier 3 own funds*

that satisfy the limits in Own Funds 4.1, as if references to the "*SCR*" in those provisions were references to the *EEA SCR;* and the limits in *Solvency II Regulations*.

(4) as to compliance with the *EEA MCR*, means the aggregate of the *third country branch undertaking'*s:

(a) *Tier 1 own funds*; and

(b) *Tier 2 basic own funds* that satisfy the limits in Own Funds 4.2, as if references to the "*MCR*" in those provisions were references to the *EEA MCR;* and the limits in the *Solvency II Regulations*.

third country branch undertaking own funds

means, in relation to a *third country branch undertaking*, the firm's aggregate *basic own funds* and *ancillary own funds* as determined in accordance with the Own Funds Part as if it were a *UK Solvency II firm*.

third country branch undertaking SCR

means

(1) for a *UK-deposit insurer*, *EEA SCR*;

(2) for an *EEA-deposit insurer*, its solvency capital requirement calculated according to the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;

(3) for all other *third country branch undertakings*, the *branch SCR*.

third country undertaking EEA branch

means a permanent presence of a *third country branch undertaking* in an *EEA State* except the *United Kingdom*, which has received authorisation in accordance with Article 162 of the *Solvency II Directive.*

[Note: Art. 162(3) of the *Solvency II Directive*]

UK-deposit insurer

means a *third country branch undertaking* that has made a deposit in the *United Kingdom* under Article 162(2)(e) of the *Solvency II Directive* in accordance with Article 167 of the *Solvency II Directive*.

2 ACCOUNTING RECORDS IN THE UK

2.1 A *third country branch undertaking* must maintain at a place of business in the *United Kingdom* all records relating to:

(1) the activities carried on from its *third country branch*; and

(2) if it is a *UK-deposit insurer*, the activities carried out from all the *third country undertaking EEA branches*.

[Note: Art. 162 (2) of the *Solvency II Directive*]

3 LOCALISATION AND DEPOSIT OF ASSETS

3.1 A *third country branch undertaking* (except a *UK-deposit insurer,* an *EEA-deposit insurer* and a *third country branch undertaking* that has a *third country pure reinsurance branch*) must hold assets required to cover the *branch SCR* as follows:

(1) in the *United Kingdom*, assets representing the *branch SCR* up to the amount of the *branch MCR;* and

(2) in any *EEA State*, assets representing the amount of the *branch SCR* in excess of the amount of the *branch MCR.*

3.2 A *UK-deposit insurer* must hold assets required to cover the *EEA SCR* as follows:

(1) in any of the *EEA States* where the *UK-deposit insurer* pursues its activities, assets representing the *EEA SCR* up to the amount of the *EEA MCR*; and

(2) in any *EEA State*, assets representing the amount of the *EEA SCR* in excess of the amount of the *EEA MCR*.

3.3 A *third country branch undertaking* (except an *EEA-deposit insurer* and a *third country branch undertaking* that has a *third country pure reinsurance branch*) must hold on deposit as security in the *United Kingdom* with a *CRD credit institution* assets of an amount equal to at least one quarter of the absolute floor of the *MCR* set out in Minimum Capital Requirement 3.2.

[Note: Art. 162(2) and 166(4) of the *Solvency II Directive*]

4 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT

4.1 A *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must:

(1) calculate a *branch SCR*; and

(2) cover the branch SCR with *third country branch undertaking eligible own funds*.

4.2 A *third country branch undertaking (*except a *UK-deposit insurer* and an *EEA-deposit insurer)* must*:*

(1) calculate a *branch MCR*; and

(2) cover the *branch MCR* with *third country branch undertaking eligible own funds*.

4.3 For the purposes of the calculations referred to in 4.1(1) and 4.2(1), the *third country branch undertaking* must take account only of the operations effected by the *third country branch*.

4.4 A *UK-deposit insurer* must:

(1) calculate an *EEA SCR*; and

(2) cover the *EEA SCR* with *third country branch undertakings' eligible own funds*.

4.5 A *UK deposit insurer* must:

(1) calculate an *EEA MCR*; and

(2) cover the *EEA MCR* with *third country branch undertaking eligible own funds*.

4.6 For the purposes of the calculations referred to in 4.4(1) and 4.5(1), the *UK-deposit insurer* must take account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

[Note: Art. 166(1), (2) and (3) of the *Solvency II Directive*]

5 CONTENTS OF THE BRANCH SCHEME OF OPERATIONS

5.1 The *branch scheme of operations* must set out the following:

(1) the nature of the risks or commitments which the *third country branch undertaking* proposes to cover;

(2) the guiding principles as to *reinsurance*;

(3) estimates of the future *branch SCR* on the basis of a forecast balance sheet, as well as the calculation methods used to derive those estimates;

(4) estimates of the future *branch MCR*, on the basis of a forecast balance sheet, as well as the calculation method used to derive those estimates;

(5) the state of the *third country branch undertaking eligible own funds* with respect to the *branch SCR* and *branch MCR*;

(6) estimates of the cost of setting up the administrative services and the organisation for securing business, the financial resources to meet those costs and, where the risks to be covered are classified under paragraph 18 of Part 1 of Schedule 1 to the *Regulated Activities Order*, the resources available for the provision of assistance;

(7) information on the structure of the system of governance; and

(8) For the first three financial years:

(a) a forecast balance sheet;

(b) estimates of the financial resources intended to cover *branch technical provisions*, *branch MCR* and *branch SCR*;

(c) for *general insurance business*:

(i) estimates of management expenses other than installation costs, in particular current general expenses and commissions;

(ii) estimates of *premiums* or contributions and *claims*;

(d) for *long-term insurance business:*

a plan setting out detailed estimates of income and expenditure in respect ofdirect business, *reinsurance* acceptances and *reinsurance* cessions.

[Note: Arts. 162(2) and 163(1) and (2) of the *Solvency II Directive*]

6 TECHNICAL PROVISIONS AND OWN FUNDS

6.1 A *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must establish adequate *branch technical provisions.*

6.2 A *UK-deposit insurer* must establish adequate *EEA technical provisions.*

6.3 A *third country branch undertaking* (except an *EEA-deposit insurer*) must value assets and liabilities in accordance with the Valuation Part for the purposes of establishing the *branch technical provisions* (or, in the case of a *UK-deposit insurer*, the *EEA technical provisions*).

6.4 A *third country branch undertaking* (except an *EEA-deposit insurer*) must determine and classify its *third country branch undertaking own funds* for the purposes of complying with its *branch SCR* and *branch MCR* (or, in the case of a *UK-deposit insurer*, its *EEA SCR* and *EEA MCR*) in accordance with the Own Funds Part as if it were a *Solvency II Firm*.

6.5 A *third country branch undertaking* (except an *EEA-deposit insurer*) must fulfil the requirements in Own Funds 5 for the purposes of complying with its *branch SCR* and *branch MCR* (or, in the case of a *UK-deposit insurer*, its *EEA SCR* and *EEA MCR*) as if it were a *Solvency II Firm*.

[Note: Art. 165 and 166(1), (2) and (3) of the Solvency II Directive]

7 CONDITIONS GOVERNING BUSINESS

7.1 A *third country branch undertaking* must fulfil the following requirements laid down in Conditions Governing Business Part, as modified by 7.2, 7.3 and 7.4:

(1) Conditions Governing Business 1;

(2) Conditions Governing Business 2.2 – 8; and

(3) Conditions Governing Business 11.

7.2 (1) A reference to "*SCR*" is to be interpreted as a reference to "*third country branch undertaking SCR*".

(2) A reference to "*MCR*" is to be interpreted as a reference to:

(a) for a *UK-deposit insurer*, the *EEA MCR*;

(b) for an *EEA-deposit insurer*, its minimum capital requirement calculated in accordance with the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;

(c) for all other *third country branch undertakings*, the *branch MCR*.

(3) A reference to "*technical provisions*" is to be interpreted as a reference to:

(a) for a *UK-deposit insurer*, the *EEA technical provisions*;

(b) for an *EEA-deposit insurer*, its technical provisions calculated in accordance with the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;

(c) for all other *third country branch undertakings*, the *branch technical provisions*.

(4) A reference to "*persons* who effectively run the firm" is to be interpreted as a reference to *persons* who effectively run the operations effected by the *third country branch*.

(5) A reference to "*function*" is to be interpreted as a reference to the *functions* performed in relation to the operations effected by the *third country branch* and includes the *function* of *authorised UK representative*.

(6) A reference to "*internal model*" is to be interpreted as a reference to any *internal model* used by a *third country branch undertaking* to calculate the *third country branch undertaking SCR*.

(7) A reference to "*standard formula*" is to be interpreted as a reference to any *standard formula* used by a *third country branch undertaking* to calculate the *third country branch undertaking SCR.*

7.3 A *third country branch undertaking* (except a *UK-deposit insurer*) must apply the requirements referred to in 7.1 taking account only of matters relevant to the operations effected by the *third country branch*.

7.4 A *UK-deposit insurer* must apply the requirements referred to in 7.1 taking account only of matters relevant to the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

[Note: Art. 162(2) of the *Solvency II Directive*]

8 INVESTMENTS

8.1 A *third country branch undertaking* must fulfil the requirements laid down in the Investments Part, as modified by 8.2 – 8.4.

8.2 A reference to "*technical provisions*" is to be interpreted as laid down in 7.2(3).

8.3 A *third country branch undertaking* (except a *UK-deposit insurer*) must fulfil the requirements in the Investments Part taking account only of the operations effected by the *third country branch*.

8.4 A *UK-deposit insurer* must fulfil the requirements in the Investments Part taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

[Note: Art. 162(2) of the *Solvency II Directive*]

9 REPORTING

9.1 A *third country branch undertaking* must fulfil the requirements laid down in Reporting 2 as modified by 9.2.

9.2 [Note: placeholder for rules on branch reporting].

[Note: Art. 168 of the *Solvency II Directive*]

10 THIRD COUNTRY BRANCH UNDERTAKINGS IN DIFFICULTY

10.1 A *third country branch undertaking* (except an *EEA-deposit insurer*) must fulfil the requirements laid down in Undertakings in Difficulty 1 – 5 as modified by 10.2.

10.2 (1) A reference to "*SCR*" is to be interpreted as a reference to the *branch SCR* or, for a *UK-deposit insurer*, to the *EEA SCR*.

(2) A reference to "*eligible own funds*" is to be interpreted as a reference to *third country branch undertaking eligible own funds*.

(3) A reference to "*MCR*" is to be interpreted as a reference to the *branch MCR* or, for a UK-*deposit insurer*, to the *EEA MCR.*

(4) A reference to "*technical provisions*" is to be interpreted as a reference to the *branch technical provisions* or, for a *UK- deposit insurer*, to the *EEA technical provisions*.

[Note: Art. 168 of the *Solvency II Directive*]

11 SEPARATION OF LONG-TERM BUSINESS AND GENERAL BUSINESS

11.1 (1) A *third country insurance undertaking* that has a *composite third country branch* must fulfil the requirements laid down in Composites 2 – 4 as modified by 11.2.

(2) Composites 3 and 4 do not apply to *EEA-deposit insurers*.

11.2 (1) The requirements referred to in 11.1 must be fulfilled taking account only of the operations effected by the *third country branch* and, in the case of a *UK-deposit insurer*, the operations effected by all the *third country undertaking EEA branches*.

(2) The reference to "*SCR*" in Composites 4.6 is to be interpreted as a reference to the *branch SCR* and, for a *UK-deposit insurer*, the *EEA SCR*.

(3) The *notional life MCR*, *notional non-life MCR*, the *notional life SCR* and *notional non-life SCR* referred to in the Composites Part shall be calculated taking account only of the operations effected by the *third country branch* and, in the case of a *UK-deposit insurer*, the operations effected by all the *third country undertaking EEA branches*.

[Note: Art. 169 of the *Solvency II Directive*]

12 RESTRICTION OF BUSINESS

12.1 A *third country branch undertaking* except a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

12.2 A *third country branch undertaking* that is a *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

13 WORLDWIDE FINANCIAL RESOURCES

13.1 A *third country branch undertaking* must maintain adequate worldwide financial resources, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

13.2 For the purposes of 13.1:

(a) a *UK-deposit insurer* must not rely upon the assets held to cover the *EEA technical provisions* and the *EEA SCR* as available to meet liabilities other than those arising from the operations effected by all the *third country undertaking EEA branches*;

(b) a *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must not rely upon the assets held to cover the *branch technical provisions* and the *branch SCR* as available to meet liabilities other than those arising from the operations effected by the *third country branch*.

14 TRANSITIONAL MEASURES

14.1 The following provisions in the Transitional Measures Part apply to *third country branch undertakings* with the modifications set out in 14.2:

(1) Transitional Measures 1.2 (insofar as relevant);

(2) Transitional Measures 3.1;

(3) Transitional Measures 3.3;

(4) Transitional Measures 4 – 7; and

(5) Transitional Measures 10 – 12 [note: this is subject to further consideration once the rules for which there are placeholders in 10 – 12 are drafted].

14.2 The modifications referred to in 14.1 are:

(1) any modification set out in this Part to any Parts referred to in the Transitional Measures Part;

(2) [Note: placeholder for any other modifications needed in light of any rules still to be included or consulted upon, for example on reporting] ;

(3) any reference to "*pre-Solvency II MCR"* is to be interpreted as a reference to *pre-Solvency II branch MCR*; and

(4) any other necessary modification.

PRA RULEBOOK: SOLVENCY II FIRMS: TRANSITIONAL MEASURES INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Transitional Measures Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency Firms: Transitional Measures Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

TRANSITIONAL MEASURES

Chapter content

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*; and

(2) the *Society*, in accordance with General Application 3.

