Bank of England PRA

CP12/23 – Review of Solvency II: Adapting to the UK insurance market

Contents

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Responses are requested by Friday 1 September 2023 for the proposals in Chapters 2 to 10, and by Monday 31 July 2023 for the proposals in Chapter 11. For further information, please see the 'Responses and next steps' section in Chapter 1 - Overview.

The PRA prefers all responses to be sent by email to: CP12_23@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

Insurance Policy Division
Prudential Policy Directorate
Prudential Regulation Authority

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London
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1. Overview

1.1 This consultation paper (CP) marks a significant milestone towards adapting the Solvency II framework to the UK insurance market. It sets out the Prudential Regulation Authority's (PRA) proposals to deliver significant reforms for Solvency II, which the PRA considers will lead to a more competitive and dynamic insurance sector in the UK, while maintaining high standards of policyholder protection.[1]

1.2 This consultation paper should be read in conjunction with the Government's **response** to its Solvency II review consultation. That response outlined the areas of the reform package that will be delivered through a combination of changes in PRA rules and legislation to achieve the objectives for the **Solvency II review**: a competitive insurance sector; investment to support growth; and policyholder protection. The PRA has worked closely with HM Treasury (HMT) on the review.

1.3 Using the new powers proposed in the Financial Services and Markets Bill 2022 (FSM Bill),[2][3] the Government has confirmed that it plans to legislate directly to implement certain parts of the Solvency II reform package. For all other reforms, it also intends to legislate to enable the PRA to make the necessary changes to rules and other policy material, including by repealing the relevant areas of retained EU law. This approach is set out in HMT's draft **Statutory Instruments** (SIs) on reforms to Solvency II. The material in this CP has been prepared on the assumption that the Government legislates in line with the approach that it has indicated, including by giving the PRA the necessary powers to implement these proposals.

1.4 This CP sets out the PRA's proposals to deliver reforms in all of the areas of the Solvency II review where the Government has not chosen to legislate directly, and which are therefore for the PRA to take forward. They focus on measures to simplify some Solvency II requirements, allow improved flexibility for others, and encourage entry into the UK insurance market. The PRA considers that the proposals will allow a meaningful reduction to the existing administrative and reporting requirements for the UK insurance sector to decrease

[1] Other proposals, including on the matching adjustment, will follow in later CPs – see 'The PRA's overall consultation plans for the Solvency II review' later in this chapter.

[2] Throughout this CP, the FSM legislation is referred to using the convention of 'FSM Bill'. At the time of finalising the CP, the Bill was nearing the end of its parliamentary process; around the time of publication of this CP it may have received Royal Assent and have become the Financial Services and Markets Act 2023.

[3] See the 'Structure of the reformed Solvency II regime' section later in this chapter for more information.

costs and complexity, while maintaining strong prudential standards. The PRA judges that the reforms in this CP will advance its primary objectives of safety and soundness and policyholder protection while also advancing its secondary competition objective and its new secondary competitiveness and growth objective arising out of the FSM Bill. The main areas of reform and the key benefits that the PRA considers would arise from them are set out below.

The PRA's proposals and the key benefits

1.5 The proposed reforms to Solvency II included in this CP consist of the following:

- **Simplifications and process improvements to the calculation of the transitional measure on technical provisions (TMTP)** to reduce costs and complexity for firms, including the costs involved in retaining legacy Solvency I models, while ensuring firms plan effectively for the end of these transitional measures in 2032. These proposals would benefit the 24 life insurance firms that currently have TMTP approval and any firm that is granted TMTP permission in the future after accepting business that already benefits from TMTP.

- **A new, streamlined set of rules for internal models (IM) where these are used by insurers to calculate their capital requirements**, designed to maintain robust standards while reducing the number of prescriptive requirements firms have to meet under the current framework. Instead, the focus will be on the application of supervisory judgement on a smaller number of more principles-based requirements. For example, the PRA proposes to move to a much more principles-based approach to assessing modelling standards, allowing it to remove the majority of the detailed requirements that firms have previously had to meet in order to get IM approval, leading to greater flexibility for firms and a more dynamic approach to model permission and approval for firms and the PRA. Rather than having to reject IMs that have residual limitations, the PRA proposes two new safeguards to support granting of model permissions, where required, in order to maintain an appropriate level of prudential soundness: a residual capital add-on tool, and model use requirements. These proposals would benefit all insurers that already have IM approval from the PRA,[4] and other insurers that may be considering applying for permission in future.

- **Greater flexibility for insurance groups in the calculation of group solvency requirements** to provide more flexibility in the development of group IMs and allow a

[4] As of June 2023, the PRA has approved 30 internal models. An internal model approval will often apply to multiple firms from the same group, so the number of firms that benefit is greater than this.

better reflection of groups' underlying risks. The PRA considers that these reforms will facilitate effective competition and increase the UK insurance sector's competitiveness while maintaining high standards of policyholder protection, including by removing an inefficient temporary increase in cost when acquiring a subsidiary. These proposals could benefit any UK insurer for which the PRA is group supervisor.

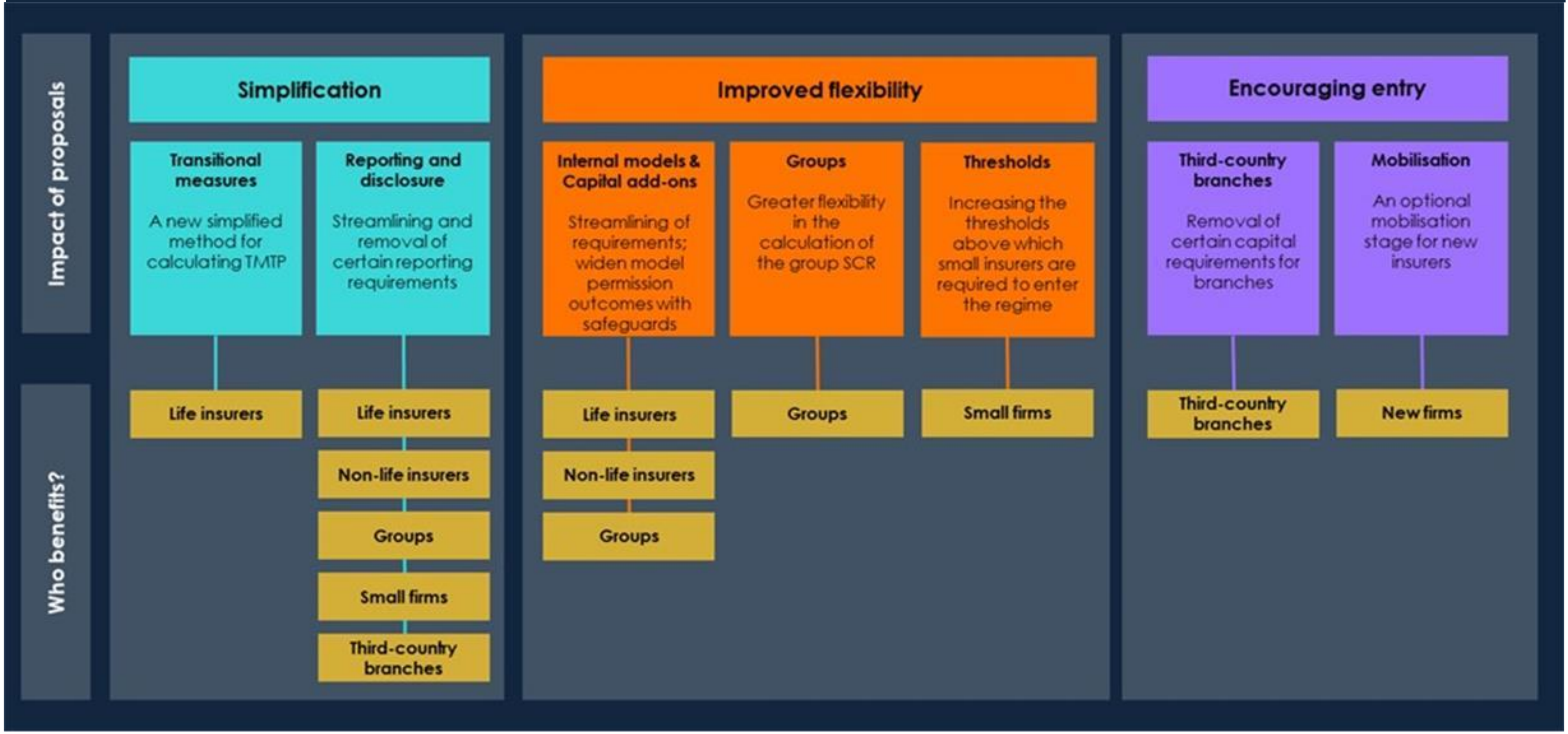
- **The removal of certain requirements for branches of international insurers operating in the UK**, to facilitate entry/expansion and competition and the international competitiveness of the UK insurance sector. Given a branch cannot fail independently of its legal entity as a whole, the PRA judges that branch capital requirements and the risk margin for branches are not effective tools to support the safety and soundness of branches operating in the UK. The proposals would benefit the 130+ branches of international insurers that currently operate in the UK across a range of business models, including general insurance firms that operate in the wholesale London insurance market and reinsurance firms.

- **The streamlining and removal of reporting requirements** that the PRA considers are not needed for the UK insurance sector, to increase proportionality and reduce complexity. The proposals lead to an overall reduction in reporting requirements and cost savings for firms in the medium term, having taken into account implementation costs and some limited proposed new reporting. This builds on previous steps the PRA has already taken under its existing powers to reduce reporting requirements and get to a reporting package that ensures the PRA has the information it needs to supervise insurers operating in the UK, while lowering overall costs and reporting burdens on firms. These proposals would benefit all insurers to a certain extent, in particular the proposed deletion of the Regular Supervisory Report (RSR), with more significant reductions likely for insurance groups and UK branches of international insurers.

- **A new 'mobilisation' regime** to facilitate entry and expansion for new insurers and to facilitate competition, and the international competitiveness and growth of the UK insurance sector. Under the proposals, the PRA would offer new insurers the option of using a set period of extra time to build up systems and resources while operating with business restrictions and proportionate regulatory requirements. The proposals would enable the PRA to lower minimum capital requirements during mobilisation. These proposals could benefit firms who are contemplating applying for authorisation as an insurer in the UK now or in the future.

- **An increase to the size thresholds** at which small insurers are required to enter the Solvency II regime, to increase proportionality for smaller or newer insurance firms. This proposal would benefit small insurers that may be close to the current thresholds, either now or in the future.