1.2 In this Part, the following definitions shall apply:

capital resources gearing rules

has the meaning set out in the out in the *PRA Handbook* Glossary as at 31 December 2015.

core tier one capital

means an item of capital that is stated in stage A (Core tier one capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be core tier one capital.

directive reorganisation measures

has the same meaning as in the Insurers (Reorganisation & Winding Up) Regulations 2004 (2004/353).

innovative tier one capital

means an item of capital that is stated in GENPRU 2.2 of the *PRA Handbook* as at 31 December 2015 to be innovative tier one capital.

lower tier two capital

means an item of capital that is stated in stage H (Lower tier two capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be lower tier two capital.

perpetual non-cumulative preference share

means an item of capital that is stated in stage B (Perpetual non-cumulative preference shares) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be perpetual non-cumulative preference shares.

upper tier two capital

means an item of capital that is stated in stage G (Upper tier two capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be upper tier two capital

2 FIRMS IN RUN-OFF

2.1 Without prejudice to General Application 2.2(7), if a *firm* has on the *Solvency II implementation date* ceased to conduct new *insurance business* and does not have a *Part 4A permission* to *effect contracts of insurance* it is not a *UK Solvency II firm* until:

(1) where the *firm* has demonstrated to the *PRA* that it will terminate its activity before 1 January 2019:

(a) 1 January 2019; or

(b) if earlier, the date upon which the *PRA* notifies the *firm* that the *firm* has not demonstrated to the *PRA* that sufficient progress has been made towards terminating the *firm's* activity; or

(2) where the *firm* is subject to *directive reorganisation measures* and an administrator has been appointed,:

(a) 1 January 2021; or

(b) if earlier, the date upon which the *PRA* notifies the *firm* that the *firm* has not demonstrated to the *PRA* that sufficient progress has been made towards terminating the *firm's* activity,

where the conditions in 2.2 are met.

[Note: Art. 308b (1), (2) of the *Solvency II Directive*]

2.2 2.1 only applies:

(1) if the *firm* is not part of a *group* unless all *undertakings* that are part of the *group* have ceased to conduct new *insurance business*;

(2) if the *firm* provides the *PRA* with an annual report setting out what progress has been made in terminating its activity; and

(3) after the *firm* has notified the *PRA* that it satisfies the requirements set out in 2.1.

[Note: Art. 308b (3) of the *Solvency II Directive*]

3 REPORTING TO THE PRA AND PUBLIC DISCLOSURE

3.1 A *firm* must submit under Reporting 2.1 and 2.2 the regular supervisory report and annual quantitative templates required to be submitted in accordance with the *Solvency II Regulations* and the annual *national specific templates* under Reporting 2.6 by no later than:

(1) 20 weeks after the *firm's* financial year end in relation to its financial year ending on or after 30 June 2016 before 1 January 2017;

(2) 18 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;

(3) 16 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;

(4) 14 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (5) of the *Solvency II Directive*]

3.2 A *firm* must disclose its *SFCR* under Reporting 3.1 by no later than:

(1) 20 weeks after the *firm's* financial year end in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;

(2) 18 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;

(3) 16 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;

(4) 14 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (6) of the *Solvency II Directive*]

3.3 A *firm* must submit under Reporting 2.1 and 2.2 the quarterly quantitative templates required to be submitted in accordance with the *Solvency II Regulations* and the quarterly *national specific templates* under Reporting 2.7 by no later than:

(1) 8 weeks related to any quarter ending on or after 1 January 2016 but before 1 January 2017;

(2) 7 weeks related to any quarter ending on or after 1 January 2017 but before 1 January 2018;

(3) 6 weeks related to any quarter ending on or after 1 January 2018 but before 1 January 2019;

(4) 5 weeks related to any quarter ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (7) of the *Solvency II Directive*]

3.4 Where Group Supervision 2.1(1) or (2) applies, the submission under Group Supervision 17.3 of the group regular supervisory report and annual quantitative templates required to be submitted in accordance with the *Solvency II Regulations* must be made by no later than:

(1) 26 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;

(2) 24 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;

(3) 22 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;

(4) 20 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (8) of the *Solvency II Directive*]

3.5 A *participating Solvency II undertaking* that is a *firm* or, if there are none, the *relevant insurance group undertakings* must disclose the solvency and financial condition at the level of the *group* under Group Supervision 18.1 by no later than:

(1) 26 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;

(2) 24 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;

(3) 22 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;

(4) 20 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (8) of the *Solvency II Directive*]

3.6 Where Group Supervision 2.1(1) or (2) applies, the submission under Group Supervision 17.3 of the quarterly quantitative templates required to be submitted in accordance with the *Solvency II Regulations* must be made by no later than:

(1) 14 weeks related to any quarter ending on or after 1 January 2016 but before 1 January 2017;

(2) 13 weeks related to any quarter ending on or after 1 January 2017 but before 1 January 2018;

(3) 12 weeks related to any quarter ending on or after 1 January 2018 but before 1 January 2019;

(4) 11 weeks related to any quarter ending on or after 1 January 2019 but before 1 January 2020.

[Note: Art. 308b (8) of the *Solvency II Directive*]

4 BASIC OWN FUNDS

4.1 Notwithstanding Own Funds 3.1 – 3.3, a *firm* with a *basic own-fund* item that:

(1) was issued prior to 1 January 2016 or the date of entry into force of the *Solvency II Regulation* referred to in Article 97 of the *Solvency II Directive*, whichever is earliest;

(2) could be used as:

(a) *core tier one capital*;

(b) *perpetual non-cumulative preference shares*;

(c) *innovative tier one capital*; or

(d) *upper tier two capital,*

on 31 December 2015; and

(3) would not otherwise be included as *Tier 1 own funds* or *Tier 2 own funds* in accordance with Own Funds 3.1 – 3.2,

must include that item in *Tier 1 own funds* for up to 10 years after 1 January 2016.

[Note: Art. 308b (9) of the *Solvency II Directive*]

4.2 Notwithstanding Own Funds 3.1 – 3.3, a *firm* with a *basic own-fund* item that:

(1) was issued prior to 1 January 2016 or the date of entry into force of the *Solvency II Regulation* referred to in Article 97 of the *Solvency II Directive*, whichever is earliest;

(2) could be used as *lower tier two capital* on 31 December 2015,

must include that item in *Tier 2 own funds* for up to 10 years after 1 January 2016.

[Note: Art. 308b (10) of the *Solvency II Directive*]

4.3 For the purposes of 4.1 and 4.2 items listed at 4.1(2)(a) to (d) and 4.2(2) must not include those items that could only be used as the item specified by virtue of *rule* GENPRU TP 4 of the *PRA Handbook*.

5 STANDARD FORMULA: THE BASIC SCR

5.1 Notwithstanding Solvency Capital Requirement – General Provisions 2, 3.1, 3.3, 3.4 and Solvency Capital Requirement – Standard Formula 3.1–3.3, the standard parameters to be used when calculating the *market risk* concentrations sub-module and the spread risk sub-module in accordance with the *standard formula* must be adjusted as follows:

(1) until 31 December 2017, the standard parameters shall be the same in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any *EEA State* as the ones that would be applied to such exposures denominated and funded in their domestic currency;

(2) from 1 January 2018 the standard parameters must be reduced by 80% in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*;

(3) from 1 January 2019 the standard parameters must be reduced by 50% in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*;

(4) from 1 January 2020 and onwards, the standard parameters must not be reduced in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*.

[Note: Art. 308b (12) of the *Solvency II Directive*]

5.2 Notwithstanding Solvency Capital Requirement – General Provisions 2, 3.1, 3.3, 3.4 and Solvency Capital Requirement – Standard Formula 3.1 – 3.3, the standard parameters to be used for equities that a *firm* purchased on or before 1 January 2016, when calculating the equity risk sub-module in accordance with the *standard formula* must be calculated as the weighted averages of:

(1) the standard parameter to be used when calculating the equity risk sub-module in accordance with 5.4; and

(2) the standard parameter to be used when calculating the equity risk sub-module in accordance with the *standard formula*.

[Note: Art. 308b (13) of the *Solvency II Directive*]

5.3 The weight for the parameter expressed in 5.2(2) must increase at least linearly at the end of each year from 0% during 2016 to 100% from 1 January 2023.

[Note: Art. 308b (13) of the *Solvency II Directive*]

5.4 The equity risk sub-module for the purpose of 5.2(1) must be calibrated using a Value-at-Risk measure, over a time period, which is consistent with the typical holding period of equity investments for the *firm* concerned, with a confidence level providing the *policyholders* with a level of protection equivalent to that set out in Solvency Capital Requirement – General Provisions 3.2-3.5.

[Note: Art. 308b (16) of the *Solvency II Directive*]

6 NON-COMPLIANCE WITH THE SCR

[Drafting note: Placeholder for any rules required to transpose Article 308b(14) of the Solvency II Directive in relation to compliance with the SCR.]

7 NON-COMPLIANCE WITH THE MCR

7.1 If on 31 December 2015 a *firm* complies with the *pre-Solvency II MCR* but does not hold sufficient *eligible own funds* to cover the *MCR* then:

(1) the *firm* must comply with Minimum Capital Requirement 2.1 by 31 December 2016; and

(2) Undertakings in Difficulty 4.1 will apply from 31 December 2016.

[Note: Art. 131 of the *Solvency II Directive*]

7.2 If a *firm* to which 7.1 applies complies with the *pre-Solvency II MCR* but does not hold sufficient *eligible own funds* to cover the *MCR* then, until 31 December 2016 a *firm* must:

(1) inform the *PRA* immediately where it observes that the *pre-Solvency II MCR* is no longer complied with or where there is a risk of non-compliance within the next three *months*; and

(2) within one *month* from the observation of non-compliance with the *pre-Solvency II MCR*, submit, for approval by the *PRA,* a short-term realistic *finance scheme* to restore, within three *months* of that observation, its capital resources, at least to the

level of the *pre-Solvency II MCR* or to reduce its risk profile to ensure compliance with the *pre-Solvency II MCR*.

7.3 Any *finance scheme* submitted under 7.2(2) must at least include particulars or evidence concerning the following:

(1) estimates of management expenses, in particular current general expenses and commissions;

(2) estimates of income and expenditure in respect of direct business, *reinsurance* acceptances and *reinsurance* cessions;

(3) a forecast balance sheet;

(4) estimates of the capital resources intended to cover the *pre-Solvency II MCR*; and

(5) the *firm's* overall *reinsurance* policy.

8 GROUPS – INTERNAL MODELS

8.1 Notwithstanding Group Supervision 11.2, until 31 March 2022, the *group SCR* of a *group* based on consolidated data (consolidated *group SCR*) must be calculated on the basis of either:

(1) the standard formula;

(2) an approved *internal model*, in a manner consistent with the general principles contained in the *SCR Rules*; or

(3) approved *internal models*, where each approved *internal model* is applicable to a part of a *group* where both the *Solvency II undertaking* and the ultimate *parent undertaking* are located in the same *EEA State* and that part of the *group* forms a distinct part having a significantly different risk profile from the rest of the *group*.

9 GROUPS

9.1 Where Group Supervision 2.1(1) or 2.1(2) applies, the following provisions apply (notwithstanding Group Supervision 4.1 – 4.2) with any necessary changes at the level of the *group*:

(1) 4.1 – 4.2;

(2) 5.1;

(3) 8.1; and

(3) 11 – 13.

[Note: Art. 308b (17) of the *Solvency II Directive*]

9.2 [Drafting note: Placeholder for any rules required to transpose Article 308b(17) of the Solvency II Directive in relation to compliance with the group SCR]

10 RISK-FREE INTEREST RATES

[Drafting note: Placeholder for any rules required to transpose Article 308c of the Solvency II Directive in relation to risk-free interest rates]

11 TECHNICAL PROVISIONS

[Drafting note: Placeholder for any rules required to transpose Article 308d of the Solvency II Directive in relation to technical provisions]

12 NON-COMPLIANCE WITH THE SCR

[Drafting note: Placeholder for any rules required to transpose Article 308e of the Solvency II Directive in relation to application of the risk-free interest rate and technical provisions transitional measures.]

13 REPORT ON FINANCIAL AND SOLVENCY CONDITIONS

13.1 This Chapter applies to a disclosure of the *SFCR* by a *firm* or, as may be applicable, the report on solvency and financial condition at the level of the *group* by *participating Solvency II undertakings* or the *relevant insurance group undertakings* within the *group*, made in relation to the relevant financial years ending on or before 31 December 2017.

13.2 In the disclosure required by Reporting 3.1, a *firm* may, unless required under other legal or regulatory requirements (including any *Solvency II EEA implementing measure*), opt not to disclose the following separately when disclosing the amount of the *MCR* and *SCR* under Reporting 3.7:

(1) the information referred to in Reporting 3.7(2) on any *capital add-on* imposed on the *firm*; and

(2) the information referred to in Reporting 3.7(3) on any *undertaking specific parameters*.

[Note: Art. 51(2) of the *Solvency II Directive*]

13.3 In the disclosure required by Reporting 3.1 as applied to a *group* by Group Supervision 18.1, the *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* may, unless required under other legal or regulatory requirements (including any *Solvency II EEA implementing measure*), opt not to disclose the following separately when disclosing the amount of the *group SCR* under Reporting 3.7:

(1) the information referred to in Reporting 3.7(2) on any *capital add-on* imposed on the *group*; and

(2) the information referred to in Reporting 3.7(3) on any parameters specific to the *group*.

[Note: Art. 256(1) and 51(2) of the *Solvency II Directive*]

PRA RULEBOOK: SOLVENCY II FIRMS: SURPLUS FUNDS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Surplus Funds Instrument [Year]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Surplus Funds Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

SURPLUS FUNDS

Chapter content

1. **APPLICATION AND DEFINITIONS**
2. **SURPLUS FUNDS AND TECHNICAL PROVISIONS**
3. **CALCULATION OF SURPLUS FUNDS**
4. **CONSISTENCY OF CALCULATION**

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *UK Solvency II firm* carrying on *with-profits insurance business*.