Chart 1: Impact of the proposals in this CP



1.6 The PRA's reforms set out in this CP are intended to maintain a high level of prudential standards for the insurance sector, while improving the proportionality of a number of aspects of the current regime. They are also intended to allow more scope for firms and the PRA to apply judgement to ensure appropriate prudential outcomes are achieved in a proportionate manner. The PRA remains committed to the principles underlying the existing Solvency II regime, which have underpinned and well served the UK's approach to insurance regulation since before that regime was developed within the EU. These principles are also consistent with the developing international capital standards for insurers: regulating firms as going concerns; the use of market-adjusted valuation for insurance liabilities; robust standards for capital resources; a '1-in-200' 1-year value at risk measure for capital requirements; and the application of judgement-based supervision. The reforms represent priority areas where the PRA can use its new powers to tailor aspects of the regime to reflect the circumstances of the UK market where these were previously fixed in retained EU law.

Scope

1.7 This CP is relevant to UK Solvency II firms, the Society of Lloyd's and its members and managing agents, insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings), firms within the PRA's Temporary Permissions Regime (TPR) for (re)insurers, and UK holding companies. This CP will refer to all of these collectively as 'insurers' or 'firms' unless otherwise specified.

1.8 The CP will also be of interest to non-Directive firms and anyone intending to provide insurance services operating in, or providing services into, the UK, in so far as the proposals relate to the thresholds for Solvency II to apply and a new mobilisation regime for prospective insurers intending to enter the UK insurance sector.

The PRA's overall consultation plans for the Solvency II review

1.9 The PRA intends to consult on its approach to adapting Solvency II for the UK market in two tranches:

- this first CP, which sets out the majority of the PRA's reform proposals, focuses on simplification, improving flexibility and encouraging entry – to achieve a meaningful reduction to the existing administrative and reporting requirements for UK insurance firms,[5] which will reduce costs for firms;

- a second CP planned for September 2023, which will cover reform proposals for life insurers relating to investment flexibility and the matching adjustment (MA), including to eligibility rules, new attestation requirements and certain changes to its calculation, and reporting.

1.10 The overall scope of reform areas covered by these two tranches is consistent with those areas originally covered by the **Solvency II review**, and outcomes as set out in the Government's **response** to its Solvency II review consultation.

1.11 Through these two consultations in 2023, and the PRA's intention (subject to feedback) to publish final policy following this CP around the end of this year, the PRA considers that firms will have a good sense of how the PRA expects the new regime to operate by that point, and so can begin to prepare for implementation and adapt their plans as they wish.

1.12 HMT published on Thursday 22 June 2023 **details of the draft SIs** needed to enable the Solvency II reforms to take effect, along with details of the expected timetable for bringing these into force. Consistent with HMT's statement, the PRA envisages that there will be a phased implementation of the reforms between the risk margin (RM), MA, and other areas. Regarding the RM, the PRA is taking the necessary steps to align the PRA Rulebook with the implementation of HMT's RM reforms by 31 December 2023. Subsequently, the PRA is planning to have final policy in place on the MA to enable implementation of HMT's MA provisions by the end of June 2024, with all other changes taking effect on 31 December 2024. Implementation of the MA provisions in June would mean that life insurance firms will be able to take advantage of these specific investment-related reforms in advance of 31 December 2024.

1.13 The PRA also intends to consult in early 2024 on transferring the remaining firm-facing Solvency II requirements from retained EU law into the PRA Rulebook and other policy materials. The PRA does not currently expect to make substantive changes to requirements that apply to firms as part of this later consultation.

[5] Some reporting changes focused on streamlining have already been made via policy statement (PS) **29/21**, and other proposed reporting improvements primarily focused on solo firms have been consulted on separately via **CP14/22**. The reporting proposals in this CP would build on those by removing some further requirements, and making updates to reflect other proposed policy changes in this CP, in particular for groups and third-country branches. The proposals in **CP14/22** and this CP are proposed to be implemented together at YE24.

1.14 The phasing of these three consultation papers has been designed to allow the PRA to publish material for consultation and give clarity for firms over final policy as soon as possible, while also giving adequate time to develop detailed proposals and seek input on implementation options for more complex areas of reform.[6]

1.15 The proposed implementation date for the majority of the reforms in this CP is 31 December 2024.[7] The PRA considers that this implementation date allows sufficient time for:

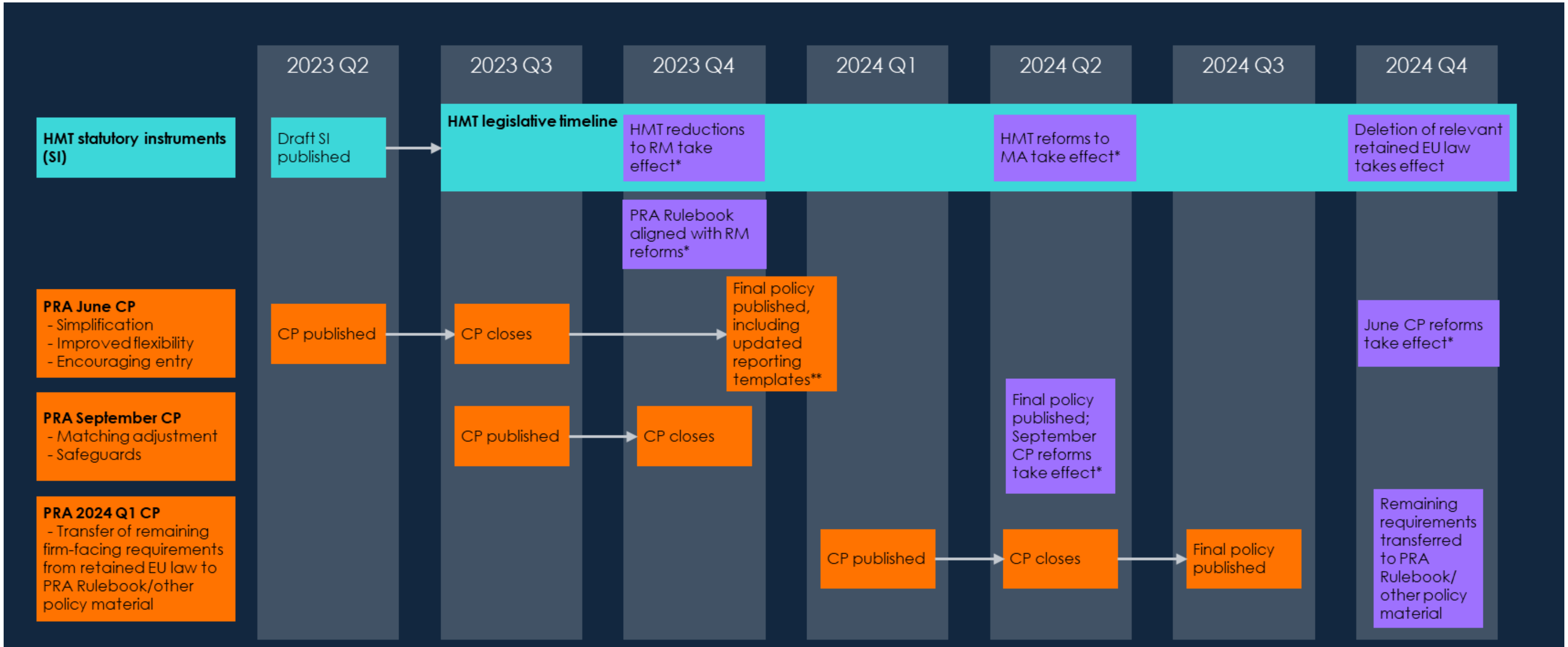
- Firms to modify their systems and reporting processes, where necessary;
- The transfer of remaining firm-facing requirements from retained EU law into the PRA Rulebook and other policy materials, as per the additional CP in early 2024. This will ensure the reforms take effect within a coherent and complete Solvency UK regime in the PRA's Rulebook. It will also avoid the complications of moving and amending firm-facing requirements from retained EU law in separate tranches, resulting in less clarity around the extent to which different Rulebook and legislative provisions are applicable at different points in time.

1.16 For this CP, the PRA is setting a two-month consultation period for the proposals in Chapters 2 to 10, and a one-month consultation period for the proposals in Chapter 11. This approach is designed to support the implementation plans outlined above. Further details are set out below in the 'Responses and next steps' section of this chapter.

[6] A series of **subject expert groups (SEGs)** have been convened jointly by the PRA and the Association of British Insurers to allow the PRA to gather information on and options for the development of the new supervisory measures announced in the Government's November 2022 consultation response. To date, the SEGs have covered topics specific to the matching adjustment (notching, attestations, and investment flexibility) and stress testing.

[7] With the exception of the proposals outlined in Chapter 11, where the PRA expects to issue final policy in advance of HMT's reforms to the risk margin taking effect.

Chart 2: Timeline of the reforms



The finalisation of HMT's legislation is a necessary pre-requisite for the PRA's proposed reforms. However, at the date of this publication, the legislative timetable is not confirmed. The timescales in this chart are based on current expectations that the relevant legislation is laid and made from Q3 2023. In addition, the timescales may also depend on other factors, such as the number and substance of consultation responses received.

*This indicates the earliest date reforms could be implemented by firms, subject to legislation.

**Firms can begin to make and test changes to reporting systems from Q1 2024, ahead of YE24 reporting.

Background to the Solvency II review

1.17 The Solvency II regime, which governs the prudential regulation of insurance firms in the UK, came into force in the UK on Friday 1 January 2016. In June 2020, the Government announced a **review of Solvency II** to ensure the prudential regime properly reflects the unique structural features of the UK insurance sector.[8] The PRA worked closely with HMT on the potential reform options. The Government set three objectives to underpin the review:

- to spur a vibrant, innovative, and internationally competitive insurance sector
- to protect policyholders and ensure the safety and soundness of firms
- to support insurance firms to provide long-term capital to support growth

1.18 In October 2020, HMT launched a **Call for Evidence** that set out the areas in scope for the review. HMT published its **response to the Call for Evidence** in 2021, which summarised the responses as being generally supportive of reforms to the areas covered in this CP. The information provided by respondents was subsequently shared with the PRA and fed into the development of its proposed reforms. Following several HMT and PRA requests for input and feedback, significant stakeholder discussions, and HMT's **consultation on the Solvency II review**, HMT published its **response** on the Solvency II review consultation in November 2022. In that document, HMT confirmed that the PRA would take forward a number of reforms, including those covered in this CP.

Structure of the reformed Solvency II regime

1.19 In December 2022, HMT published a **policy statement** (PS) on its implementation plan to deliver a new regulatory framework for financial services regulation in the UK. The legislative changes needed to enable the new regulatory framework are being brought in by the FSM Bill.

1.20 Under the FSM Bill, HMT will have the power to revoke retained EU law relating to financial services. Financial services regulators will generally take responsibility for setting the direct regulatory requirements that were previously contained within that retained EU law, acting within a framework set by government and Parliament. This means that detailed regulatory requirements that currently sit within EU law, and can currently only be amended by primary or secondary legislation, can move into the regulators' rules, in line with the UK's

[8] A more detailed **list of updates on the PRA's work on Solvency II** can be found on the Bank of England website.

model of operationally independent regulators and where they will be easier and less time-consuming to update.

1.21 In line with this new framework, the reforms under the Solvency II review will be delivered through a combination of the FSM Bill (including the deletion of retained EU law), HMT's SIs, and changes to the PRA's rules and policy. The material in this CP has been prepared on the assumption that the Government legislates in line with the approach that it has indicated via HMT's draft SIs, and amendments to the materials consulted on may be required to reflect the final version of HMT's SIs.

1.22 This CP sets out the PRA's proposed changes to the PRA's rules and policy to deliver a large part of the reforms. This generally involves starting with retained EU law that HMT plans to revoke using its powers under the FSM Bill and:

- not transferring requirements into PRA policy where the PRA considers they are no longer required; or
- amending requirements at the point of transfer to reflect proposed policy changes; or
- reproducing requirements in PRA policy without change, but signalling in the PRA's policy that relevant rules can be waived or modified in individual cases where appropriate.

1.23 This CP does not address the entirety of the Solvency II retained EU law; the remainder will be covered by future CPs, as outlined above, or (for example in the case of the RM and some elements of the MA) by provisions in HMT's SIs.

1.24 The new UK prudential regime for insurers will eventually be known as 'Solvency UK'. However, since the reforms are being consulted on and implemented in stages, for clarity and internal consistency of the PRA's policy materials, the PRA will continue to refer to the regime as Solvency II until such time as all references to Solvency II can be changed across all relevant materials.

Reforms to the risk margin

1.25 The Government's November 2022 reform package for Solvency II announced that it will legislate to reduce the risk margin, an important component of firms' insurance liabilities, by around 65% for long-term life insurance business and 30% for non-life business, and to enable a modified cost of capital approach to its calculation.[9] To enable timely

[9] The reduction of around 65% will also apply to Periodic Payment Orders.

implementation of these changes, HMT has since confirmed its intention to effect them initially through transitional amendments to the existing **onshored Commission Delegated Regulation (EU) 2015/35 (SII CDR).**

1.26 To understand and prepare for these changes, firms should look to the provisions in HMT's SIs for details of the revised formula and parameters, as well as the implementation timeline. The PRA considers that implementation of the changes to the RM as set out by the Government is likely to be a material change to a firm's risk profile such that firms should apply to recalculate TMTP, as per the expectations of the PRA's **Supervisory Statement 6/16.**

1.27 In view of HMT bringing forward these reforms in advance of YE24, the PRA considers that some minor consequential amendments to the PRA Rulebook are necessary in order to maintain its clarity and coherence. The proposed amendments would also provide firms with legal certainty as to the interaction between HMT's SIs and PRA rules. These proposed amendments are set out in Chapter 11 – Administrative amendments.

1.28 Alongside its proposed changes to the RM calculation, the Government will legislate to amend **Article 54 of the Solvency 2 Regulations 2015** such that firms' TMTP approvals will be unaffected by the reduction in Solvency II financial resource requirements (FRR) arising from the RM reforms.

1.29 HMT's SIs specify that the amended RM provisions within the SII CDR will later be revoked, with certain parts including the formula and parameters being restated within secondary legislation. Those parts not restated in legislation are intended ultimately to be transferred into PRA rules and other policy material.

Accountability framework

1.30 The PRA has a statutory duty to consult when introducing new rules and changing existing rules (s138J of the Financial Services and Markets Act (FSMA) 2000), or new standards instruments (FSMA s138S). When not making rules, the PRA has a public law duty to consult widely where it would be fair to do so.

1.31 In carrying out its policymaking functions, the PRA is required to comply with several legal obligations. Appendix 1 lists the statutory obligations applicable to the PRA's policy development process. Further, the FSM Bill, when enacted, will add specific obligations for the PRA to engage with Parliament via the relevant parliamentary committees. The PRA will comply with these obligations for this consultation and future policymaking activity.

1.32 The PRA considers that the proposals in this CP would continue to advance its primary objectives to promote the safety and soundness of the firms that it regulates and secure an appropriate degree of policyholder protection. The proposals focus on areas where the PRA considers that existing requirements can be simplified and streamlined without compromising safety and soundness and policyholder protection. Where necessary, the proposals include some new requirements which the PRA considers will be sufficient to address any additional risks to safety and soundness and policyholder protection which might otherwise occur. At the same time, the PRA considers that the proposals would also advance its secondary competition objective and forthcoming secondary competitiveness and growth objective by tailoring rules to UK circumstances. This is because the proposals would result in a less burdensome regime and streamline existing processes thus facilitating entry and expansion of new firms and branches. They would also provide firms with greater flexibility when applying for IMs and calculating the group solvency capital requirement (SCR). The proposed changes to regulatory reporting requirements would also reduce the burden for firms and branches while enhancing the relevance of information collected where an exposure is considered material. More detailed analysis of the proposals against the PRA's objectives is set out in the individual chapters that follow.

Cost benefit analysis

1.33 In developing the proposals set out in this CP, the PRA has had regard to its objectives and a range of factors that contribute to the cost benefit analysis (CBA). The baseline for the CBA is the current Solvency II rules and legislation (unless stated otherwise). Each individual policy chapter contains analysis of the expected costs and benefits of the specific proposals. A summary of key benefits and costs is outlined below.

Benefits

1.34 The proposals set out in this CP would lead to a reduction in both compliance costs to firms and supervision costs to the PRA, which is a benefit, through:

- offering firms greater flexibility to meet regulatory requirements (eg IM, groups);
- making regulatory requirements more appropriate for the risks posed to the PRA's objectives (eg thresholds, mobilisation, branches);
- simplifying compliance with certain regulatory requirements (eg TMTP, reporting and disclosure, currency redenomination, IM).

1.35 In addition, the proposals could give rise to capital compliance benefits through:

- proposed removal of the FRR test for the TMTP calculation;
- allowing the group SCR calculation to recognise some of the diversification benefits between Method 2 entities.

1.36 As a result, the proposals could facilitate effective competition, international competitiveness, and growth through:

- reduced costs for insurers, together with increased flexibility, making it more attractive to locate or expand in the UK (IM, reporting, TMTP, groups);
- facilitating entry/expansion of new firms and branches (mobilisation, thresholds).

Costs

1.37 The proposals could give rise to some implementation compliance costs; however, the PRA expects that there would be an ongoing saving in costs in the longer term. In addition, in many cases (eg TMTP, thresholds, mobilisation), firms have the option to continue existing practices.

1.38 The PRA has also considered whether the use of residual model limitation capital add-ons (RML CAOs) would result in materially higher levels of capital requirements. This is not expected because the proposed reforms would not change the '1-in-200' calibration standard for IM firms, but rather introduce flexibility for an IM firm to meet its requirement either directly with its model calibration, or to allow residual limitations to be addressed through the combination of model and RML CAO.

1.39 In summary, the proposals in this CP would continue to advance an appropriate level of protection for policyholders, and the safety and soundness of insurers, while facilitating effective competition, international competitiveness, and growth.

'Have regards' analysis

1.40 In developing the proposals in this CP, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter.

1.41 The FSMA regulatory principles that are considered most significant to the proposals in this CP are those relating to proportionality, efficient use of the PRA's resources, and transparency. The PRA considers that the proposals would increase the proportionality of the regime, and would streamline regulatory requirements. In particular, they would result in a simpler IM application process, a reduction in reporting costs for firms, and a more proportionate regime for smaller insurers via increased thresholds. The PRA would also expect to see an overall increase in its efficiency as a result of the proposed changes to reduce the existing set of IM tests and standards, introduce a more consistent approach to the TMTP calculation, and remove branch capital and branch risk margin requirements on an ongoing basis for third-country branches.

1.42 The PRA considers that the proposals are in line with the principle of transparency since the policy materials the PRA proposes to amend or introduce are intended to give increased clarity to firms over the PRA's intended approach and its expectations of firms.

1.43 The HMT recommendation letter (December 2022) focuses on competitiveness and growth in the interests of consumers and businesses. The PRA considers that its proposals would support both the competitiveness of the UK and (particularly by increasing competition and reducing costs) would also support growth and benefit consumers. By revoking EU law and replacing it with rules designed for the UK, and streamlining requirements on firms, the proposals in this CP are aligned with the Government's desire to swiftly implement the outcomes of its Future Regulatory Framework review (FRF) (supporting competitiveness), and its aim to deliver smart regulatory reform (supporting growth).

1.44 The 'have regards' that gave rise to particularly significant issues for consideration in relation to the proposals in this CP are set out in the individual chapters. Where analysis has not been provided against a 'have regard' for a proposal, it is because the PRA considers that 'have regard' to not be a significant factor for that proposal.

Impact on mutuals

1.45 The PRA has a statutory obligation to consider the impact of its proposals on mutual societies (s138K FSMA), referred to as 'mutuals'. The PRA considers that the impact of the proposals in this CP on mutuals is expected to be no different from the impact on other firms, with the exception of the proposal to increase the threshold at which firms are required to enter the Solvency II regime, which is aimed at simplifying regulatory requirements for small firms. Given more than half of small firms operating near the thresholds are mutuals, the PRA considers they are more likely to benefit from the proposed changes, as explained in Chapter 9 – Thresholds.

Equality and diversity

1.46 In making its rules and carrying out its policies, services, and functions, the PRA is required by the Equality Act 2010 to have due regard to the need to eliminate discrimination, to promote equality of opportunity, and to foster good relations between persons who share a protected characteristic and those who do not. In line with its responsibility under the Equality Act, the PRA has performed an assessment and considered the equality implications in formulating its proposals. The PRA considers that the proposals in this CP do not give rise to equality and diversity implications. The PRA will continue to consider the equality and diversity implications of the proposals during the consultation period, and in relation to further consultation concerning future operative proposals.

Structure of the CP

1.47 The proposals in this CP are structured into the following chapters. The draft rules and related policy materials are included in the relevant appendices.