1.2 In this Part, the following definitions shall apply:

FCA Handbook

means the *FCA's* Handbook of rules and guidance as amended from time to time.

future policy-related liabilities

means, in relation to a *with-profits fund,* the aggregate of the following amounts (to the extent each constitutes a liability) less the aggregate of such amounts (to the extent each constitutes an asset):

(1) planned deductions for the costs of guarantees, options, smoothing and provision of life cover and other benefits from the amount calculated in accordance with 3.3 or, where a *firm* is required under 3.2 to use the calculation method in 3.4, in accordance with 3.4;

(2) planned deductions for other costs deemed chargeable to the amount calculated in accordance with 3.3 or, where a *firm* is required under 3.2 to use the calculation method in 3.4, in accordance with 3.4;

(3) future costs of contractual guarantees (other than financial options);

(4) future costs of financial options, including guaranteed annuity and cash options;

(5) future costs or proceeds of smoothing;

(6) future liabilities to repay financing costs of a *with-profits fund* where the *firm* expects to have to meet such liabilities; and

(7) other future costs related to the provision of the benefits referred to in 3.4(4) (regardless of whether the firm is required to effect the calculation in 3.4);

but only to the extent that they are not already included in the amount calculated in accordance with 3.3 or, if applicable, 3.4.

surplus funds

means, in relation to a *with-profits fund*, accumulated profits which have not been made available for distribution to policyholders or other *beneficiaries* and which:

(1) satisfy the criteria for classification as *Tier 1 own funds* set out in Own Funds 3.1; and

(2) are represented by the output of the calculations set out in 3.

with-profits assets

means the assets in a *with-profits fund* except those meeting liabilities in respect of non-profit insurance.

with-profits fund

means [see below[1]].

with-profits insurance business

the business of *effecting contracts of insurance* or *carrying out contracts of insurance* that are *with-profits policies.*

with-profits policy

means a contract of *long-term insurance* which provides benefits through eligibility to participate in discretionary distributions based on profits arising from the *firm's* business or from a particular part of the *firm's* business.

with-profits policy liabilities

means, in relation to a *with-profits fund*, the value of liabilities attributable to *with-profits policies* (excluding any liabilities relating to non-profit insurance associated with such policies) set out in, and calculated on the basis prescribed by, 3.3 or, if applicable, 3.4 and (in either case) having also made adequate provisions for amounts representing *future policy-related liabilities*.

2 SURPLUS FUNDS AND TECHNICAL PROVISIONS

2.1 A *firm* shall not treat *surplus funds* as insurance and *reinsurance* obligations when valuing payments to *policyholders* and *beneficiaries* in the calculation of *technical provisions* in accordance with Technical Provisions 2.

[Note: Arts. 78(3) and 91(2) of the Solvency II Directive]

2.2 In order to comply with 2.1, a *firm* must calculate the amount, if any, of its *surplus funds* in accordance with 3.

3 CALCULATION OF SURPLUS FUNDS

3.1 A *firm* must calculate the amount (if any) of its *surplus funds* in relation to each of its *with-profits funds* as follows:

(1) the value of *with-profits assets;*

less

(2) the value of *with-profits policy liabilities;*

less

(3) the amount of any tax or other costs which will arise on the recognition of future shareholder transfers properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*, to the extent that such amounts are not included in (2);

[1] A definition of *with-profits fund* will be consulted on as part of the PRA's broader proposals for the regulation of with-profits insurance business planned for later this year.

less

(4) the value of any other liabilities (not being liabilities attributable to *with-profits policies* or any other policies in the *with-profits fund*) properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook;* and

less

(5) the value attributable to any future shareholder transfers (calculated by reference to the benefits referred to in 3.5(3) and in a manner consistent with the method of calculation specified in 3.4) relating to *with-profits polices* in that *with-profits fund* which may properly be made out of that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*.

3.2 A *firm* must value its *with-profits policy liabilities* (other than *future policy-related liabilities*) in accordance with 3.3 unless:

(1) valuation under 3.3 does not adequately reflect the value of some or all of such liabilities; or

(2) the *firm* can demonstrate that valuation under 3.3 is impracticable in respect of some or all of such liabilities;

in which case the *firm* must value such liabilities in accordance with 3.4.

3.3 Unless the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) as the aggregate of the retrospective value, in respect of each *with-profits policy,* of the following (treating items that increase the future liability to *policyholders* as positive values and treating items that reduce the future liability to *policyholders* as negative values):

(1) *premiums* received;

(2) any investment income on, and any increases (or decreases) in, asset values;

(3) any amounts representing permanent enhancements which the *firm* will take into account when determining the benefits ultimately payable;

(4) any past miscellaneous surplus (or deficit) which has been allocated;

(5) any expenses incurred (or deductions made in respect of expenses);

(6) any past deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits provided;

(7) any partial benefits paid or due (other than benefits in respect of which deductions have been made under (6));

(8) any tax paid or payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook;*

(9) any amounts received (or paid) under contracts of *reinsurance* or arrangements which have a similar financial effect, which relate to that *with-profits policy* (other than in respect of benefits for which deductions have been made under (6)); and

(10) any past shareholder transfers which are properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook,*

but deducting from that aggregate value any implicit allowance for the value of future shareholder transfers.

3.4 Where the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) on a prospective basis as the aggregate of the net present values of the following expected future cash-flows in respect of each *with-profits policy*:

(1) future *premiums*;

(2) expenses expected to be incurred (or deductions expected to be made in respect of expenses);

(3) planned deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits;

(4) any benefits payable of the type (or substantially similar to the type) specified in 3.5;

(5) any amounts receivable (or payable) under contracts of *reinsurance* or arrangements which have a similar financial effect which relate to that *with-profits policy* but excluding amounts in respect of benefits:

(a) which have been allowed for under (3); or

(b) for which deductions have previously been made with the result that they do not fall under (3); and

(6) tax payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook*.

3.5 The benefits referred to in 3.4(4) are:

(1) all guaranteed benefits, including amounts guaranteed to be payable on death and maturity (or on other events), guaranteed surrender values and paid-up values;

(2) declared bonuses to which the *policyholder* is contractually entitled; and

(3) future discretionary additions to guaranteed benefits and discretionary payments, in addition to the guaranteed benefits, which are expected to be made when the benefits under the *with-profits policy* becomes payable but only if and to the extent they are additions to benefits or payments which, if the *firm* had been able to effect the calculation required by 3.3, are consistent with those for which allowance would have been made in accordance with that calculation.

3.6 A *firm* must not attribute any charges to a *with-profits policy* for the purposes of this Part unless permitted to do so by any relevant provisions of the *FCA Handbook.*

4 CONSISTENCY OF CALCULATION

4.1 A *firm* must ensure that the valuations included in the calculations required to be carried out in accordance with 3.1 are consistent with the valuation methodologies adopted for the calculation of its *technical provisions* in accordance with Technical Provisions 2.

PRA RULEBOOK: SOLVENCY II FIRMS: GLOSSARY AMENDMENTS INSTRUMENT [YEAR]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

   (1) section 137G (The PRA's general rules); and
   (2) section 137T (General supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA) and section 319 of the Act (Consultation), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and the proposed direction and had regard to representations made.

PRA Rulebook: Solvency II Firms: Glossary Amendments Instrument [YEAR]

D. The PRA makes the rules in Annex A to this instrument.

Commencement

E. This instrument comes into force on [Date].

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Glossary Amendments Instrument [Year].

By order of the Board of the Prudential Regulation Authority
[Date]

Annex A

Amendments to the Glossary

Insert the following new definitions (in the appropriate alphabetical position) into the Glossary Part of the PRA Rulebook:

ancillary own funds

(1) (in relation to a *UK Solvency II firm* and the *Society*) has the meaning given in Own Funds 2.3 and are determined in accordance with Own Funds 2.3 – 2.7; or

(2) (in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with the applicable *Solvency II EEA implementing measures*; or

(3) (in relation to an *insurance holding company*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with (1) as if it were a *UK Solvency II firm*; or

(4) (in relation to a *third country branch undertaking*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with (1) as if it were a *UK Solvency II firm*.

[Note: Art. 89 of the *Solvency II Directive*]

approved reinsurance to close

means;

(1) a *reinsurance to close* effected before 1 January 2005; or

(2) an agreement under which *members* of a *syndicate* in one *syndicate year* ("the reinsured *members*") agree with the *members* of that *syndicate* in a later *syndicate year* or the *members* of one other *syndicate* ("the reinsuring members") that the reinsuring *members* will discharge, or procure the discharge of, or indemnify the reinsured *members* against, all known and unknown *insurance business* liabilities of the reinsured *members* arising out of the *insurance business* carried on by the reinsured *members* in that *syndicate year* that is:

  (a) effected after 1 January 2005; and

  (b) not a balance transfer between two *syndicate years* where the *syndicate* has only one *member* and the *member* is the same in each of those years; or

(3) an agreement under which *members* of a *syndicate* in one *syndicate year* ("the reinsured *members*") agree with a *subsidiary* of the *Society* that that *subsidiary* will discharge, or procure the discharge of, or indemnify the reinsured *members* against, all known and unknown *insurance business* liabilities of the reinsured *members* arising out of the *insurance business*

carried on by the reinsured *members* in that *syndicate year* ("the reinsured liabilities") and where:

(a) that *subsidiary* is wholly owned by the *Society* and if from time to time the *subsidiary* has an asset or cash flow deficiency such that the *subsidiary* is unable to meet any of the liabilities which it has reinsured, the *Society* is legally obliged to pay to the *subsidiary* a sum equal to that deficiency; and

(b) at the effective date of the agreement, the relevant *syndicate year* has been open for at least two years after the date at which it would normally have been closed in accordance with the policies and practices in relation to the *syndicate* concerned.

Article 12(1) relationship

means a relationship where *undertakings* are linked by a relationship within the meaning of Article 12(1) of Council Directive of 13 June 1983 on consolidated accounts (No 83/349/EEC).

basic own funds

(1) (in relation to a *UK Solvency II firm* and the *Society*), has the meaning given in Own Funds 2.2; or

(2) (in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*) means an *own funds* item referred to in Article 88 of the *Solvency II Directive*, determined in accordance with the applicable *Solvency II EEA implementing measures*; or

(3) (in relation to an *insurance holding company*) means an *own funds* item referred to in Article 88 of the *Solvency II Directive* determined in accordance with (1) as if it were a *UK Solvency II firm*; or

(4) (in relation to a *third country branch undertaking*) means an *own funds* item referred to in article 88 of the *Solvency II Directive* determined in accordance with (1) as if it were a *UK Solvency II firm*.

[Note: Art. 88 of the *Solvency II Directive*]

basic SCR

means the minimum basic *SCR,* as set out in Solvency Capital Requirement – Standard Formula 3 and as supplemented by the *Solvency II Regulations.*

beneficiary

means any *person* who is entitled to a right under a *contract of insurance*.

[Note: Recital 16 of the *Solvency II Directive*]

best estimate

means the best estimate of future cash-flows, calculated in accordance with Technical Provisions 3.

byelaw

means any Byelaw, direction, regulation, or other instrument made using the powers of the *Council* under section 6 of Lloyd's Act 1982 (including any regulation ratified by the *Council* by special resolution) and any condition or requirement made under any such Byelaw, direction, regulation or other instrument.

capital add-on

means the amount by which the *SCR* of a *UK Solvency II firm*, or the *group SCR* of a *group* (as appropriate), is increased by the *PRA* as a result of a *standard formula significant risk profile deviation*, *internal model significant risk profile deviation*, *significant system of governance deviation*, *significant deviation from relevant assumptions* or (if appropriate) a specific risk existing at *group* level.

central assets

means the *Society's* own assets that are available at its discretion to meet a *member's* liabilities in respect of *insurance business*.

Central Fund

means the Central Fund established under Lloyd's Central Fund Byelaw (No 4 of 1986) and the New Central Fund established under Lloyd's New Central Fund Byelaw (No 23 of 1996).

central liabilities

means the liabilities of the *Society,* excluding any liabilities of *members* (unless the *Society* has exercised its discretion to meet such liabilities) or any other participant at Lloyd's other than the *Society*.

central requirement

means the calculation made by the *Society* pursuant to the requirements of Solvency Capital Requirement – General Provisions 7.3.

class

means (in relation to a *contract of insurance*) any class of *contract of insurance* listed in Schedule 1 to the *Regulated Activities Order* (Contracts of insurance) and references to:

(1) *general insurance business class* 1, 2, 3, etc. are references to *contracts of insurance* of the kind mentioned in the corresponding numbered paragraph in Part I of Schedule 1 to that Order or, as the context may require, to the *effecting* or *carrying out of contracts of insurance* of that kind; and

(2) *long-term insurance business class* I, II, III, etc. are references to *contracts of insurance* of the kind mentioned in the corresponding numbered paragraph in Part II of Schedule 1 to that Order or, as the context may require, to the *effecting* or *carrying out of contracts of insurance* of that kind.

composite firm

means a *firm* that carries on both *long-term insurance business* and *general insurance business*.

contract for differences

means the investment, specified in article 85 of the *Regulated Activities Order* (Contracts for differences etc).

contract of insurance

has the meaning given in article 3(1) of the *Regulated Activities Order*.

control

means the relationship between a *parent undertaking* and a *subsidiary undertaking* where that relationship falls within (a) to (g) of the definition of *parent undertaking*, or a similar relationship between any *person* and an *undertaking.*

[Note: Art. 13(18) of the *Solvency II Directive*]

credit risk

means the risk of loss, or of adverse change, in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which a *Solvency II undertaking* is exposed, in the form of counterparty default risk, or *spread risk*, or *market risk* concentrations.

[Note: Art. 13(32) of the *Solvency II Directive*]

derivative

means a *contract for differences*, a *future* or an *option.*

diversification effects

means the reduction in the risk exposure of *UK Solvency II firms* related to the diversification of their business, resulting from the fact that the adverse outcome from one risk can be offset by a more favourable outcome from another risk, where those risks are not fully correlated.

[Note: Art. 13(37) of the *Solvency II Directive*]

EEA

means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being and which consists of the *EEA States.*

EEA State

has the meaning given in the Interpretation Act 1978 and, where the context requires, references to an *EEA state* include references to Gibraltar as appropriate.

EIOPA

means the European Insurance and Occupational Pensions Authority established in accordance with Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010.

eligible own funds

means:

(1) as to compliance with a *UK Solvency II firm's SCR*, the aggregate of the *firm*'s:

(a) *Tier 1 own funds*; and

(b) *eligible Tier 2 own funds*; and

(c) *eligible Tier 3 own funds*; and

(2) as to compliance with a *UK Solvency II firm's MCR*, the aggregate of the *firm's*:

(a) *Tier 1 own funds*; and

(b) *eligible Tier 2 own funds*; and

(3) as to compliance by a *composite firm* with the *notional life MCR*, the aggregate of the *firm's*:

(a) *Tier 1 own funds*; and

(b) the *firm's Tier 2 basic own funds*

that satisfy the limits in Own Funds 4 as if references to the "*MCR*" in those provisions were references to the *notional life MCR*; and the limits in the *Solvency II Regulations*; and

(4) as to compliance by a *composite firm* with the *notional non-life MCR*, the aggregate of the *firm's*:

(a) *Tier 1 own funds*; and

(b) the *firm's Tier 2 basic own funds*

that satisfy the limits in Own Funds 4.2 as if references to the "*MCR*" in those provisions were references to the *notional non-life MCR;* and the limits in the *Solvency II Regulations*.

employers' liability

means a *contract of insurance* against risks of the *persons* insured incurring liabilities to their employees.

exceptional adverse situation

means situations where the financial situation of a firm representing a significant share of the market or the affected lines of business are seriously or adversely affected by one or more of the following:

(1) a fall in financial markets which is unforeseen, sharp and steep;

(2) a persistent low interest rate environment; and

(3) a high impact catastrophic event.

finance scheme

means the finance scheme required to be provided by a *UK Solvency II firm* to the *PRA* under Undertakings in Difficulty 4.1(2).

function

means, within a system of governance, an internal capacity to undertake practical tasks.

[Note: Art. 13(29) of the *Solvency II Directive*]

funds at Lloyd's

means the assets (not being *syndicate assets*) provided by or on behalf of a *member* to meet the liabilities arising from the *member's insurance business* at Lloyd's which are held in a *Lloyd's trust fund* and managed by the *Society* as trustee.

future

means the investment, specified in article 84 of the *Regulated Activities Order* (Futures).

group

means a group of *undertakings* that:

(1) consists of a *participating undertaking*, its *subsidiary undertakings* and the *undertakings* in which it holds a participation, as well as *undertakings* linked to each other by an *Article 12(1) relationship*; or

(2) consists of a *mutual-type group*.

[Note: Art. 212(1)(c) of the *Solvency II Directive*]

group SCR

means the solvency capital requirement calculated at the level of the *group*, in accordance with Group Supervision 4 – 15.

incorporated friendly society

means a society incorporated under the Friendly Societies Act 1992.

insurance holding company

means a *parent undertaking*, other than a *Solvency II undertaking* and a *mixed financial holding company*, the main business of which is to acquire and hold *participations* in *subsidiary undertakings* and which fulfils the following conditions:

(1) its *subsidiary undertakings* are either exclusively or mainly *Solvency II undertakings, third country insurance undertakings* or *third country reinsurance undertakings*; and

(2) at least one of those *subsidiary undertakings* is a *Solvency II undertaking*.

[Note: Art. 212(1)(f) of the *Solvency II Directive*]

internal model

means the methodology used by a *firm* to calculate all or part of its *SCR*, or by a *group* to calculate part or all of its *group SCR*, in place of the *standard formula*.

internal model approval

means;

(1) the approval granted to a *firm* by the *PRA* to use an *internal model* to calculate part (*partial internal model*) or all of its *SCR*; and

(2) in relation to a *UK Solvency II firm* that is a member of a *group* the approval granted to that *firm* by the *PRA* to use an *internal model* to calculate part (*partial internal model*) or all of its *group SCR*.

internal model significant risk profile deviation

means the determination by the *PRA* of a significant deviation in the risk profile of a *UK Solvency II firm*, or a *group* (as appropriate), from the assumptions underlying the *SCR* (*or group SCR*, as appropriate) in circumstances where the *firm's SCR* (or the *group's group SCR*, as appropriate) is calculated using an *internal model*.

ISPV

means an *undertaking*, whether incorporated or not, other than a *Solvency II undertaking*, which has received authorisation in accordance with Article 211(1) or (3) of the *Solvency II Directive* and:

(1) which assumes risks from *Solvency II undertakings*; and

(2) which fully funds its exposures to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the *undertaking's* obligations to the *Solvency II undertaking* in respect of the risks referred to in (1).

[Note: Art. 13(26) of the *Solvency II Directive*]

linked long-term

means (in relation to a *contract of insurance*) a *contract of long-term insurance* where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

Lloyd's trust deed

means a trust deed in the form prescribed by the *Society* and notified to the *PRA*, for execution by a *member* in respect of his *insurance business*.

Lloyd's trust fund

means a fund held on the terms of a *Lloyd's trust deed*.

major business unit

means a defined segment of an *undertaking* that operates independently from other parts of the *undertaking*, has dedicated governance resources and procedures within the *undertaking* and contains risks which are material in relation to the whole business of the *firm*.

[Drafting note: Expected to be defined the *Solvency II Regulations*]

matching adjustment

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of a *relevant portfolio of insurance or reinsurance obligations* in accordance with:

(1) Technical Provisions 4B and 4C;

(2) the *Solvency II Regulations* adopted under Article 86(1)(h) - (i) of the *Solvency II Directive*; and

(3) any technical information made by *EIOPA* under Article 77e(1)(b) of the *Solvency II Directive* and adopted in the *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

matching adjustment approval

means the approval granted to a *firm* by the *PRA* to permit it to apply a *matching adjustment* for the purposes of calculating the *best estimate* in relation to a *relevant portfolio of insurance and reinsurance obligations.*

MCR

means the minimum capital requirement calculated in accordance with the Minimum Capital Requirement Part.

mixed financial holding company

means a mixed financial holding company as defined in Article 2(15) of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

[Note: Art. 212(1)(h) of the *Solvency II Directive*]

mutual

means an *insurer* which:

(1) if it is a *body corporate* has no *share* capital (except a wholly owned *subsidiary undertaking* with no *share* capital but limited by guarantee); or

(2) is a *registered friendly society* or *incorporated friendly society*; or

(3) is a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies (Northern Ireland) Act 1969.

mutual-type group

means a group of *undertakings* that is based on the establishment, contractually or otherwise, of strong and sustainable financial relationships among those *undertakings*, and that may include mutual or mutual-type associations, provided that:

(1) one of those *undertakings* effectively exercises, through centralised coordination, a dominant influence over the decisions, including financial decisions, of the other *undertakings* that are part of the group of *undertakings*; and

(2) the establishment and dissolution of such relationships for the purposes of Title III of the *Solvency II Directive* are subject to prior approval by the *group supervisor*,

where the undertaking exercising the centralised coordination shall be considered as the *parent undertaking*, and the other *undertakings* shall be considered as *subsidiary undertakings*.

[Note: Art. 212(1)(c)(ii) of the *Solvency II Directive*]

national specific template

means a template which a firm is required to complete pursuant to Solvency II – Reporting 2.6 and 2.8.

notional life MCR

means the notional minimum capital requirement calculated under Composites 4.2(1).

notional life SCR

means the notional solvency capital requirement for *long-term insurance business*, calculated in accordance with the *Solvency II Regulations*.

notional non-life MCR

means the notional minimum capital requirement calculated under Composites 4.2(2).

notional non-life SCR

means the notional solvency capital requirement for general insurance business, calculated in accordance with the *Solvency II Regulations*.

operational risk

means the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events, including legal risks but, for the purposes of Solvency Capital Requirement – General Provisions 3.3(1) it excludes risks arising from strategic decisions and reputational risks.

[Note: Art. 13(33) and Art. 101(4) of the *Solvency II Directive*]

option

means the investment, specified in article 83 of the *Regulated Activities Order* (Options).

ORSA

means the own risk and solvency assessment carried out from time to time, as detailed in Conditions Governing Business 3.6 – 3.8.

outsourcing

means an arrangement of any form between a *Solvency II undertaking* and a service provider, whether a supervised entity or not, by which that service provider performs a process, a service or an activity, whether directly or by sub-outsourcing, which would otherwise be performed by the *Solvency II undertaking* itself.

[Note: Art. 13(28) of the *Solvency II Directive*]

own funds

means;

(1) in relation to a *UK Solvency II firm*, the *firm's* aggregate *basic own funds* and *ancillary own funds* as determined in accordance with Solvency II – Own Funds; or

(2) in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*, own funds determined in accordance with *Solvency II EEA implementing measures*; or

(3) in relation to an *insurance holding company*, own funds determined in accordance with (1) as if it were a *UK Solvency II firm.*

[Note: Art. 87 of the *Solvency II Directive*]

parent undertaking

means, in accordance with section 420 of *FSMA* (Parent and subsidiary undertaking) and section 1162 of the Companies Act 2006 (Parent and subsidiary undertakings), an *undertaking* which has the following relationship to another *undertaking* ("S"):

(1) it holds a majority of the voting rights in S; or

(2) it is a member of S and has the right to appoint or remove a majority of its board of *directors*; or

(3) it has the right to exercise a dominant influence over S through:

   (a) provisions contained in S's memorandum or articles; or

   (b) a control contract; or

(4) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or

(5) (a) it has the power to exercise, or actually exercises, dominant influence or control over S; or

   (b) it and S are managed on a unified basis; or

(6) it is a *parent undertaking* of a *parent undertaking* of S; or

(7) (except as the Group Supervision Part applies to *members* of the *Society* or to the *Society* or *managing agents* in respect of *members*) it is incorporated in

or formed under the law of another *EEA State* and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the Council Directive of 13 June 1983 on consolidated accounts (No 83/349/EEC); or

(8) where, in accordance with Article 212(2) of the *Solvency II Directive*, it effectively exercises a dominant influence over S;

and:

(9) in relation to (2) and (4), the undertaking will be treated as a member of S if any of its *subsidiary undertakings* is a member of S, or if any shares in S are held by a person acting on behalf of the *undertaking* or any of its *subsidiary undertakings*;

(10) the provisions of Schedule 7 to the Companies Act 2006 (Parent and subsidiary undertakings: supplementary provisions) explain the expressions used in and supplement paragraphs (1) – (6).

[Note: Art. 212(2) of the *Solvency II Directive*]

partial internal model

means an *internal model* that is:

(1) used to calculate one or more of the following:

(a) one or more risk modules, or sub-modules, of the *basic SCR* ;

(b) the capital requirement for *operational risk* set out in Solvency Capital Requirement – Standard Formula 5;

(c) the adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes set out in Solvency Capital Requirement – Standard Formula 6; or

(2) applied to the whole of a *firm's insurance business*, or only to one or more of its *major business units*.

[Note: Art. 112(2) of the *Solvency II Directive*]

participating Solvency II undertaking

means a *Solvency II undertaking* that holds a *participation* in another *undertaking.*

participating undertaking

means an *undertaking* that holds a *participation* in another *undertaking*, or an *undertaking* linked with another *undertaking* by an *Article 12(1) relationship*.

[Note: Art. 212(1)(a) of the *Solvency II Directive*]

participation

means:

(1) the ownership, direct or by way of *control*, of 20% or more of the voting rights or capital of an *undertaking*; or

(2) where, in accordance with Article 212(2) of the *Solvency II Directive*, an *undertaking* effectively exercises a significant influence over another *undertaking.*

[Note: Art. 13(20) and 212(2) of the *Solvency II Directive*]

policy

has the meaning given in article 2 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361).

policyholder

means, in respect of a *contract of insurance* where the *insurance undertaking* is a *Solvency II undertaking*, a policyholder, which includes a *beneficiary*.

premium

means the consideration payable under a *contract of insurance* by the *policyholder* to the *insurer*.

pre-Solvency II MCR

means the minimum capital requirement that applied to the *UK Solvency II firm* under *PRA rules* as at 31 December 2012.

probability distribution forecast

means a mathematical function that assigns a probability of realisation to an exhaustive set of mutually exclusive future events.

[Note: Art. 13(38) of the *Solvency II Directive*]

pure reinsurer

means an *insurer* whose *insurance business* is restricted to *reinsurance*.

recovery plan

means;

(1) (except in the Group Supervision Part of the Solvency II Firms Sector), the recovery plan required to be provided by a firm to the *PRA* under Undertakings in Difficulty 3.1(2); and

(2) (in the Group Supervision Part of the Solvency II Firms Sector), the recovery plan required to be provided by a *relevant insurance group undertaking* to the *PRA* under Group Supervision 4.4(2).

registered friendly society

means a *friendly society* registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any registered branches.

reinsurance to close

means;

(1) an agreement under which members of a *syndicate* in one *syndicate year* ("the reinsured members") agree with the members of that *syndicate* in a later *syndicate year* or the members of another *syndicate* ("the reinsuring members") that the reinsuring members will discharge, or procure the discharge of, or indemnify the reinsured members against, all known and unknown *insurance business* liabilities of the reinsured members arising out of the *insurance business* carried on by the reinsured members in that *syndicate year*; or

(2) a similar *reinsurance* agreement or arrangement that has been approved by the *Council* as a reinsurance to close.

relevant insurance group undertaking

means, in relation to an *group* falling within Group Supervision 2.1(1)(a) or 2.1(1)(b), each *UK Solvency II undertaking* within that *group*.

relevant portfolio of insurance or reinsurance obligations

means a portfolio of insurance or *reinsurance* obligations falling within any *long-term insurance business class*, including annuities stemming from a *contract of general insurance*, in respect of which a *firm* has been granted a *matching adjustment approval.*

relevant risk-free interest rate term structure

means the relevant risk-free interest rate term structure, in accordance with:

(1) Technical Provisions 4A and 4D.3 – 4D.4;

(2) the *Solvency II Regulations* adopted under Article 86 of the *Solvency II Directive*; and

(3) any technical information made by *EIOPA* under Article 77e(1)(a) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

risk margin

means the portion of *technical provisions* calculated in accordance with Technical Provisions 4.1 – 4.2.

risk measure

means a mathematical function which assigns a monetary amount to a given *probability distribution forecast* and increases monotonically with the level of risk exposure underlying that *probability distribution forecast*.