- **Chapter 2 – Transitional measures on technical provisions and the risk-free interest rate** – sets out the PRA's proposals to introduce a new simplified method for calculating TMTP.
- **Chapter 3 – Internal models** – sets out the PRA's proposals on changes to the IM framework, including streamlining the requirements that firms (and groups) must meet for permission to use an IM, and the PRA's use of safeguards to support model permissions.
- **Chapter 4 – Capital add-ons** – sets out the PRA's proposed approach to the use of capital add-ons, which complements and supports the proposals set out in Chapter 3 – Internal models.
- **Chapter 5 – Flexibility in calculating the Group SCR** – sets out the PRA's proposals to provide greater flexibility in the calculation of the group solvency capital requirement.
- **Chapter 6 – Third-country branches** – sets out the PRA's proposals to remove the rules that require third-country branch undertakings to calculate branch capital requirements and a branch risk margin.
- **Chapter 7 – Reporting and disclosure** – sets out the PRA's proposals to streamline and update reporting requirements.
- **Chapter 8 – Mobilisation** – sets out the PRA's proposals to introduce an optional mobilisation stage for new insurers.
- **Chapter 9 – Thresholds** – sets out the PRA's proposals to increase the thresholds that determine whether a firm is regulated under Solvency II.
- **Chapter 10 – Currency redenomination** – sets out the PRA's proposals to redenominate monetary values within the Solvency II Firms Sector of the PRA Rulebook from euros (EUR) to pounds sterling (GBP).

- **Chapter 11 – Administrative amendments** – sets out the PRA's proposals to make minor amendments to PRA rules as a consequence of HMT's proposed reforms to the Solvency II risk margin.

1.48 Within this CP, to increase the readability of each chapter, a number of abbreviations have been defined in full upon first usage in each chapter.

Changes to PRA rules and policy materials

1.49 The proposals set out in this CP would result in changes to the following parts of the PRA Rulebook and existing policy materials:

Table 1: Changes to PRA rules and policy materials

Policy material	Proposals
PRA Rulebook:	**The instruments would introduce new parts of the PRA Rulebook, as follows:** Transitional Measure on Technical Provisions
PRA Rulebook:	**The instruments would amend the following Parts of the PRA Rulebook:** Insurance General Application Minimum Capital Requirement Composites Solvency Capital Requirement – Internal Models Solvency Capital Requirement – General Provisions Conditions Governing Business Third Country Branches Insurance – Supervised Run Off Run Off Operations

Policy material	**Proposals**
	Group Supervision Reporting External Audit Financial Conglomerates Own funds Glossary
Supervisory statements (SS)	**This CP would amend:** Solvency II: calculation of technical provisions and the use of internal models for general insurers (SS5/14) Solvency II: approvals (SS15/15) Solvency II: internal models - assessment, model change and the role of non-executive directors (SS17/16) Solvency II: the solvency and minimum capital requirements (SS4/15) Solvency II: Lloyd's (SS12/15) Solvency II: group supervision (SS9/15) Solvency II: transitional measures on risk-free interest rates and technical provisions (SS17/15) Solvency II: third-country insurance and pure reinsurance branches (SS44/15) Solvency II: External audit of, and responsibilities of the governing body in relation to, the public disclosure requirement (SS11/16)

Policy material	Proposals
	Solvency II: reporting and public disclosure options provided to supervisory authorities (SS40/15) Solvency II: Data collection of market risk sensitivities (SS7/17) **This CP would delete:** Solvency II: Changes to internal models used by UK insurance firms (SS12/16) Maintenance of the 'transitional measure on technical provisions' under Solvency II' (SS6/16) Solvency II: Regulatory Reporting and exemptions (SS11/15) Solvency II: National Specific Template LOG files (SS6/18) **This CP would introduce:** Draft SS Expectations for complying with the Solvency II internal model requirements
Statements of policy (SoP)	**This CP would introduce:** Draft SoP Solvency II internal models: permissions and ongoing monitoring Draft SoP Solvency II: capital add-ons Draft SoP Permissions for transitional measures on technical provisions and risk-free interest rates Draft SoP The PRA's approach to insurance group supervision Draft SoP Solvency II regulatory reporting waivers

1.50 Appendix 2 of this CP sets out the proposed draft rules in full for the proposals being consulted on in Chapters 2 to 10. Appendix 30 includes draft rules for the proposals in Chapter 11.

1.51 HMT has announced that it intends to use the power in the new section 138BA of FSMA (which will be inserted by Clause 32 of the FSM Bill) to grant the PRA flexibility to disapply or modify the application of any of its rules, by giving firms permissions where appropriate.[10] The PRA intends to use these permissions to replace the approvals currently in Part 4 of the Solvency 2 Regulations 2015. This CP therefore uses the language of 'permissions' rather than 'approvals' when discussing proposed new policy in these areas.

1.52 HMT has also set out its intention to ensure that any existing approvals that firms have to use measures covered by Part 4 of the Solvency 2 Regulations 2015 will continue to be valid. The PRA does not therefore expect that firms will need to reapply for permissions that have been granted under that legislation.

1.53 This CP includes proposals to use s138BA FSMA to give permissions to:

- apply the TMTP (Chapter 2);
- calculate the SCR and group SCR using an IM (Chapter 3);
- calculate the group SCR using the output of multiple IMs (Chapter 5); and
- use an IM to calculate a single sub-group SCR, where a group contains a sub-group located in a country that applies a solvency regime to insurers that is equivalent to the UK regime, and Method 2 is used to calculate the group SCR in respect of that sub-group (Chapter 5).

1.54 The PRA may also consider further aspects relating to the use of s138BA of FSMA in future. This may affect some of the operational aspects outlined in the draft SoP for granting IM permissions.

1.55 References related to the UK's membership of the EU in the policy materials covered by this CP have been updated as part of these proposals to reflect the UK's withdrawal from the

[10] See **Draft Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations**.

EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.[11]

1.56 Where the draft rules and policy material included in this CP include references to retained EU law that is not addressed in this CP, the drafts cross refer to the retained EU law as it currently stands. When making any rules and issuing final policy material in relation to drafts included in this CP, those cross references will be updated to refer to those requirements as they have been absorbed into the PRA's rules or other parts of the overall framework. In the draft rules included in this CP, such references have been highlighted in square brackets.

Implementation

1.57 The PRA proposes that the implementation date for the changes resulting from proposals in Chapters 2 to 10 of this CP would be 31 December 2024. Assuming that final policy in relation to this CP is able to be published around the end of this year, this implementation date is intended to give firms notice to prepare for the changes. This reflects the PRA's understanding of the time firms have indicated they would need to update their systems and processes. Further, this approach allows sufficient time for the PRA to implement its final policy, taking into account the steps needed to transfer the remaining firm-facing requirements into the PRA Rulebook and other policy material, as outlined above in the section, 'The PRA's overall consultation plans for the Solvency II review'. The PRA understands that this approach is in line with HMT's current expectation on the timetable for bringing the necessary regulations into force.

1.58 The PRA proposes that the implementation date for the changes resulting from the proposals in Chapter 11 of this CP be aligned to HMT's timeline for implementation of its RM reforms. This will deliver consistency between the on-shored SII CDR and PRA rules at the point at which HMT's RM reforms take effect.

Responses and next steps

1.59 This consultation closes on Friday 1 September 2023 for the proposals in Chapters 2 to 10, and closes on Monday 31 July 2023 for the proposals in Chapter 11. The PRA invites feedback on the proposals set out in this consultation, including:

- The specific reform proposals per chapter;

[11] For further information please see **Transitioning to post-exit rules and standards**.

- The cost benefit analysis set out above and within each chapter;
- The implementation timeline set out above.

1.60 Please address any comments or enquiries to **CP12_23@bankofengland.co.uk**. Please indicate in your response if you believe any of the proposals in this CP are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be. Your responses may be shared with HMT and/or the FCA. This means HMT and/or the FCA may review the responses and may also contact you to clarify aspects of your response.

1.61 For Chapters 2 to 10 of this CP, the PRA is setting a two-month consultation period. This reflects the PRA's desire to give firms certainty as soon as possible about the final reforms resulting from the Solvency II review, and also recognises that many of the reform areas in this CP have already been subject to significant stakeholder discussions, including through HMT's Call for Evidence and earlier consultations on which firms have already provided feedback, which the PRA has been able to take into account in developing these proposals. The PRA has also highlighted clearly, in previous communications, the high-level areas of reform it intends to take forward. With a shortened consultation period, and subject to responses received, the PRA would expect to be able to issue final policy in relation to the proposals in Chapters 2 to 10 of this CP at around the end of the year.

1.62 For Chapter 11 of this CP, the PRA is setting a one-month consultation period. This reflects the nature of the proposals in Chapter 11 as minor amendments that arise as a consequence of HMT's amendments to the SII CDR to reform the Solvency II RM. Subject to responses received, the PRA would expect to be able to issue final policy in advance of HMT's reforms to the RM taking effect.

1.63 The PRA appreciates that this is an acceleration of its usual consultation timetable, particularly given it would normally allow extra time for responses when consulting over the summer. The PRA would consider any representations from stakeholders saying that they need longer to assess any of the CP proposals.

2. Transitional measures on technical provisions and the risk-free interest rate

2.1 This chapter sets out the PRA's proposed changes to the transitional measure on technical provisions (TMTP), designed primarily to simplify a number of aspects of its calculation and reduce costs to firms. It also contains a proposal to remove third-country branch eligibility to use the TMTP or the transitional measure on the risk-free interest rate (TMIR), as a consequence of the proposals in Chapter 6 – Third-country branches.

2.2 The PRA proposes to:

- introduce a simplified new default method for calculating TMTP (the 'new TMTP method');[12]
- permit firms for which the new TMTP method would be inappropriate to continue to use the existing calculation approach, with some modifications (the 'legacy approach');
- remove the financial resource requirement (FRR) test;
- require all firms to amortise TMTP so that it is expected to decrease in a consistent manner to zero by the end of the transitional period;
- introduce an expectation that firms consider risks to meeting their solvency risk appetite in the medium term due to TMTP run-off;
- allow firms to calculate TMTP at the final day of each reporting period, and remove the requirement for firms to seek the PRA's permission for a recalculation;
- remove the expectation for TMTP calculations to have audit committee sign-off;
- introduce a more consistent approach to TMTP methodology changes where business is transferred or 100% reinsured;

[12] In the proposed rules and policy materials, this will be referred to as the 'TMTP method'.

- only grant any new permissions to apply TMTP in circumstances where a firm without an existing TMTP permission acquires or accepts business that already benefits from TMTP; and
- as a consequence of the policy proposals set out in Chapter 6 – Third-country branches, to remove the ability for third-country branches to use TMTP or TMIR.

2.3 The proposals in this chapter would:

- introduce a new Transitional Measure on Technical Provisions Part of the PRA Rulebook (Annex H of Appendix 2);
- amend the Glossary Part of the PRA Rulebook, the Conditions Governing Business Part of the PRA Rulebook, the Transitional Measures Part of the PRA Rulebook, and the Third Country Branches Part of the PRA Rulebook (Annexes A, J, I, and K of Appendix 2);
- amend supervisory statement (SS) 17/15 – Solvency II: transitional measures on risk-free interest rates and technical provisions (Appendix 3);
- delete SS6/16 – Maintenance of the 'transitional measure on technical provisions' under Solvency II; and
- introduce a new statement of policy (SoP) – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 4).

2.4 TMTP and TMIR are intended to smooth the financial impact for firms of the transition from the previous Solvency I regime to Solvency II. They allow firms to apply temporary reductions to the amount of technical provisions for business written before 2016, and increase available capital. Their use is subject to PRA approval.

2.5 The existing TMTP requirements can result in significant resource overheads for firms and the PRA. They have also led to firms using a wide range of different calculation approaches. Further, as TMTP relief must amortise to zero by 2032, firms will need to ensure they are prepared for the end of the transitional period.

2.6 The proposals in this chapter aim to:

- reduce the resourcing overheads, for firms and the PRA, associated with calculating TMTP;
- simplify and increase consistency in how TMTP is calculated; and

- place greater focus on firms' management of the run-off of TMTP for the remainder of the transitional period.

The charts below show how the proposals would simplify the TMTP calculation:

Chart 3: The current TMTP framework

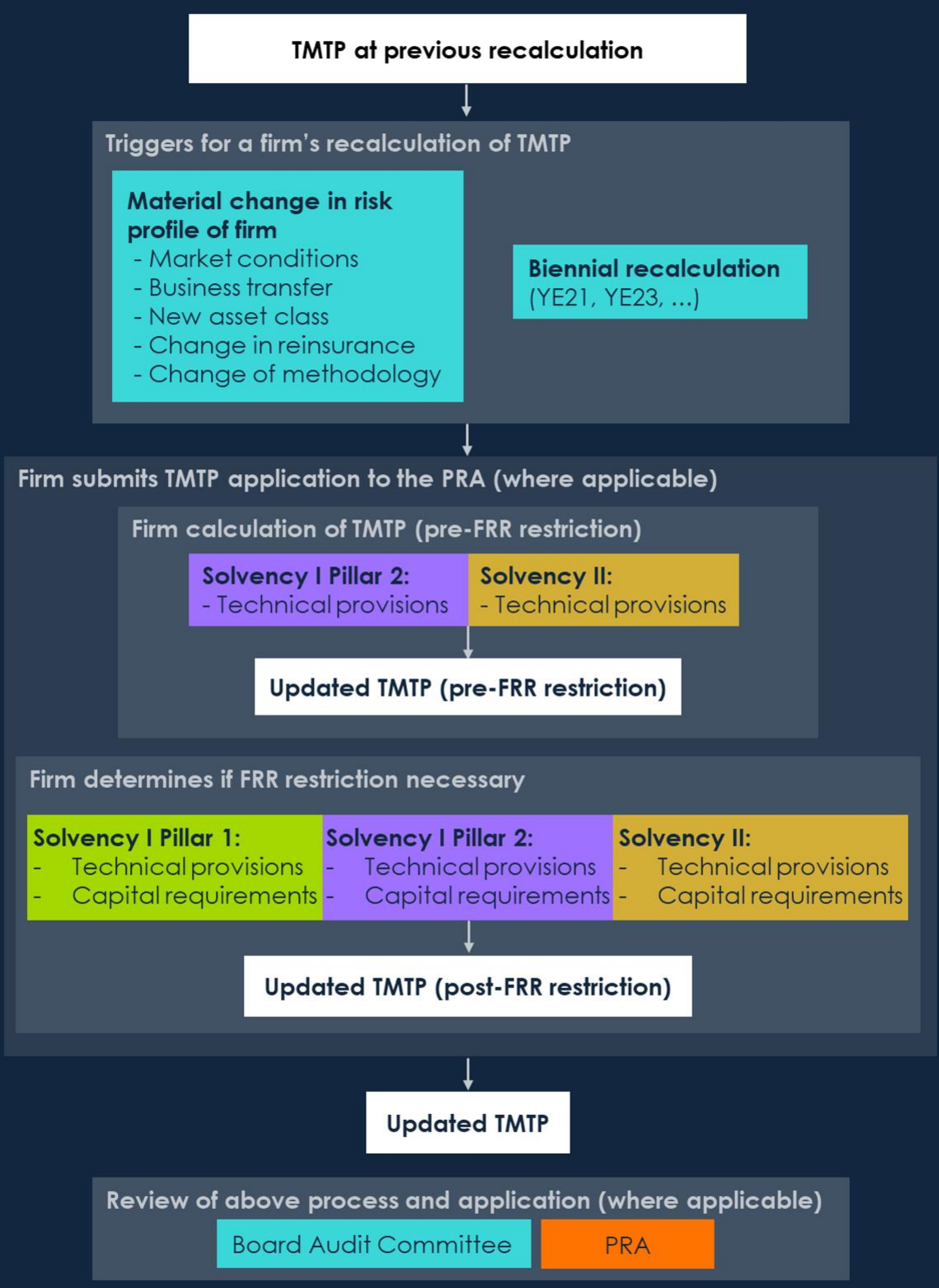
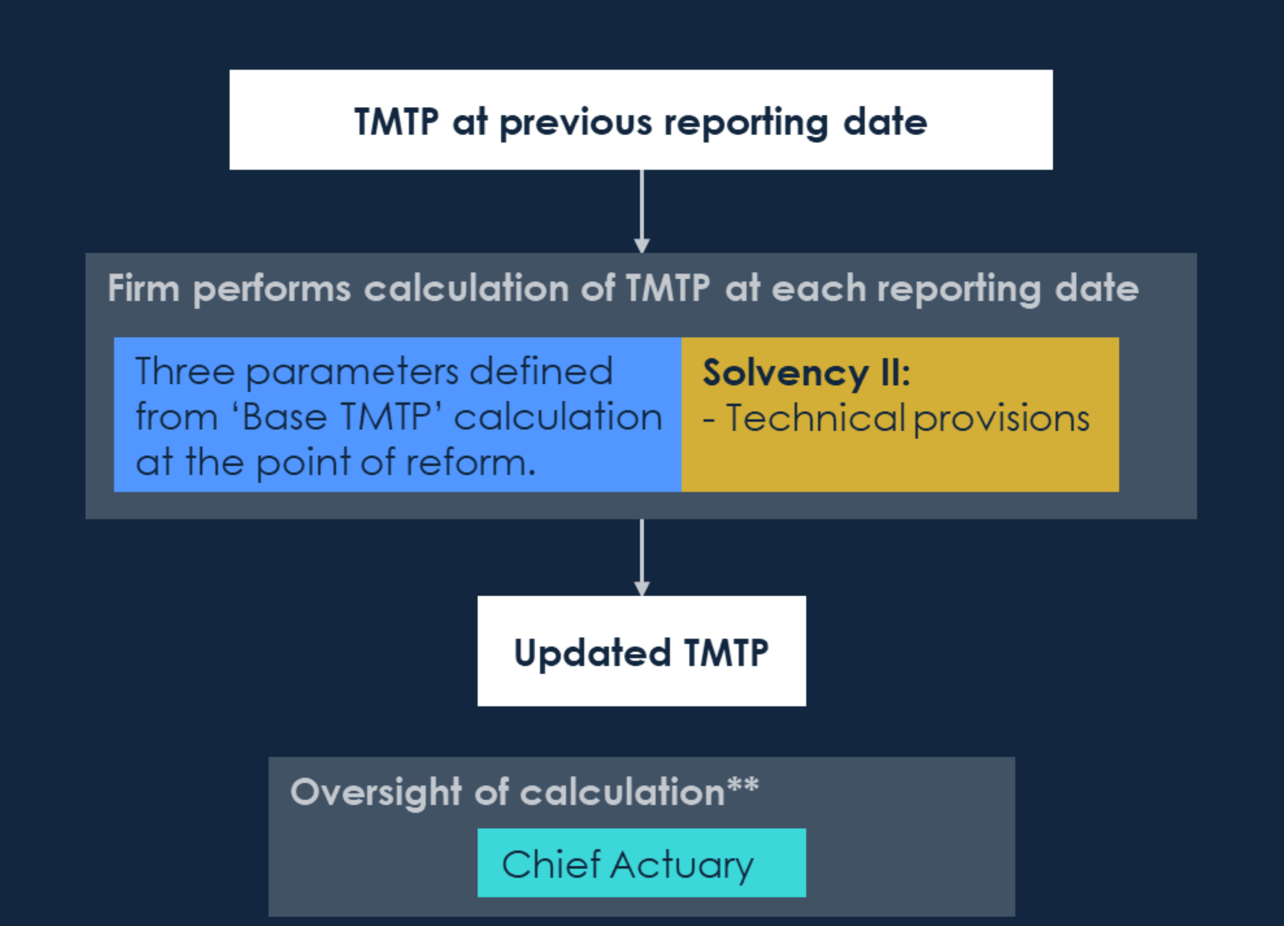


Chart 4: The proposed TMTP framework* (new TMTP method firms)



*The framework would be different for Legacy Approach firms.
**Overseen as part of the Chief Actuary's responsibility for the calculation of technical provisions

2.7 The PRA considers that its primary objectives of safety and soundness and policyholder protection would continue to be advanced by the proposals in this chapter. Under the proposed new calculation approaches, TMTP would remain linked to firms' risk profiles. This is important given that for some firms, TMTP continues to have a significant influence on the overall solvency position. The proposal to remove the FRR test would potentially lead to a one-off increase in own funds for a small number of firms, but the effect is not expected to be material. The proposals relating to amortisation and firms' management of the remaining TMTP run-off are intended to mitigate any prudential risks around the end of the transitional period.

2.8 The chapter is relevant to UK Solvency II firms, particularly those that use TMTP and also to the Society of Lloyd's, its members, and managing agents. The proposal to no longer permit third-country branches to use either TMIR or TMTP is of particular relevance for third-country branches and third-country insurance undertakings that may seek authorisation to operate as a branch in the UK in the future.

The new TMTP method

2.9 The existing method for calculating TMTP requires firms to calculate regulatory figures on both a Solvency I and II basis, creating significant resource costs for firms. As each firm has different Solvency I methodologies, there are a wide range of approaches to calculating TMTP. This increases the resource cost for the PRA when considering TMTP queries and applications. TMTP is amortising over time and will also become materially smaller following the Government's planned reduction to the risk margin (RM).[13] The PRA therefore proposes to simplify the TMTP calculation and make it more consistent, which would reduce resource costs for firms and the PRA.

2.10 The PRA proposes a new TMTP method that would become the default calculation approach for firms. Under the new TMTP method, the TMTP would be derived in each reporting period exclusively from figures produced under Solvency II. Specifically, firms would derive the TMTP based on the Solvency II RM and the best estimate liabilities (BEL) relating to business written prior to 2016. This would remove any reliance on Solvency I models. Reducing the burden of applying Solvency I models was a reform suggested by respondents to HMT's Call for Evidence.