[Note: Art. 13(39) of the *Solvency II Directive*]

risk-mitigation techniques

means all techniques which enable a *Solvency II undertaking* to transfer part or all of their risks to another party.

[Note: Art. 13(36) of the *Solvency II Directive*]

SCR

means the solvency capital requirement calculated in accordance with the *SCR Rules*.

[Note: Art. 100 of the *Solvency II Directive*]

SCR Rules

means the *PRA rules* contained in the Solvency Capital Requirement – General Provisions Part, the Solvency Capital Requirement – Standard Formula Part and the Solvency Capital Requirement – Internal Models Part.

security

has the meaning specified in article 3(1) of the *Regulated Activities Order.*

SFCR

means the solvency and financial condition report, as detailed in Reporting 3 – 6.

share

means the investment, specified in article 76 of the *Regulated Activities Order.*

significant deviation from relevant assumptions

means a significant deviation from the assumptions underlying the *matching adjustment* or the *volatility adjustment* or the transitional measures referred to in Articles 308c and 308d of the *Solvency II Directive*.

significant system of governance deviation

means the determination by the *PRA* of a significant deviation by a *UK Solvency II firm*, or a *group* (as appropriate), from the system of governance requirements set out in Conditions Governing Business 2.2 – 8 (including pursuant to Group Supervision 17.1(1) where appropriate).

Solvency II Directive

means the Directive of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (No 2009/138/EC).

Solvency II EEA implementing measures

means any measures implementing the *Solvency II Directive* in an *EEA State* other than the *United Kingdom*.

Solvency II Regulations

the directly applicable EU Regulations adopted in accordance with the *Solvency II Directive.*

Solvency II undertaking

means;

(1) an *undertaking* authorised in accordance with *Solvency II EEA implementing measures* transposing Article 14 of the *Solvency II Directive*; or

(2) a *UK Solvency II firm*.

spread risk

means the risk that a spread (that is, the difference in price or yield) between two variables will change.

standard formula

a methodology used by a *firm* to calculate its *SCR* according to the *rules* in the Solvency Capital Requirement – Standard Formula Part.

standard formula significant risk profile deviation

means the determination by the *PRA* of a significant deviation in the risk profile of a *UK Solvency II firm*, or a *group* (as appropriate), from the assumptions underlying the *SCR* (or *group SCR*, as appropriate) in circumstances where the *firm's SCR* (or the *group's group SCR*, as appropriate) is calculated using the *standard formula*.

subsidiary undertaking

means an *undertaking* of which another *undertaking* is its *parent undertaking.*

supervisory authority

means a national authority or the national authorities empowered by law or regulation of an *EEA State* to supervise *Solvency II undertakings* for the purposes of the *Solvency II Directive*, including the *PRA* and *FCA*.

[Note: Art. 13(10) of the *Solvency II Directive*]

syndicate assets

means the assets managed by or at the direction of a *managing agent* in respect of *insurance business* carried on through a *syndicate* and overseas business regulatory deposits funded from those assets.

syndicate year

means a year of account of a *syndicate*.

technical provisions

means the technical provisions established in accordance with Technical Provisions 2.1.

third country branch undertaking

means

(1) a *third country insurance undertaking* that has a *third country insurance branch*; or

(2) a *third country insurance undertaking* or *third country reinsurance undertaking* that has a *third country pure reinsurance branch*.

third country insurance branch

means a permanent presence in the *United Kingdom* of a *third country insurance undertaking* or *third country reinsurance undertaking,* that has a *permission* to *effect contracts of insurance* and *carry out contracts of insurance.*

[Note: Art. 163(3) of the *Solvency II Directive*]

third country insurance undertaking

means an *undertaking* that would require authorisation as an insurance undertaking in accordance with Article 14 of the *Solvency II Directive* if its head office was situated in the *EEA*.

[Note: Article 13(3) of the *Solvency II Directive*]

third country pure reinsurance branch

means a permanent presence in the *United Kingdom* of a *third country insurance undertaking* or *third country reinsurance undertaking*, that has a *permission* to *effect contracts of insurance* and *carry out contracts of insurance* and which pursues only the business of *reinsurance* in the *United Kingdom.*

[Note: Art. 162(3) of the *Solvency II Directive*]

third country reinsurance undertaking

means an *undertaking* that would require authorisation as a *reinsurance* undertaking in accordance with Article 14 of the *Solvency II Directive* if its head office were situated in the *EEA*.

[Note: Article 13(6) of the *Solvency II Directive*]

Tier 1 own funds

means an item of *basic own funds* that satisfies the conditions in Own Funds 3.1.

Tier 2 basic own funds

means an item of *Tier 2 own funds* that is an item of *basic own funds*.

Tier 2 own funds

means an item of *own funds* that satisfies the conditions in Own Funds 3.2.

Tier 3 own funds

means an item of *own funds* referred to in Own Funds 3.3.

UK Solvency II firm

has the meaning in General Application 2.

undertaking specific parameters

means, for the purposes of determining the *SCR* using the *standard formula*, the replacement of a subset of parameters used in the life *underwriting risk* module, non-life *underwriting risk* module or health *underwriting risk* module with parameters specific to a *firm*.

underwriting member

means a *person* admitted to the *Society* as an underwriting member.

underwriting risk

means the risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.

[Note: Art. 13(30) of the *Solvency II Directive*]

volatility adjustment

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate* in accordance with:

(1) the *Solvency II Regulations* adopted under Article 86(1)(j) of the *Solvency II Directive*; and

(2) any technical information made by *EIOPA* under Article 77e(1)(c) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

waiver

means a direction waiving or modifying a *rule*, given by the *PRA* under section 138A of *FSMA* (Modification or waiver of rules).

Amend the following definitions as shown:

insurance undertaking

means an *undertaking* ~~, whether or not an *insurer*, which carries on *insurance business*.~~(except for an *ISPV*) or a *member*, that carries on *insurance business*, whether or not an *insurer*.

insurer

means a *firm* with *permission* to *effect contracts of insurance* or *carry out contracts of insurance* (other than a~~n~~ ~~*UK ISPV*~~ *ISPV*).

market risk

(1) (except in the Solvency II Firms Sector) means the risk that arises from fluctuations in values of, or income from assets, or in interest or exchange rates; and

(2) (in the Solvency II Firms Sector) means the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

[Note: Art. 13(31) of the *Solvency II Directive*]

UK ISPV

Appendix 2.1

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: general application

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to those firms which are subject to the Solvency II rules in the Prudential Regulation Authority (PRA) Rulebook and to Lloyd's. The statement should be read alongside the General Application Part of the PRA Rulebook. It explains the scope of application of the PRA Rulebook Parts on Solvency II to UK Solvency II firms and to Lloyd's.

1.2 The PRA is publishing this statement to ensure that firms understand the requirements that they are expected to fulfil in order to comply with the PRA's rules. It expands on the general approach as set out in its insurance approach document.[1] By clarifying the scope of Solvency II, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Scope of application of Solvency II

2.1 In the PRA Rulebook, the Solvency II rules apply to a UK Solvency II firm. They also apply to Lloyd's by virtue of the application of various provisions to the Society and, where specified, to managing agents. In addition, the Lloyd's instrument of the PRA Rulebook contains provisions relevant only to the application of the rules transposing the Solvency II Directive and certain other rules to Lloyd's.

2.2 Though a firm might otherwise be excluded from the scope of 'UK Solvency II firm' under General Application 2, the provisions in the Solvency II rules will apply if the firm's Part 4A permission includes a requirement that it must comply with the Solvency II rules. This will be the case where a firm has opted in to the Solvency II regime or where a firm might otherwise be excluded pursuant to the Solvency II Directive but the PRA has decided to apply the Solvency II rules to that firm.

(1) www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

Appendix 2.2

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: own funds

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms and to Lloyd's, whether they are assessing the quality of their existing own funds and/or intending to issue new own fund items under Solvency II.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations of firms in relation to own funds, on the following topics in particular:

(a) ancillary own funds and Article 96 of the Solvency II Directive;

(b) the transitional measures for own funds;

(c) the right to cancel (or defer) dividends or other distributions; and

(d) pre-issuance notification.

1.3 Firms should read this statement alongside all relevant European legislation as well as the Own Funds Part of the PRA Rulebook. In particular, among other relevant provisions:

(a) Articles [ ] of Regulation (EU) No [ ] set out requirements relating to applications for the approval of ancillary own funds and their assessment;

(b). Articles [ ] of Regulation (EU) [ ] set out the adjustments that must be made to own funds to reflect the lack of transferability of ring-fenced funds that can only be used to cover losses arising from a particular segment of liabilities or from particular risks;

(c) Articles [ ] of Regulation (EU) [ ] set out a list of own funds items and the criteria for classifying them as Tier 1 own funds, Tier 2 own funds or Tier 3 own funds.

(d) For the purposes of Own Funds 4, Articles [ ] of Regulation (EU) [ ] set out the applicable limits regarding the proportion of Tier 1 own funds, Tier 2 own funds and Tier 3 own funds which can be included in a firm's eligible own funds to cover the firm's SCR and MCR.

(e) For the purposes of Own Funds 3.1 in connection with the classification of an item as ordinary share capital in Tier 1 own funds a firm must assess whether that item of basic own funds satisfies all relevant criteria for that classification in the Solvency II Regulations. For example, a firm must assess whether the item ranks after all other claims including other classes of share capital in the event the firm is wound up.

1.4 This statement expands on the PRA's general approach as set out in its insurance approach document and the Own Funds Part of the PRA Rulebook. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Ancillary own funds and Article 96 of the Solvency II Directive

2.1 The PRA does not envisage approving an amount under Own Funds 2.5(1) or a method under Own Funds 2.5(2) unless it is satisfied that the amount approved or determined using the approved method reflects the loss absorbency of the item of ancillary own funds and is based on prudent and realistic assumptions. Therefore, where an item of ancillary own funds has a fixed nominal value the amount of that item that can be included in a firm's own funds will only be equal to its nominal value where that value appropriately reflects its loss-absorbency (see article 90(2) of the Solvency II Directive).

2.2 Article 96 of the Solvency II Directive contemplates that:

(a) surplus funds will normally be classified as Tier 1 own funds;

(b) letters of credit and guarantees which are held on trust for the benefit of policyholders by an independent trustee and are provided by credit institutions authorised in accordance with the Banking Consolidation Directive will normally be classified as Tier 2 ancillary own funds;

(c) any future claims which a mutual of shipowners with variable contributions solely insuring risks listed in general insurance business class 6 (ships), class 12 (liability of ships) and class 17 (legal expenses), may have against their members by way of a call for supplementary contributions within the next twelve months will normally be classified as Tier 2 ancillary own funds; and

(d) any future claims which a mutual with variable contributions may have against their members by way of a call for supplementary contributions within the next twelve months which do not fall within (b) above will normally be classified as Tier 2 ancillary own funds where they substantially possess the characteristics set out in Own Funds 3.2(2)

2.3 The classification of the items referred to in (a) to (d) will depend on the extent to which they satisfy the requirements in Own Funds 3.1–3.6 and Articles [ ] of Regulation (EU) [ ],

Table 1 The operation of the transitional measures

GENPRU instrument subject to transitional arrangements	Treatment under Directive 2002/83/EC or Directive 2002/13/EC to cover the available solvency margin	Treatment under Solvency II transitional measures (for up to 10 years from 1 January 2016)
Core Tier 1	Not limited	Tier 1 restricted (Transitional Measures 4.1 (3) in the Transitional Measures Part of the PRA Rulebook applies)
Perpetual non-cumulative preference shares	Not limited	Tier 1 restricted (Transitional Measures 4.1 (3) applies)
Innovative Tier 1	Category limited to 50%	Tier 1 restricted (Transitional Measures 4.1 (3) applies)
Upper Tier 2	Category limited to 50%	Tier 1 restricted (Transitional Measures 4.1 (3) applies)
Lower Tier 2	Category limited to 25%	Tier 2

which set out requirements relating to the classification of own funds.

3 The transitional measures for own funds

3.1 Article 308b (9) and (10) of the Directive sets out how regulatory capital items could be used to meet capital requirements before 1 January 2016 that do not meet the criteria for available basic own funds, will be treated under Solvency II. These are referred to as the transitional measures for own funds in this statement.

3.2 Firms should not assume that all instruments issued before the cut-off date for the transitional measures automatically receive transitional treatment. The PRA expects firms to carry out their own analysis of instruments against the required features in the Solvency II Regulations and the transitional measures. The purpose is to determine which instruments can be classified as Solvency II compliant and those for which the transitional measures will be required.