2.11 The PRA proposes that at the point of implementation of the new TMTP method, firms would perform the following initial steps once only:

- Carry out a final TMTP calculation based on the existing calculation method, but without the application of the FRR test.[14] This 'base TMTP' amount would be calculated as at the final day of the reporting period that immediately precedes the firm starting to use the new TMTP method.
- Segment the base TMTP into three components: a component relating to the RM of the pre-2016 business that is subject to TMTP ('the RM component'); a component relating to the BEL on pre-2016 annuity business that is subject to TMTP ('the annuity BEL component');[15] and a component relating to the BEL on pre-2016 non-annuity

[13] See Chapter 1 – Overview for further background on reforms to the RM.

[14] See also the later section of this chapter – Removal of the FRR test.

[15] At an aggregate industry level, the PRA estimates that annuity business generates the largest proportion of TMTP relief based on current data; therefore, the PRA considers that it would be appropriate to allow this

business that is subject to TMTP ('the non-annuity BEL component'). The non-annuity BEL component would also include any 'base TMTP' generated from technical provisions that are calculated in line with Technical Provisions 2.5(2).

- Determine a factor Z_A representing the relationship between the 'base TMTP' RM component, and the RM applicable to the relevant business at the point of implementation, such that:
  - the RM component is equal to the RM on the firm's pre-2016 business that is subject to TMTP multiplied by Z_A.
- Determine a factor Z_B representing the relationship between the 'base TMTP' annuity BEL component and the annuity BEL portion applicable to the relevant business at the point of implementation, such that:
  - the annuity BEL component is equal to the Solvency II BEL on the firm's pre-2016 annuity business that is subject to TMTP multiplied by Z_B.
- The PRA would expect firms to share these initial calculations with their supervisors.

2.12 After performing the initial steps to determine Z_A and Z_B, these factors would then be used on an ongoing basis as part of the new TMTP method, as explained in the next paragraph. The purpose of these factors would be to allow TMTP to be derived only from Solvency II figures on an ongoing basis, while also avoiding a discontinuity in the amount of TMTP at the point of implementation. For the avoidance of doubt, no TMTP would be lost at the point of implementation of the new TMTP method.

2.13 The PRA proposes that from the point of implementation and over the remaining transitional period up to 2032:

- The new TMTP method would require firms to calculate TMTP as the sum of an RM component, an annuity BEL component and a non-annuity BEL component, minus an amortisation adjustment.
- The RM and annuity BEL components would be determined as the RM and the Solvency II annuity BEL on the pre-2016 business that is subject to TMTP (as at the final day of the most recent reporting period) multiplied by Z_A and Z_B respectively. This

business to have a specific 'dynamic' component. The PRA does not consider it necessary to have a dynamic component for non-annuity business as, at an aggregate industry level, this is a far less material proportion of TMTP relief. In addition, the PRA considers that linking TMTP to the behaviour of BEL would not be appropriate for other non-annuity lines that behave differently.

means the RM and annuity BEL components would change in line with changes to the underlying pre-2016 liabilities, so would reflect changes in market conditions, risk profile, and company experience.

- The non-annuity BEL component would not change to reflect changes in the underlying pre-2016 liabilities after its initial calculation, and its initial amount (determined when the base TMTP was segmented) would amortise linearly to zero over the remaining transitional period.

- If the firm projects that TMTP will be greater than zero at the end of the transitional period then it would calculate a further amortisation adjustment at least annually to ensure that its total TMTP decreases in a consistent manner to reach zero by the end of the transitional period.[16]

2.14 The PRA considers that the proposed new TMTP method would strike a reasonable balance between:

- ensuring TMTP remains appropriately risk-sensitive, by allowing the more material components of TMTP to vary dynamically with the underlying liabilities; and

- adopting an approach that is straightforward to implement and maintain.

2.15 The proposed new TMTP method is set out in Transitional Measure on Technical Provisions (Annex H of Appendix 2).

The legacy approach to calculating TMTP

2.16 The PRA expects that the proposed new TMTP method would be appropriate for the majority of firms and would be a proportionate simplification to the existing calculation that can be adopted for the remainder of the transitional period to 2032. However, the PRA recognises that after its initial implementation, the proposed new TMTP method could, for some firms and under certain economic conditions, produce different results than the existing approach. This would be the case particularly where the existing TMTP calculation captures idiosyncratic features of firms' risk profiles.

2.17 The primary motivation for the proposed new TMTP method is to reduce resource costs and increase consistency. It is not intended to materially alter firms' ongoing amount of TMTP compared to the existing approach, or to cause firms material operational impacts. Therefore, the PRA proposes that firms that would be affected by the new TMTP method in such ways

[16] The proposed amortisation approach is described further in the 'Amortisation of TMTP' section below.

would be able to apply to vary their TMTP permission in order to continue to calculate TMTP using the existing approach, with some modifications as described below (the 'legacy approach'). An application would need to be submitted at least six months prior to the PRA's proposed implementation date of 31 December 2024 and the PRA would not consider any applications received after this point.

2.18 The PRA proposes that it would assess applications to use the legacy approach by considering whether, when compared to the legacy approach, use of the new TMTP method would either:

- lead to a material financial impact under certain economic scenarios;
- carry a disproportionately high compliance cost for a firm; or
- significantly disrupt a firm's risk management practices.

2.19 A financial impact would be considered material where it would change a firm's solvency coverage ratio by five percentage points or more under certain forward-looking economic scenarios. This is consistent with the PRA's existing expectation in paragraph 4.16 of SS6/16 – **Maintenance of the 'transitional measure on technical provisions' under Solvency II** for determining a material change in risk profile in the context of TMTP recalculations. A firm's assessment of the potential financial impact would need to, on a forward-looking basis:

- include a comparison of both approaches over an appropriate time horizon, consistent with the scenarios in the firm's medium-term capital management plan;
- include a separate consideration of stress conditions that are consistent with the reporting sensitivities set out in the existing SS7/17; and
- take account of the expected amortisation of TMTP under both approaches.

2.20 The PRA proposes to introduce an expectation that firms with permission to use the legacy approach should monitor the criteria above on an annual basis as part of the Own Risk and Solvency Assessment (ORSA). The firm would notify the PRA where these criteria are no longer met or where a firm no longer wishes to use the legacy approach. The PRA, after discussing with the firm, would then decide when to switch the firm to the new TMTP method, which would be expected to be no later than 12 months from the date of notification. Following the switch, the firm would then use the new TMTP method until the end of the transitional period. The PRA expects that most legacy approach firms are likely to switch to the new TMTP method prior to the end of the transitional period due to the decreasing materiality of TMTP over time.

2.21 Furthermore, consistent with the overall aim to simplify TMTP and to reduce resource costs for firms and the PRA, the legacy approach would differ from the existing TMTP calculation approach in several ways:

- Firms using the legacy approach would not be permitted to make any further Solvency I Pillar 2 methodology changes.
- Firms using the legacy approach would be able to calculate TMTP at each reporting period without regulatory approval, as described in more detail later in the chapter.
- Firms would be required to only make changes to Solvency I Pillar 2 best estimate assumptions to reflect changes in market conditions and/or demographic assumptions.
- Firms that use the matching adjustment (MA) would be required to assume, in the TMTP calculation, that any new asset class invested in carried the same level of Solvency I illiquidity premium benefit as the rest of the relevant asset portfolio. Firms would also have requirements relating to amortisation and scope of their TMTP permission in order to implement some of the proposals described later in this chapter.

2.22 The above changes would also provide the PRA with safeguards to ensure that the legacy approach remains calculated on a consistent basis and removes the need for the PRA to undertake further reviews. It also mitigates the need for the PRA to reassess any potential Solvency I Individual Capital Guidance in this area. In combination with the other proposals, this helps to simplify the TMTP calculation and reduce resource costs.

2.23 The legacy approach is set out in the proposed new SoP – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 4), and reflected in the proposed amendments to SS17/15 (Appendix 3).

Removal of the FRR test

2.24 The PRA proposes to remove the FRR test for all firms with a TMTP permission at the PRA's proposed implementation date, whether they use the new TMTP method or legacy approach. Removing the FRR test was suggested as a reform by respondents to HMT's Call for Evidence.

2.25 The FRR test sets out that a firm's TMTP amount can be limited where necessary, so that the firm's FRR under Solvency II would not be lower than under Solvency I. The calculation for the test requires firms to compare the FRRs on their total business, including business written from 2016 onwards.

2.26 The FRR test was designed to ensure that firms did not claim any more TMTP than was necessary to transition from Solvency I to Solvency II. The PRA considers that it was reasonable to restrict the amount of transitional benefit to ensure that firms claiming this transitional benefit do not end up being better off under Solvency II than under Solvency I. This would undermine the purpose of a measure that is meant to aid a transition to the Solvency II regime.

2.27 Nevertheless, the PRA recognises that the requirement to use legacy Solvency I models to calculate an FRR for the entire business creates ongoing resource costs for firms and the PRA. The credibility of those Solvency I calculations has also diminished over time, as they represent a snapshot of methodologies and assumptions that firms applied at a certain point in the increasingly distant past. Although the test now only results in TMTP being limited for a small number of firms, all firms using TMTP are still required to carry out the calculation regularly. The test is likely to continue to become less relevant over time, as TMTP amortises towards zero over the remainder of the transitional period, resulting in a diminishing effect of any limit on the amount of TMTP.

2.28 In addition, because the FRR test is determined based on a firm's total business, it affects firms differently based on their business models and the types of business they have written before and after 2016. This has led to some firms being incentivised to take management actions to influence the relative sizes of the Solvency I and Solvency II FRRs, and hence to mitigate the impact of the test.

2.29 For the above reasons, the PRA considers that, by the time of the PRA's proposed implementation date, the prudential benefits of maintaining the FRR test would no longer outweigh its resource costs to firms and the PRA. Instead, the PRA considers that firms should take a forward-looking view to manage any potential prudential risks as the end of the transitional period approaches, as outlined in the following two sections. The PRA notes this position is based on the current data it has available, and the PRA will continue to collect further data ahead of the proposed implementation date to validate the analysis laid out above.

2.30 The PRA considers that removing the FRR test is a key part of the package of proposals in this chapter, which when combined, would help to simplify the TMTP calculation, reduce resourcing costs for both firms and the PRA, and also support the objective of placing greater focus on preparation by firms for the end of the transitional period. The proposals are designed to support each other to achieve these aims.

2.31 This proposal is reflected in the proposed amendments to SS17/15 (Appendix 3) and deletion of SS6/16.

2.32 As set out in Chapter 1 – Overview (in the section 'Reforms to the risk margin'), alongside its proposed changes to the RM calculation, the Government will legislate to ensure that firms' TMTP approvals will be unaffected by the reduction in Solvency II FRR arising from the RM reforms.

Amortisation of TMTP

2.33 Under the existing requirements, firms are required to linearly amortise TMTP by 1/16th each year to zero in 2032. Firms currently adopt different approaches to achieve this, some of which are to mitigate the 'double run-off' effect.[17] The PRA proposes to introduce new requirements to ensure greater consistency in firms' approaches, to avoid a cliff-edge effect in relation to TMTP run-off, and to improve transparency in this area.

2.34 The PRA proposes that firms using either the proposed new TMTP method or the legacy approach would be required to amortise TMTP in a consistent manner to zero by 2032. For new TMTP method firms, if they projected that there would be any excess TMTP on 1 January 2032 based on a projected best estimate run-off of the business to which the TMTP permission relates, then they would need to make a further deduction to TMTP each year based on this estimate. Firms would be required to either increase or decrease the deduction at least annually to reflect the deductions required to ensure that the TMTP reduces consistently to zero on 1 January 2032 and to reflect any changes in the projected best estimate run-off of the business. For legacy approach firms, consistent amortisation would be achieved by a bespoke approach defined in their permissions. Firms that apply to use the legacy approach would include details of their preferred amortisation approach as part of their application.

2.35 For the avoidance of doubt, this proposed approach to amortisation is intended to ensure that a firm's TMTP is subject to a consistent annual deduction to ensure it reaches zero by 2032 and is not intended to give rise to a 'double run-off' effect. Removing 'double run-off' was suggested as a reform by respondents in HMT's Call for Evidence.

2.36 The aim of this proposal would be to ensure that TMTP runs off smoothly, to avoid a cliff-edge effect at the end of the transitional period, and to minimise the risk of a firm experiencing a capital deterioration where TMTP runs off more quickly than the underlying

[17] A 'double run-off' effect refers to a situation where the natural run-off of the TMTP business, combined with an adjustment made for the purposes of amortisation, would result in an excessive degree of amortisation beyond what would be needed to ensure that TMTP reduces linearly to zero by 2032.

liabilities.[18] The PRA also considers that this proposal would increase the consistency of TMTP amortisation methods across firms.

2.37 This proposal is reflected in the proposed Transitional Measures on Technical Provisions 5.2 and in the proposed new SoP – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 4).

Management of TMTP run-off

2.38 The PRA proposes to introduce an expectation that firms consider annually whether there are any risks arising to meeting their solvency risk appetite over the medium term due to TMTP run-off. This proposal is intended to ensure that firms prepare actively for the end of the transitional period and to manage any risks emerging from TMTP run-off.

2.39 This proposal is set out within the proposed amendments to SS17/15 (Appendix 3).

TMTP calculation in each reporting period

2.40 The PRA proposes that firms using either the new TMTP method or legacy approach would be allowed to calculate the amount of TMTP at the final day of each reporting period, rather than only when certain conditions are met. Alongside this, the PRA also proposes to remove the requirement for firms to seek the PRA's approval for TMTP recalculations. Allowing continuous calculation of TMTP was suggested by respondents to HMT's Call for Evidence.

2.41 Allowing calculation at the final day of each reporting period would align the amount of TMTP calculated for regulatory purposes with most firms' internal TMTP calculation practices. It would also result in the TMTP being better aligned with a firm's risk profile and economic conditions at each reporting date, reducing the risk of TMTP being understated or overstated.

2.42 Dealing with applications for permission to recalculate TMTP creates resource costs for firms and the PRA. Removing the requirement for firms to have the PRA's prior permission to recalculate would remove those costs. Under the proposed new calculation approaches, the PRA expects calculations to be more straightforward, removing the need for the PRA to retain the existing requirement for PRA permission.

2.43 This proposal is reflected in the proposed Transitional Measure on Technical Provisions (Annex H of Appendix 2), and the proposed new SoP – Permissions for transitional measures

[18] Such a capital deterioration could occur where the surplus emerging from the liability run-off is not sufficient to support the run-off of TMTP.

on technical provisions and risk-free interest rates (Appendix 4). As a result of this proposal, the PRA also proposes to delete SS6/16.

Removing audit committee oversight of TMTP

2.44 Under the existing regime, firms' audit committees are expected to oversee the TMTP calculation and assess recalculation applications before they are submitted to the PRA.

2.45 The PRA proposes that, instead, TMTP calculations would be overseen by the Chief Actuary, alongside their existing responsibility for the Solvency II technical provisions. The PRA considers this would be more appropriate and proportionate given the declining materiality of TMTP, and the other proposals in this chapter to simplify the TMTP calculation and to remove the requirement for TMTP recalculations to have the PRA's prior permission.

2.46 This proposal is reflected in the proposed amendments to SS17/15 (Appendix 3).

Insurance business transfers and reinsurance

2.47 Insurance business transfers and 100% reinsurance transactions can result in significant changes to the liabilities that are subject to TMTP. The PRA proposes that new TMTP method firms would be required to adjust their calculation approaches where necessary within two months of any transfer event,[19] to account for the change in their liabilities.[20] However, such adjustments would generally be subject to a requirement that no additional TMTP be generated overall between the two parties. The PRA also proposes to allow legacy approach firms to update calculation approaches following a transfer event in order to accept the acquired business, subject to no additional TMTP being generated overall between the two parties. However, unlike TMTP method firms, legacy approach firms must apply to the PRA before making such an update.[21]

2.48 Under the existing regime, it can be complicated for firms to update their TMTP calculations following an acquisition of business written before 2016, particularly where that

[19] Transfer events are: 1) transfer of business either under Part VII of Financial Services and Markets Act 2000 or the Friendly Societies Act 1992; 2) a 100% reinsurance contract; 3) an amendment to an existing 100% reinsurance contract if there has been a change to the reinsurer's economic liabilities; or 4) cancellation or expiration of an 100% reinsurance contract.

[20] Firms using the proposed new TMTP method would update the values of Z_A, Z_B, and the non-annuity BEL component. They would be required to submit documentary evidence to the PRA of the methods they had used to recalculate these values.

[21] Due to differences in calculation methodologies among legacy approach firms, it would not be possible to define a specific approach to updating the calculation as is the case for new TMTP method firms. Therefore, such firms would need to apply for a bespoke rule modification.

business has features that were not previously accounted for by the acquiring firm's Solvency I methodologies and assumptions. This complexity has made TMTP more challenging for the PRA to supervise, due to the need to review a firm's calculation and challenge any material differences in the TMTP claimed as a result of the business transfer.

2.49 While insurance business transfers and reinsurance transactions are not equivalent transactions, they can result in a similar economic impact. 100% reinsurance contracts in particular are designed for the purpose of transferring the full economic risk (often ahead of a business transfer), which is why the PRA proposes to consider them a 'transfer event'.[22] The PRA expects that the impact on TMTP of less material reinsurance arrangements would be recognised in the firm's usual TMTP calculation, and therefore should not require a methodology update and would not be considered a 'transfer event'.

2.50 The PRA considers that the proposal to have rules on how new TMTP method firms should adjust their TMTP calculation approaches following a transfer of business or 100% reinsurance transaction would introduce greater consistency and transparency in how firms should update their TMTP calculations in such situations. The proposal to not allow the generation of new TMTP would also be expected to prevent new TMTP relief being claimed purely as a result of a business transfer. The PRA considers that these would be reasonable outcomes at this point in the transitional period and would be in the interest of moving all firms in a timely and orderly way towards being fully transitioned to Solvency II.

2.51 This proposal is set out in the proposed Transitional Measures on Technical Provisions Chapter 6 (Appendix 2), the proposed new SoP – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 4) and the proposed amendments to SS17/15 (Appendix 3).

Limiting new TMTP permissions

2.52 TMTP is a transitional measure to support the transition of firms' balance sheets from Solvency I to Solvency II. As the transitional period began in 2016, the PRA considers that all firms that require TMTP for that purpose will by now have sought approval to apply TMTP.

2.53 The PRA therefore proposes that TMTP can only be applied to technical provisions to which a TMTP permission related on the proposed implementation date of 31 December 2024. The PRA also proposes that it would generally not consider any further new applications for TMTP permissions, except in cases where a firm without an existing TMTP

[22] Similarly, amendments to the volume of risk covered by a 100% reinsurance contract, transfer the full economic liabilities of some of the risks covered by the contract back to the cedant, and therefore are also considered a 'transfer event' as noted in footnote 19.

permission is accepting business (via a business transfer or 100% reinsurance) that already benefits from TMTP.

2.54 The PRA considers that this approach would be consistent with the intended purpose of TMTP, and would support firms towards full compliance with Solvency II, while avoiding the introduction of competitive distortions between firms with and without an existing TMTP permission that may be looking to accept business.

2.55 This proposal is set out in the proposed Transitional Measures on Technical Provisions 2.1 (Annex H of Appendix 2) and the proposed new SoP – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 4).

Removal of branch eligibility for TMTP and TMIR

2.56 The PRA proposes to remove the ability for third-country branches to use TMTP or TMIR. Since 2016, no branch has applied to use either measure. Further, following the reforms proposed in Chapter 6 of this CP, branches would no longer be routinely required to calculate an RM, which is often one of the key drivers of TMTP benefit. As such, the PRA does not consider that it would be appropriate or proportionate to make provision for branches to use TMTP or TMIR after the PRA's proposed implementation date, as there would be limited rationale for them to do so.

2.57 This proposal will result in amendments to Third Country Branches (Annex K of Appendix 2).

PRA objectives analysis

2.58 The PRA considers that the proposals in this chapter would continue to advance its primary objectives of safety and soundness and policyholder protection for a number of reasons:

- The proposed new TMTP method, and the option for firms to apply for permission to use the legacy approach, would support the TMTP remaining suitably linked to firms' risk profiles which is important as TMTP is a significant contributor to some firms' overall solvency position.

- The proposal to remove the FRR test would result in a one-off increase in own funds for any firms for which the test was still a constraint at the PRA's proposed implementation date. However, the PRA does not expect the test to be binding on many firms by that point, or for any increase in own funds to be material. The PRA also expects the relevance of the test to reduce over time as TMTP amortises. The PRA notes this position is based on the current data it has available, and the PRA will continue to collect further data ahead of the proposed implementation date to validate this analysis.

- The PRA considers that the proposals relating to amortisation and to firms' management of TMTP run-off would support firms in preparing for 2032 when transitional relief will no longer be available. This would help ensure safety and soundness and policyholder protection is maintained as the end of the transitional period approaches.