3.3 This analysis should be carried out before 1 January 2016 in order that any necessary discussions with supervisors can take place, and that the firm can be clear as to the treatment of its instruments, before Solvency II applies. It is important that firms consult the Solvency II Regulations as the PRA rules transposing the Directive do not contain all of the necessary requirements in order to apply the transitional measures. Firms will also be expected to comply with the EIOPA Guidelines that complement and clarify the Solvency II Regulations. Firms should note that the inclusion of an item in Tier 1 own funds under the transitional measures is subject to the effect of the limits on such items specified in the Solvency II Regulations.

3.4 The operation of the transitional measures are summarised in the **Table 1**.

3.5 The PRA also expects firms to analyse the impact of the transitional measures on their current and projected capital position, instruments currently in issue, the ten-year transitional period and the incidence of call dates within that time.

3.6 The PRA expects firms not to rely on capital instruments that are already subject to transitional measures under GENPRU. Such instruments are unlikely to provide adequate loss-absorbency, thereby running contrary to the PRA's objectives to promote the safety and soundness of firms and the securing of an appropriate degree of protection for policyholders. For this reason, the PRA is excluding from the scope of Own Funds 4.1 and 4.2 items that are only eligible for the treatment specified by virtue of GENPRU Transitional Provision 4 of the PRA Rulebook. Similarly, the PRA does not expect to renew existing waivers, relating to capital instruments, which expire before 1 January 2016.

4 The right to cancel (or defer) dividends or other distributions

4.1 This section is relevant to all firms assessing the quality of their own-fund items by reference to the features determining classification as Tier 1.

4.2 The same considerations can also apply where own fund items are classified in Tier 2 and the Solvency II Regulations require deferral as opposed to cancellation of distributions.

4.3 All items of basic own-funds must meet the criteria in Own Funds 3 and the features determining classification in the Solvency II Regulations. In relation to paid-in ordinary share capital, matters such as the absence of mandatory fixed charges or encumbrances will be a characteristic until such time as a dividend is declared but the shares would cease to meet this criterion unless there is the ability to cancel a dividend after this point but prior to payment.

4.4 The PRA considers that where a firm's articles of association do not prohibit the cancellation of a dividend at any time, including after declaration, then they may be said to allow such cancellation so that the firm may be able to declare a dividend on a conditional basis, allowing cancellation of the dividend at any time prior to payment, if the applicable conditions are not met. Firms should ensure that they review their own articles to establish the absence of any such prohibition. Firms should also consider whether it is appropriate to amend their articles to include a specific power for the firm to declare dividends subject to conditions or even for all declarations of dividend to be conditional.

4.5 Article [ ] of Regulation (EU) [ ] sets out in more detail the nature of the conditionality that firms will need to apply to their declaration of dividends for these purposes. In order to link these provisions with the PRA Rulebook, the PRA is also proposing a rule that requires firms to include in their classification of Tier 1 own-funds only ordinary share capital in respect of which a dividend or other distribution is capable of being cancelled and withheld at any time prior to payment and where the firm exercises its rights to do so, where necessary. Where firms whose articles so permit adopt the practice of declaring all dividends conditionally (or amend their articles to provide that all dividends are conditional) and the conditions applied satisfy the requirements of article [ ] of Regulation (EU) [ ], they would be in a position to satisfy Own Funds 3.7(1).

4.6 There may be additional considerations for any firms with publicly traded shares for which an 'ex dividend' date may apply. Such firms may also have disclosure or other obligations arising from their listing arrangements in relation to possible non-payment of a declared dividend. The PRA expects firms to continue to monitor their solvency position carefully during this time and to engage with supervisors at an early stage to be assured that the need to cancel dividends is unlikely to arise.

4.7 The same considerations as to cancellation (or, in the case of Tier 2 own funds, deferral) of distributions apply to relevant Tier 1 own-fund items of mutuals. These comprise paid-in initial fund, members' contributions and any other equivalent items. While for many mutuals, distributions in relation to these items may not be relevant or common, reference to the firm's constitution or governing statute should be made to confirm that there are no provisions in relation to distributions which would disqualify the item as Tier 1 own funds.

4.8 Articles [ ] and [ ] of Regulation (EU) [ ] envisages exceptional circumstances in which respectively the cancellation (or deferral in the case of a Tier 2 item) may be waived. In the event of a firm applying for a waiver of cancellation (or deferral in the case of a Tier 2 item), the PRA would consider those circumstances carefully and, if it is satisfied the relevant conditions are met, signify its permission to the firm not to cancel or defer by waiving the relevant part of Own Funds 3.7(1) or (2) respectively.

4.9 The PRA is adopting this approach in order to provide clarity as to the manner in which relevant firms can demonstrate when classifying items as own funds that ordinary share capital can qualify as Tier 1 (or Tier 2) own funds. While firms may incur some administrative and legal costs in order to achieve compliance with this approach, the benefits of retaining compliant own funds will outweigh these.

5 Pre-issuance notification

5.1 Own Funds 5.2 provides that, in exceptional circumstances, a firm may provide less than one month's notice of the intended issue of own fund items. The PRA is unlikely to consider circumstances to be exceptional unless they are such that there is a risk of a firm not complying with its SCR or, as the case may be, MCR if a one-month notification period is observed. In such circumstances, a firm should notify the PRA as soon as it has resolved to issue further items it intends to include as basic own funds, and provide details of its circumstances and why it is not possible to provide one month's notice of the intended issue.

5.2 Details of the notification to be provided by a firm in relation to items of basic own funds issued by another undertaking in its group for inclusion in its own funds are set out in Group Supervision 6.

Appendix 2.3

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: solvency capital requirement

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms and to Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) expectations of firms in relation to the calculation of their Solvency Capital Requirement (SCR) under Solvency II.

1.2 In particular, this statement expands on the following topics:

- Undertaking specific parameters;
- Significant deviations from the assumptions underlying the standard formula, internal models, or the system of governance;
- Reversion to the standard formula; and
- Statistical quality standards.

1.3 This statement should be read alongside the relevant European legislation, as well as the Solvency Capital Requirement Parts of the PRA Rulebook.

1.4 The Solvency II Regulations set out requirements in respect of the calculation of the SCR. The Regulations:

(1) supplement the formula in Solvency Capital Requirement — Standard Formula 3.1(2) for calculating the basic SCR;

(2) set out the formula for calculating the capital requirement for the non-life underwriting risk module is set out in the Solvency II Regulations;

(3) set out a correlation matrix for the purposes of calculating the capital requirement for the life underwriting risk, the correlation coefficient 'Corr i,j' referred to in Solvency Capital Requirement — Standard Formula 3.1(2);

(4) set out the formula for calculating the capital requirement for health underwriting risk; and

(5) set out the formula for calculating the capital requirement for the market risk module.

1.5 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Undertaking specific parameters

2.1 Under Article 104(7) of the Solvency II Directive, firms may, with the prior approval of the PRA, replace a subset of parameters with undertaking specific parameters when calculating the life, non-life and underwriting risk modules. A firm may apply for this approval by applying to the PRA for a waiver.

2.2 Firms should be aware that undertaking specific parameters must be calibrated on the basis of the firm's internal data or on the basis of data which is directly relevant for the operations of the firm using standardised methods (see Article 104(7) of the Solvency II Directive).

2.3 The PRA may also require a firm, using its powers under section 55M of the Financial Services and Markets Act 2000 (FSMA), to replace a subset of the parameters used in the standard formula by undertaking specific parameters when calculating the life, non-life and health underwriting risk modules, where it is inappropriate to calculate the SCR in accordance with the standard formula because the firm's risk profile deviates significantly from the assumptions underlying the standard formula (see Article 110 of the Solvency II Directive).

3 Significant deviations from the assumptions underlying the standard formula calculation, internal model, and/or system of governance

3.1 Where it is inappropriate for a firm to calculate the SCR in accordance with the standard formula, because its risk profile deviates significantly from the assumptions underlying the standard formula calculation, then the PRA may require the firm to use an internal model to calculate the SCR, or the relevant risk modules of the SCR.

3.2 Article 37 of the Solvency II Directive contemplates the PRA applying a capital add-on to a firm in circumstances where there has been a standard formula significant risk profile deviation, an internal model significant risk profile deviation, a significant system of governance deviation, or a significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures in Articles 308c or d, in circumstances where the conditions stipulated in article 37(1)(a), (b), (c) or (d) have been met. The PRA will use its powers under section 55M of FSMA in order to apply a capital add-on. The Solvency II Regulations also apply in relation to the imposition of a capital add-on.

Reversion to the standard formula

3.3 A firm may apply to the PRA for a waiver of Solvency Capital Requirement — Internal Models 8.1, if there are duly justified circumstances for the firm to revert to calculating the SCR on the basis of the standard formula.

3.4 If a firm fails to implement the plan to restore compliance referred to in Solvency Capital Requirement — Internal Models 9.1, the PRA may require the firm to revert to calculating the SCR in accordance with the standard formula.

Statistical quality standards

3.5 No particular method for the calculation of the probability distribution forecast is prescribed by PRA rules.

3.6 For the purposes of Solvency Capital Requirement — Internal Models 11.8(1), the PRA would only approve diversification effects to be taken into account in a firm's internal model dependencies within and across risk categories provided the firm satisfies the PRA that the system used for measuring those diversification effects is adequate.

3.7 If a firm cannot derive the SCR directly from the probability distribution forecast generated by its internal model, then the firm may apply to the PRA for a waiver of Solvency Capital Requirement — Internal Models 12.2 so that approximations may be used in the process to calculate the SCR. In considering whether to grant such a waiver, the PRA will consider whether policyholders are provided with a level of protection equivalent to that set out in Solvency Capital Requirement — General Provisions 3.2–3.5 and Solvency Capital Requirement — Internal Models 3.1(2). The Solvency II Regulations contain additional requirements relevant to a firm seeking a waiver of Solvency Capital Requirement — Internal Models 12.2.

3.8 Article 37 of the Solvency II Directive contemplates the PRA applying a capital add-on to a firm in circumstances where there has been a standard formula significant risk profile deviation, an internal model significant risk profile deviation, a significant system of governance deviation, or a significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures in Articles 308c or d, in circumstances where the conditions stipulated in article 37(1)(a), (b), (c) or (d) have been met. The PRA will use its powers under section 55M of FSMA in order to apply a capital add-on. The Solvency II Regulations also apply in relation to the imposition of a capital add-on.

Appendix 2.4

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: minimum capital requirement

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to all UK Solvency II firms and to Lloyd's. Firms should read this alongside all relevant European legislation as well as the Minimum Capital Requirement Part of the Prudential Regulation Authority (PRA) Rulebook. It clarifies the PRA's expectations regarding the period during which the PRA is to apply the percentages that relate to the calculation of the Minimum Capital Requirement (MCR) as specified in Article 129 of the Solvency II Directive.

1.2 This statement expands on the PRA's general approach as set out in its insurance approach document and the Minimum Capital Requirement Part of the PRA Rulebook. By clearly and consistently explaining its expectations of firms in relation to the particular area addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Minimum capital requirement

2.1 The PRA may, until 31 December 2017, require a firm to apply the percentages referred to in Minimum Capital Requirement 3.3 to the firm's SCR calculated in accordance with the standard formula. An example of when the PRA may require this would be where the output from the firm's internal model has deviated from the firm's risk profile and where the standard formula provides a better fit to the firm's risk profile.

Appendix 2.5

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: supervision of firms in difficulty or in run-off

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms. It sets out how the Prudential Regulation Authority (PRA) expects to deal with firms in the circumstances envisaged by Article 144 of the Directive, where a firm does not meet the Minimum Capital Requirement (MCR) and where either the PRA considers that the finance scheme it has submitted is manifestly inadequate or the firm fails to comply with the approved scheme within three months from the observation of non-compliance with the MCR.

1.2 It is also addressed to firms in run-off which may fall within the ambit of the transitional provision set out in Transitional Measures 2 in the Transitional Measures Part of the PRA Rulebook.

1.3 This statement should be read alongside all relevant European legislation as well as the Undertakings in Difficulty Part of the PRA Rulebook.

1.4 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Firms in breach of the minimum capital requirement

2.1 The PRA will take the same approach to firms which are failing to meet the MCR, whether they are still being run by their directors or whether an administrator or liquidator has been appointed.

2.2 The PRA expects those firms to act in a way which avoids significant systemic disruption, while protecting vital economic functions and which ensures that policyholders are appropriately protected. The interests of shareholders and creditors other than policyholders are therefore likely to be of lesser priority for the PRA in discharging its statutory functions. This approach is aligned with Solvency II, which has as its main objective the protection of policyholders and requires the PRA to take all measures necessary to safeguard the interests of insured persons when insurers or reinsurers fail to meet MCR.

2.3 The PRA will be particularly concerned to ensure that:

- policyholders can maintain their insurance cover or obtain alternative insurance cover on reasonable terms where this is critical to them or their business;
- payments to them, which are essential for their living necessities, continue without disruption; and
- where this becomes necessary, the method for distributing assets amongst creditors (and shareholders) is fair to both those whose claims have arisen and those who may have claims in the future, given the increased risk that the firm will not have sufficient assets to pay all creditors in full.

2.4 The PRA will require a firm with no realistic prospect of prompt restoration of compliance with the MCR to bring its business to a close in as rapid and orderly manner as is consistent with the generality of policyholders' best interests. This may well take time and there are many circumstances in which a run-off strategy is in the best interests of policyholders (whether the firm is solvent or insolvent) and thus consistent with the main objective of Solvency II.

2.5 A firm in this position will not be permitted by the PRA to effect new contracts of insurance but the firm may be permitted to continue activities necessary to carry out existing contracts in a manner, and for so long as, the PRA considers necessary in order to afford an appropriate degree of protection to policyholders. Where a firm continues carrying out contracts of insurance as principal under the Financial Services and Markets Act 2000 (FSMA), the firm would continue to be authorised and retain a Part 4A permission for these limited purposes. The effect of this would be that the firm would also remain subject to PRA supervision, to the ongoing requirements of the PRA Rules which transpose Solvency II and to the Solvency II Regulations during this time. The same will be the case where an insolvency practitioner has been appointed. The PRA would expect such a person to conduct the firm's affairs in a way which is compatible with the main objective of Solvency II, as well as with their own statutory duties.

2.6 The PRA will seek to exercise its powers under FSMA (and in particular, section 55M) in order to satisfy the requirements of Article 144 of the Directive by imposing an assets requirement on a firm which is failing to meet the MCR and is unable to rectify this. The purpose of such a requirement will be to restrict the disposal by the firm of its assets but will generally permit the firm to pay the necessary costs of administering its business and to pay policyholder claims as appropriate. Any other transactions are likely to require the PRA's approval to ensure (among other things) that assets are disposed of for fair value. Where the firm is subject to insolvency proceedings then any asset requirement would permit the insolvency practitioner to realise the firm's assets and distribute them, where necessary to ensure compliance with legal requirements arising from the insolvency process and where consistent with the PRA's objectives.

3 Firms in run-off

3.1 The PRA expects firms in run-off, who consider that they meet the conditions set out in Transitional Measures 2, to inform the PRA of their assessment of their circumstances sufficiently before 1 January 2016, such that the PRA can determine whether it is satisfied that the conditions are met. In particular, the PRA will expect firms to have a credible plan for transferring or extinguishing all their existing insurance liabilities within the timescales specified in Transitional Measures 2.1 (1 January 2019 or 1 January 2021, according to their circumstances). Firms should note that, in order for these provisions to apply, the firm must not be part of a group containing any other insurer or reinsurer which is not also in run-off.

3.2 The PRA will notify supervisory authorities in other member states of those firms which it considers meet the transitional provisions.

Appendix 2.6

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: composites

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms and to Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) approach to implementing the Solvency II Directive requirements that are specific to composite firms. It should be read alongside the Composites Part of the PRA Rulebook.

1.2 In particular, this statement explains in detail requirements regarding the following topics:

- pursuit of life and non-life insurance activity; and
- separation of life and non-life insurance management.

1.3 This statement expands on the PRA's general approach as set out in its insurance approach document.(1) By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Pursuit of life and non-life insurance activity

2.1 Under section 19 of the Financial Services and Markets Act 2000 (FSMA), a firm may not carry on a regulated activity unless it has permission to do so (or is exempt in relation to the particular activity). Both general insurance business and long-term insurance business are regulated activities and permission will extend to the effecting or carrying out of contracts of insurance for one or more particular classes.

2.2 A firm's permission can be varied so as to add other classes. The permission of an existing composite firm may be varied by adding classes of both general insurance business and long-term insurance business.

2.3 It is PRA policy, in compliance with the Solvency II Directive, not to grant or vary permission if that would allow a newly established firm, or an existing firm engaging solely in general insurance business or solely in long-term insurance business, to engage in both general insurance business and long-term insurance business. This does not apply where a firm's permission to carry on long-term insurance business is or is to be restricted to reinsurance. It also does not apply where a firm's permission to carry on general insurance business is or is to be restricted to effecting or carrying out contracts of insurance in general insurance business class 1 (accident) or class 2 (sickness) (see Article 73(2) of the Solvency II Directive).

3 Separation of life and non-life insurance management

3.1 For the purpose of Composites 2.2, the PRA would expect a composite firm to:

(a) comply with the governance rules set out in the Conditions Governing Business Part of the PRA Rulebook separately in respect of its general insurance business activities and its long-term insurance business activities to the extent that it is practicable to do so;

(b) separately identify the assets attributable to each of its long-term insurance business and its general insurance business on the basis of the accounts referred to in Composites 3.2; and

(c) maintain the assets attributable to its long-term insurance business and the assets attributable to its general insurance business separate from each other.

3.2 The firm should consider the appropriateness of the apportionment referred to in Composites 3.3(2), having regard to the requirements in Composites 2.2.

3.3 In order to comply with Composites 3.2 and Composites 3.3 the firm should prepare a notional balance sheet for each of its long-term insurance business and general insurance business, identifying the assets and liabilities relating to its long-term insurance business and its general insurance business, respectively.

3.4 For the purpose of Composites 4.2, firms should note that the Solvency II Regulations set out the method for calculating the notional MCR.

3.5 Article 74(6) of the Solvency II Directive provides that, in the circumstances referred to in Composites 4.8 supervisory authorities may authorise the transfer of eligible own funds from one activity to the other. Therefore, if a composite firm that is in breach of either Composites 4.3(1) or 4.3(2) wishes, as part of its finance scheme referred to in Undertakings in Difficulty 4 of the Undertakings in Difficulty Part of the PRA Rulebook, to use eligible own funds attributable to its long-term insurance business to cover its notional non-life MCR or eligible own funds attributable to its general insurance business to cover its notional life MCR, it may only do so if it obtains a waiver of Composites 4.3 and 4.4 under section 138A of FSMA.

3.6 In deciding whether to grant a waiver to authorise the transfer of eligible own funds from one activity to the other, in

(1) www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

addition to the statutory tests under section 138A of FSMA, the PRA will have regard to whether the interests of policyholders of long-term insurance contracts would be prejudiced by a transfer of eligible own funds attributable to the long-term insurance business to cover the notional non-life MCR and whether the interests of policyholders of general insurance contracts would be prejudiced by a transfer of eligible own funds attributable to the general insurance business to cover the notional life MCR.

3.7 For the purposes of complying with its minimum financial obligations in Composites 4, a firm should consider whether it has any ring-fenced funds which would result in adjustments to its eligible own funds attributable to its long-term insurance business or to its general insurance business.

Appendix 2.7

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: conditions governing business

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms and to Lloyd's. It sets out the types of business that a pure reinsurer can carry on as related to its insurance business. It should be read alongside the Conditions Governing Business Part of the Prudential Regulation Authority (PRA) Rulebook.

1.2 This statement expands on the PRA's general approach as set out in its insurance approach document.(1) By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Related Operations

2.1 In Conditions Governing Business 10.2, 'related operations' include, for example, activities such as provision of statistical or actuarial advice, risk analysis or research for its clients. It may also include a holding company function and activities with respect to financial sector activities within the meaning of Article 2, point 8, of the Financial Conglomerates Directive (Directive 2002/87/EC). But it does not allow the carrying on of, for example, unrelated banking and financial activities (see Recital (13) and Article 18(1)(b) of the Solvency II Directive).

(1) www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

Appendix 2.8

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: group supervision

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to UK Solvency II firms that are part of a group (and the Society of Lloyd's as a mixed activity insurance holding company). It sets out the Prudential Regulation Authority's (PRA's) expectations in respect of the Solvency II groups provisions.

1.2 Firms should note that if the group supervisor is a supervisory authority other than the PRA, the PRA still requires the UK insurers to comply with the groups provisions set out in the Solvency II Directive.

1.3 The groups provisions referred to in this statement should be read alongside the relevant European legislation, which includes Articles 213 to 246, 256, 256a, 257 and 260 to 266 of the Solvency II Directive. It should also be read in conjunction with the Solvency II Regulations, the rules in the Group Supervision Part of the PRA Rulebook and the high-level expectations outlined in the PRA's approach to insurance supervision.

1.4 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Entities excluded from the scope of group supervision (Article 214)

2.1 Where a group, for which the PRA is the group supervisor, wishes to exclude entities from the scope of group supervision, it will be expected to make a formal application to the PRA. The PRA expects this application to articulate the way in which the firm believes that the conditions set out in Article 214(2) are met.

2.2 The PRA will assess applications to exclude entities from the scope of group supervision under Article 214 on a case-by-case basis. The PRA expects to only grant a waiver with respect to undertakings where it is satisfied that conditions in Article 214(2) are met, following a consultation with the concerned supervisory authorities.

3 Choice of calculation method (Article 220)

3.1. Where the PRA is the group supervisor, Article 220 of the Solvency II Directive allows the PRA to decide, after consulting the concerned supervisory authorities and the group, to apply to the group method 2 (deduction and aggregation method) or a combination of methods 1 and 2, where the exclusive application of method 1 (accounting consolidation-based method) would not be appropriate.

4 Group capital add-on (Article 232)

4.1 Where the PRA is the group supervisor, in considering whether the consolidated group SCR appropriately reflects the risk profile of the group, it may consider a capital add-on for a group if the circumstances referred to in Article 37(1)(a) to (d) of the Solvency II Directive arise at the group level.

4.2 In particular, the PRA will consider imposing a capital add-on under Article 232 of the Solvency II Directive where:

(a) a specific risk at group level is not sufficiently covered by the standard formula or an internal model; or

(b) a capital add-on is imposed on a Solvency II undertaking in the insurance group because its risk profile deviates significantly from the assumptions underlying the group's internal model.

5 Centralised risk management (Article 237)

5.1 A group, for which the PRA is the group supervisor, may apply to be subject to the rules set out for centralised risk management in order to allow it to calculate the SCR for its subsidiary undertakings in accordance with a decision taken in the context of Article 238.

5.2 The PRA, together with the college of supervisors, will assess such applications for centralised risk management assessment in accordance with the approach set out in Article 237.

6 Single own risk and solvency assessment report (Article 246)

6.1 A group, for which the PRA is the group supervisor, may apply to produce a single document covering own risk and solvency assessments (ORSA) at the level of the group and at the level of any subsidiary in the group at the same time. The PRA will assess applications to produce a single ORSA document in consultation with the college of supervisors.

6.2 In addition to the ORSA conducted at group level, the PRA expects the group-wide ORSA document to include sufficient details on the solo firms included within the scope of the group wide ORSA such that Article 45 (solo ORSA) is satisfied in respect of each of those firms.

7 Single solvency and financial condition report (Article 256)

7.1 A group, for which the PRA is the group supervisor, may apply to produce a single report on its solvency and financial condition (SFCR) at the level of the group, and at the level of any subsidiary in the group which must be individually identifiable. The PRA will assess applications to produce a single SFCR in consultation with the college of supervisors.

7.2 The PRA expects the single document produced to cover the same level of detail on the solo subsidiary firms as is required in the solo SFCR.

8 Responsibilities of the relevant insurance group undertaking

8.1 Where the PRA is the group supervisor it may determine, after consulting the relevant supervisory authorities, the relevant insurance group undertaking in accordance with Article 219, which will be responsible for the group solvency calculations referred to in Article 218(2) and (3).

8.2 For a group, for which the PRA is the group supervisor, it is sufficient for one relevant insurance group undertaking within an insurance group to undertake the following activities on behalf of the group:

(a) to submit the relevant data for and the results of the group eligible own funds and the group solvency capital requirements (SCR) to the PRA, as referred to in Group Supervision 5.2;

(b) to ensure ongoing compliance with the conditions for the prudent management of subsidiaries, production of a single document covering all relevant ORSAs and production of a single SFCR, as referred to in Group Supervision 15.4(2);

(c) to inform the PRA in an event of non-compliance with the group SCR within the appropriate timeframes, as referred to in Group Supervision 4.4;

(d) to submit a realistic recovery plan and take measures to ensure compliance with the group SCR in an event of non-compliance with the group SCR within the appropriate timeframes, as referred to in Group Supervision 4.4;

(e) to inform the PRA and the supervisory authorities of the subsidiary undertakings concerned of non-compliance with the centralised risk management (CRM) criteria, as referred to in Group Supervision 15.4(2)(a); and

(f) to present a plan on how compliance will be restored with the CRM criteria to the PRA and the supervisory authorities, as referred to in Group Supervision 15.4(2)(b).

Appendix 2.9

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: reporting

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to all UK Solvency II firms and to Lloyd's. It should be read alongside all relevant EU legislation, and the Reporting Part of the Prudential Regulation Authority (PRA) Rulebook. It clarifies the PRA's implementation of the Solvency II regime's requirements in relation to supervisory reporting.

1.2 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Solvency II reporting

2.1 The submission of the national-specific templates, are in addition to those set out in the Solvency II Regulations, and as referred to in Reporting 2.3 in the Reporting Part of the PRA Rulebook.

2.2 A firm may disclose on a voluntary basis any information or explanation related to its solvency and financial condition which is not already required to be disclosed in accordance with Reporting 3.3–3.8, 4, 5.1, 5.3 and 5.5.

Appendix 2.10

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: Lloyd's

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) expectations in relation to the application of certain parts of Solvency II to Lloyd's. This draft supervisory statement also covers the Lloyd's Part of the PRA Rulebook that is included in this consultation.

1.2 In particular, this statement sets out the PRA's expectations regarding the following topics:

- Amendments to Trust deeds
- Solvency capital requirement
- Capital add-on
- Composites

1.3 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of Lloyd's in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Amendments to trust deeds, standard form letters of credit and guarantee arrangements

2.1 Except in urgent cases, the PRA expects the Society to consult members, managing agents and other interested parties in the Lloyd's market in relation to any proposed new Lloyd's trust deed or amendments to any existing deed before the new deed or amendment take effect.

2.2 The PRA would normally expect to receive the information required in Lloyd's 6.3 for any new or amended Lloyd's trust deed not less than three months in advance of the proposed change.

2.3 The PRA would also expect the Society to apply the approach in paragraphs 2.1 and 2.2 above in case of amendments to standard form letters of credit and guarantee arrangements.

3 Solvency capital requirement

3.1 The requirement to hold eligible own funds covering the central requirement is intended to ensure that risks to the Society, including risks to central assets (and in particular, the risk that own funds attributable to a member may not be sufficient to enable the member to meet obligations arising from the member's insurance business at Lloyd's) are suitably covered by the Society.

3.2 Solvency Capital Requirement — General Provisions 6.6 in the Solvency Capital Requirement— General Provisions Part of the PRA Rulebook recognises in its application to Lloyd's that own funds attributable to a member are not available to absorb the losses of other members, or any losses of the Society. Consequently, in respect of own funds attributable to a member, where there is no diminution in those own funds consequent upon the application of scenarios taken into account in the internal model, those own funds attributable to that member must not be taken into account for the purposes of satisfying Solvency Capital Requirement — General Provisions 6.2. Similarly, in respect of own funds attributable to a member, any surplus of own funds in excess of the diminution to those own funds consequent upon the application of the scenarios taken account of in the internal model, must not be taken into account for the purposes of satisfying Solvency Capital Requirement — General Provisions 6.2.

3.3 The notional syndicate SCR is intended to facilitate the Society's compliance with Solvency Capital Requirement — General Provisions 8.3. While the PRA expects the calculation of the notional SCR to meet the relevant standards required under Solvency II, managing agents do not need to seek separate approval from the PRA for any internal model that is used to calculate the notional SCR of a syndicate. The notional SCR will also assist the Society in determining the notional SCR of each member of the syndicate pursuant to Solvency Capital Requirement — General Provisions 8.4. However, the notional member SCR will, to the extent applicable, also take account of diversification effects in respect of members participating on more than one syndicate which have not been reflected in the notional syndicate SCR.

3.4 In deriving the SCR, the Society should have regard to the notional SCR for each syndicate, that is calculated by managing agents either by reference to the standard formula or an internal model. However, the Society should make its own assessment of the risk profile and governance arrangements in respect of each syndicate, in conjunction with the methodology applied by each managing agent to calculate the notional SCR. It may need to increase a notional syndicate SCR, and hence the overall SCR for Lloyd's, if it concludes that there are additional risks to which the Society is exposed in relation to the business written by a syndicate, that would not otherwise be covered, when performing the calculations envisaged by Solvency Capital Requirement — General Provisions 7.

3.5 The approach set out in Solvency Capital Requirement — Internal Models 17.2 in the Solvency Capital Requirement Part of the PRA Rulebook is, when combined with the internal model requirements set out in Solvency Capital Requirement — Internal Models 10 to 16 and Solvency Capital Requirement — General Provisions 8.2, intended to produce, for each risk taken into account in the internal model, the negative impact on basic own funds at Lloyd's. In this way, the effect of the application of the risks taken into account in the internal model may be determined in respect of Lloyd's as a whole.

4 Capital add-on

4.1 Solvency Capital Requirement — General Provisions 7.3 requires the Society to calculate a central requirement for Lloyd's. As the central requirement forms part of the Lloyd's SCR, the provisions of Article 37 of the Solvency II Directive will apply in respect of any risk profile deviation on the part of the Society from the assumptions underlying the calculation of the central requirement. The PRA will exercise its power under the Financial Services and Markets Act 2000 (FSMA) in order to apply a capital add-on to the Society.

5 Composites

5.1 As Lloyd's is (and was prior to 15 March 1979, being the relevant date set out in the Solvency II Directive) composed of syndicates which separately accept general insurance business or long-term insurance business, the PRA considers Lloyd's to be a composite undertaking for the purposes of the Solvency II Directive.

5.2 The Solvency II Directive requires composite firms to maintain separate management of general insurance business and long-term insurance business. In practical terms, this requires that managing agents separately manage syndicates which carry on general insurance business from syndicates which carry on long-term insurance business. However, where a single syndicate carries on both general insurance business and long-term insurance business pursuant to the exceptions referred to at Composites 6.2 in the Composites Part of the PRA Rulebook, paragraphs 3.1–3.3 of the draft supervisory statement on Composites in Appendix 6 are intended to assist in determining how the requirements of the Composites Part will apply to managing agents.

5.3 Paragraphs 2.1–2.3 of the draft supervisory statement on Composites refer to a firm's permission to effect and/or carry out contracts of insurance which may be general insurance business or long-term insurance business, or both, and, within those categories, to the particular classes of insurance business. For the purpose of the application of rules in the Composites Part to Lloyd's, references in paragraphs 2.1–2.3 of the draft supervisory statement on Composites to a firm's 'permission' in respect of 'classes' of insurance business are to be interpreted by reference to syndicates which carry on what would be, as the context requires:

(a) general insurance business, if the syndicate was a firm authorised to effect and/or carry out contracts of general insurance business;

(b) long-term insurance business, if the syndicate was a firm authorised to effect and/or carry out contracts of long-term insurance business; and

(c) both general insurance business and long-term insurance business, if the syndicate was a firm authorised to effect and/or carry out both contracts of general insurance business and contracts of long-term insurance business, as contemplated by paragraph 2.3 of the draft supervisory statement on Composites.

The references in Composites 2.2 to 'general insurance business' and 'long-term insurance business', and the activities relating thereto, are to be similarly interpreted.

Appendix 2.11

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: surplus funds

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to all UK Solvency II firms which write with-profits insurance business and which are therefore required to calculate surplus funds. It sets out the PRA's expectations of firms in relation to surplus funds.

1.2 In particular, this statement sets out the PRA's expectations of firms in relation to the following topics:

- interaction of the surplus funds calculation with the calculation of technical provisions; and
- the calculation of surplus funds.

1.3 This statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

1.4 Firms should have regard to the Solvency II Regulations as well as the PRA Rulebook when calculating surplus funds and considering whether they meet the criteria for classification as Tier 1 own funds. In particular, Article [ ] sets out a list of own funds items and the features determining classification as Tier 1 own funds.

2 Interaction of the surplus funds calculation with the calculation of technical provisions

2.1 Article 78 of the Solvency II Directive requires a firm to include, when calculating its technical provisions, all payments to policyholders, including future discretionary bonuses, unless those payments constitute surplus funds that fall within Article 91(2). This is reflected in 5.1(1)(c) of the Technical Provisions Part of the PRA Rulebook. Article 91 provides that surplus funds are not to be considered insurance and reinsurance liabilities, to the extent that national law permits and where those surplus funds meet the requirements for Tier 1 ownfunds.

2.2 The Surplus Funds Part of the PRA Rulebook is the national law provision, referred to in Article 91(2) of the Solvency II Directive, which prescribes the extent to which surplus funds shall not be treated as insurance or reinsurance liabilities and therefore the extent to which they affect the calculation of a firm's technical provisions.

2.3 The PRA expects that surplus funds will normally meet the criteria for classification as Tier 1 own funds as referred to in paragraph 1.4. While surplus funds within a with-profits fund may satisfy these criteria, firms should be aware of any other restrictions that may apply to such funds by virtue of their being within the with-profits fund, in particular policyholder fairness rules in the FCA Handbook, and as a consequence, such surplus funds are likely to be treated as part of a ring-fenced fund under the Solvency II Regulations.

2.4 The calculation of surplus funds in the Surplus Funds Instrument does not refer to or include a risk margin. The risk margin is a Solvency II requirement in respect of technical provisions and does not therefore fall within the scope of domestic requirements for the calculation of surplus funds. However, this does not affect the Solvency II requirements for firms to calculate and recognise the risk margin element of technical provisions in respect of their business as a whole, including with-profits business.

3 Surplus funds calculations

3.1 Surplus Funds 3.2 generally requires the value of with-profits policy liabilities to be calculated on the basis of a retrospective approach set out in Surplus Funds 3.3. However where this approach would not adequately reflect the value of the liabilities, or the firm is able to demonstrate that this approach is not practicable, then the prospective basis for calculation in Surplus Funds 3.4 is required. The PRA expects firms to consider whether the application of the retrospective approach would be practicable given the nature of their with-profits policies and, even if possible, whether the results would be meaningful or an appropriate basis for the calculations. While each firm will need to consider its own specific circumstances, whole of life policies or other policies where the result of the retrospective calculation might be negative or significantly lower than the value calculated using the prospective approach are examples where the prospective approach might be necessary.

3.2 Calculations of with-profits policy liabilities are determined on the basis of the aggregate value in respect of each with-profits policy. For this purpose calculations may be based on groupings of similar policies (or other approximations) provided that firms can demonstrate that:

(a) where approximations or generalisations are made they are likely to provide the same, or a higher, result than a separate calculation for each with-profits policy;

(b) the grouping of policies does not materially misrepresent the underlying exposure or misstate the costs of guarantees, options or smoothing; and

(c) the selection of groupings is based on policies with similar attributes including the status of guarantees.

The PRA expects firms to ensure that the choice of groupings is appropriate having regard to (a) to (c) above each time it calculates surplus funds.

3.3 Surplus Funds 3.5 specifies the extent to which future discretionary additions to guaranteed benefits and discretionary payments should be included in benefits payable for the purposes of the prospective calculation in Surplus Funds 3.4. The PRA expects that firms will have regard to their current expectations as to payments which are likely to be made taking into account the principles underlying the retrospective approach. In arriving at their projections of future discretionary benefits firms will need to comply with the requirements of the Solvency II Regulation as well as the intent and provisions of the Surplus Funds Part. The PRA would not expect a firm to include within benefits payable distributions from the estate that it might make over the life of the with-profits policies were the with-profits fund in run-off, or that it expects to make if it is currently in run-off. Firms' current expectations as to an affordable, prudent and realistic level of distributions should inform their projections of future discretionary benefits.

Appendix 2.12

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS[xx]/14

Solvency II: third country branch undertakings

August 2014

1 Introduction

1.1 This draft supervisory statement is addressed to the UK branch undertakings of non-EEA insurance undertakings. It should be read alongside the Third Country Branches Part of the Prudential regulation Authority (PRA) Rulebook, the relevant European legislation, and the relevant provisions of the Financial Services and Markets Act 2000 (FSMA). It sets out the PRA's expectations of firms with regard to third country branch undertakings,

1.2 In particular, this statement explains the PRA's expectations of firms in relation to the following topics:

- Worldwide financial resources
- Scheme of operations
- Third country branches as composites
- Application of other draft supervisory statements to third country branches

1.3 This statement expands on the PRA's general approach as set out in its insurance approach document.(1) By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

2 Worldwide financial resources

2.1 A third country branch undertaking must maintain adequate worldwide financial resources and to assess the adequacy of these resources, the PRA will consider the undertaking's compliance with the prudential regime under which it is supervised in its home country.

2.2 The PRA expects the third country branch undertaking to provide the PRA with sufficient information so that the PRA may form an opinion on the adequacy of the worldwide financial resources of the undertaking.

2.3 Where the PRA assesses that prudential regime to be broadly equivalent to the regime applied by the PRA to insurers (or reinsurers) whose head office is in the United Kingdom, then compliance with the financial resources requirements of that prudential regime may be relied on by the third country branch undertaking as tending to establish compliance with the PRA's worldwide financial resources rule. Contravention of financial resources requirements of that prudential regime may be relied on as tending to establish contravention of the PRA's worldwide financial resources rule.

2.4 Where that prudential regime is not broadly equivalent to the regime applied by the PRA to insurers or reinsurers whose head office is in the United Kingdom, then the PRA will assess the adequacy of financial resources using the methods and techniques applicable to insurers and reinsurers whose head office is in the United Kingdom.

3 Scheme of operations

3.3 The PRA will ask for a scheme of operations that sets out all the information required under Third Country Branches 5.1 as part of the application process for any third country branch undertaking applying for a grant or variation of permission (except a Swiss general insurance company to whom different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC)).

4 Third country branches as composites

4.1 The PRA will not grant or vary permission if that would allow a newly established third country insurance branch or an existing third country insurance branch engaging solely in general insurance business or solely in long term insurance business, to engage in both general insurance business or long-term insurance business. This does not apply to a third country pure reinsurance branch.

4.2 The PRA will not grant permission to allow a third country branch undertaking that pursues both general insurance business and long-term insurance business in its home jurisdiction to establish a branch in the United Kingdom if that branch will engage in long-term business.

5 Application of other draft supervisory statements to third country branches

5.1 The draft supervisory statements concerning instruments that are referred to in the Third Country Branches Part apply to third country branch undertakings with any necessary modifications and insofar as relevant to rules referred to in the Third Country Branches Part.

(1) www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

National Specific Templates and LOG Files

Number	Template name	Template and LOG file link
NS.01	With-profits value of bonus	With-profits Value of Bonus template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns01template.xlsx With-profits Value of Bonus log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns01log.pdf
NS.02	With-profits assets and liabilities	With-profits assets and liabilities template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns02template.xlsx With-profits assets and liabilities log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns02log.pdf
NS.03	Pools	Pools template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns03template.xlsx Pools log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns03log.pdf
NS.04	Assessable Mutuals	Assessable Mutuals template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns04template.xlsx Assessable Mutuals log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns04log.pdf
NS.05	Revenue account (Life)	Revenue Account (Life) template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns05template.xlsx Revenue Account (Life) log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns05log.pdf
NS.06	Business Model Analysis (Life)	Business Model Analysis (Life) template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns06template.xlsx Business Model Analysis (Life) log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns06log.pdf
NS.07	Business Model Analysis (non-life)	Business Model Analysis (Non-Life) template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns07template.xlsx Business Model Analysis (Non-Life) log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns07log.pdf
NS.08	Business Model Analysis — financial guarantee insurers	Business Model Analysis — Financial Guarantee Insurers template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns08template.xlsx Business Model Analysis — Financial Guarantee Insurers log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns08log.pdf
NS.09	Best-estimate assumptions for life insurance risks	Life Best Estimate Assumptions template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns09template.xlsx Life Best Estimate Assumptions log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns09log.pdf
NS.10	Projection of future cash flows (Best Estimate — Non Life: liability claim types)	Projection of future cash flows (Best Estimate - Non Life: liability sub-classes) template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns10template.xlsx Projection of future cash flows (Best Estimate - Non Life: liability sub-classes) log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns10log.pdf
NS.11	Non-life insurance claims information (general liability sub-classes)	Non-life Insurance Claims Information (General Liability sub-classes) template: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns11template.xlsx Non-life Insurance Claims Information (General Liability sub-classes) log file: www.bankofengland.co.uk/pra/Documents/publications/cp/2014/solvency2/ns11log.pdf