- The proposals to limit the creation of new overall TMTP upon transfer or reinsurance, to limit new TMTP permissions, and to remove third-country branch eligibility for TMTP and TMIR would promote the appropriate use of these measures as tools intended for transitional relief.

2.59 The PRA considers that the proposals in this chapter would also advance the PRA's secondary competition objective:

- Simplifying the TMTP calculation and removing reliance on Solvency I models should help to facilitate effective competition between firms using TMTP and other firms, by reducing compliance costs for firms that use TMTP.

- Moving to a more standardised approach to the default TMTP calculation, to amortisation, and to business transfers would also improve consistency between firms using TMTP, facilitating more effective competition between them.

- Removing the FRR test would also help to facilitate effective competition between firms using TMTP, some of which are affected disproportionately by the test due to having particular business models or having written certain lines of business prior to 2016.

- The proposal to permit certain firms to use the legacy approach would facilitate effective competition by allowing firms to continue to recognise material idiosyncratic features of their businesses where necessary. The PRA considers that the risk of legacy approach firms gaining a competitive advantage over firms using the proposed new TMTP method would be mitigated by having transparent eligibility criteria that would permit the use of the legacy approach only in cases where the proposed new TMTP method would materially disadvantage a firm. In addition, legacy approach firms would continue to bear the ongoing costs of retaining Solvency I models.

2.60 In the light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA considers that the proposals could help support international competitiveness as:

- the proposals reduce the costs for firms of complying with TMTP requirements, while still guarding against any increased prudential risk; and

- the proposal to remove third-country branch eligibility for TMIR and TMTP would not materially affect the attractiveness of the UK as a destination for branches, particularly when considered in the round with the other third-country branch proposals in Chapter 6 of this CP and given that no third-country branches have historically used these measures.

In addition, the PRA consider the proposals could also support growth as:

- the cost reductions could increase available capital which could subsequently be invested;
- the proposals would facilitate effective competition which is good for growth.

The PRA considers that there are no international standards relevant to this assessment.

Cost benefit analysis

2.61 When considering impacts as part of this CBA, and therefore the baseline for the CBA, the PRA has assumed its proposals would take effect after the Government has implemented legislative changes for the Solvency II Review, as per HMT's draft SIs. The Government's reform of the RM is particularly significant for the proposals in this chapter because the RM is a material driver of TMTP for UK insurers. Any reduction in the RM would; therefore, also lead to a reduction in the amount of TMTP. Firms reported an aggregate amount of £12.9 billion of TMTP at year-end 2022. Based on an assessment of the average contribution of RM to TMTP, the PRA expects this amount would have been £6.5 billion after applying the Government's proposed RM reforms. While this is a significant reduction in the overall amount of TMTP, the level remains material for firms, comprising about 13% of eligible own funds based on an average across individual firms.

2.62 TMTP was designed to help firms gradually phase in the impact of applying higher technical provisions under Solvency II to business written before the introduction of Solvency II. Firms are currently expected to recalculate the transitional measure at least once every two years, and the PRA also expects it to be recalculated where the risk profile of the firm has materially changed. As highlighted above, TMTP will continue to make a signification contribution to UK insurers' own funds even after the impact of RM reform. However, the PRA notes that the TMTP will continue to decline in size as eligible business runs off and as

TMTP must amortise to zero by 2032, strengthening the case for simplifying and standardising the calculation for the second half of the transition period.

2.63 This CBA considers the impact of the PRA's proposals to reform the TMTP, compared to leaving the TMTP approach unchanged. It is based on analysis of information from a range of sources, including data from regular quarterly reporting, **responses to the PRA's quantitative impact study (QIS) and qualitative questionnaire** in 2021, and ad-hoc information provided by firms to support the PRA's work on TMTP reform. There are currently 24 firms with permission to apply the TMTP, primarily life insurance firms with annuity business, including large groups and smaller insurers.

Benefits

2.64 The PRA processed 28 applications relating to TMTP calculation over the past year, with applications usually taking between two weeks and two months to resolve alongside other supervisory and policy work. Consequently, the PRA expects to be able to reduce its resourcing relating to TMTP.

2.65 The proposal to limit new TMTP permissions outside of business transfers would also remove the need for the PRA to review these applications; however, the impact of this would be expected to be limited as firms have already had more than seven years to apply for TMTP approvals.

2.66 The PRA expects the proposed changes would lead to a significant overall reduction in the complexity of calculating and reviewing the TMTP. The proposed new TMTP method would allow firms to maintain the transitional measure more easily, ensuring that the benefits of the transitional remain proportionate as it runs off. The proposed new TMTP method will also allow firms to calculate the TMTP in each reporting period in a more straightforward way, which is easier for the PRA to monitor and supervise, making the process significantly less onerous for both firms and the PRA.

2.67 The proposal to remove the FRR test and to introduce the proposed new TMTP method would mean that most firms would no longer need to maintain Solvency I systems and processes when calculating the TMTP. Firms indicated in their responses to the QIS exercise in 2021 that maintaining models for the Individual Capital Adequacy Standards (ICAS) under Solvency I accounted for around 30% of the overall annual cost of applying the TMTP, which can reach up to £1.2 million per year. The new TMTP method would also remove the need for firms to apply for approval to change Solvency I models and for the PRA to review and approve such changes.

2.68 In the short term, the TMTP may be larger under the proposed new TMTP method than under the legacy approach, which in isolation, could potentially lead to capital releases.

2.69 Removing the FRR test would have resulted in an immediate capital benefit of about £990 million across a small number of firms with TMTP restricted by the test at year-end 2022, assuming recalculation of the TMTP. The immediate capital impacts from the proposal will change following reform of the RM, which will affect both the calculation of TMTP and the calculation of the FRR test, and is expected to reduce the overall impact across the currently restricted firms by around a third, though this will depend on the specific drivers of the TMTP for each firm and the prevailing economic conditions.

Costs

2.70 The PRA would expect there to be administrative costs associated with implementing the proposals in this chapter, as firms and the PRA would need to adapt to a new method for determining the TMTP. The PRA expects such implementation costs to not be material, given the new calculation methodology is simplified and based on existing elements of the Solvency II balance sheet that firms will already be calculating. There may be additional costs where firms choose to apply to use the legacy approach, as this would require them to evidence the expected impact of adopting the new TMTP method for review by the PRA. However, this additional cost will be minimal.

2.71 The PRA does not consider that the proposal to introduce an expectation that firms consider risks to meeting their solvency risk appetite in the medium term due to TMTP run-off would lead to any significant immediate costs. The PRA considers that the majority of firms will already be assessing this risk as part of wider risk management practices; however, including this explicit expectation would help ensure that firms are prepared for the end of the transitional period.

2.72 The PRA does not expect that the proposal to remove branch eligibility for transitional measures would have a significant impact on third-country branches given that there are no branches that currently make use of either transitional measure. Furthermore, the PRA considers that it would be unlikely for a branch to apply for either measure in the future due to the proposed reforms to branch capital requirements and RM as set out in Chapter 6 of this CP, and the likely disproportionate costs of going through the application process.

2.73 The PRA notes that the proposed changes to the TMTP calculation methodology would not have an immediate impact on the size of firms' TMTP, other than any change arising from the removal of the FRR test (as the starting position is based on the existing calculation), and that the TMTP is still required to run off to zero by 2032. Therefore, the impact of the proposed changes to the TMTP calculation methodology would only affect the pattern of firms' TMTP run-off between these two points.

2.74 The PRA expects that final TMTP figures calculated using the proposed new TMTP method will closely match the TMTP that would have been calculated under the legacy approach for most firms. Analysis of historic TMTP data has shown that implementing the new calculation methodology near the beginning of the transitional period would have led to differences of below five percentage points in SCR coverage emerging to year-end 2022 for the majority of firms. Therefore, for most firms, there should be little change in TMTP amount, and limited costs or benefits relating to the size of TMTP. The PRA recognises that there could be some instances where the proposed new TMTP method deviates more significantly from the legacy approach over time (see ‘The legacy approach to calculating TMTP’). The size of these impacts will depend on prevailing economic conditions and the actual run-off experience of the underlying business.

2.75 In some cases, there may be a reduction in TMTP, which would have a direct cost for firms through reducing capital ratios. Where firms are faced with a significant reduction in TMTP under the proposed new TMTP method, the PRA proposes to limit these costs by permitting firms to use a version of their legacy approach where they can demonstrate that the new TMTP method would lead to a change in their solvency coverage ratio of five percentage points or more under relevant forward-looking scenarios. The PRA expects that only a small number of firms will be affected to this degree.

2.76 There could be a cost for firms that seek to acquire legacy business that does not currently benefit from TMTP relief, as they could not then claim TMTP on such business. However, the PRA considers that, at this stage in the transitional period, TMTP has already been utilised where required for transitional relief and it is therefore not appropriate to allow TMTP to be applied on business that is already treated on a Solvency II basis. The PRA expects this cost would impact a small number of firms, as such transactions are rare.

2.77 Similarly, the additional safeguards around the legacy approach could be a cost to firms that use the legacy approach and would have liked to include new assets for their back book business. At this point in the transitional period, the PRA would not be expecting firms to significantly change the assets backing their TMTP business and; therefore, the PRA would expect any such impact to be limited given the time firms have had to introduce new asset types to their models and the decreasing size of the TMTP.

2.78 To the extent that the increase in the TMTP following removal of the FRR test could potentially lead to a reduction in firms’ capital resources, this may reduce policyholder protection and the safety and soundness of firms.

2.79 However, the PRA notes there are supervisory controls already in place to ensure that firms do not overly rely on the TMTP to meet capital requirements, including requirements for firms to take measures to achieve compliance with the SCR by 1 January 2032 and to submit a phasing-in plan to the PRA within two months if unable to meet SCR requirements without the TMTP. Therefore, the PRA does not anticipate any significant costs in terms of policyholder protection and the safety and soundness of firms from increased TMTP in these cases. In addition, the TMTP will reduce over time.

2.80 The PRA also proposes to mitigate these risks through greater emphasis on firm's preparedness for the end of the transitional period such as reviewing firms' assessments as to their ability to absorb the run-off of TMTP, which would ensure the TMTP remains appropriate over the remainder of the transition period. This includes requiring firms to consider any risks to meeting their solvency risk appetite in 2032 due to the run-off of the TMTP. The PRA expects the benefits from its proposal to remove the FRR test would outweigh the costs, based on current data, particularly as the costs to firms of maintaining the test are increasing over time, while the prudential benefit is reducing over time. The PRA will continue to collect further data ahead of the proposed implementation date to validate the analysis laid out above.

2.81 In summary, the PRA the proposed changes to the TMTP calculation methodology would ensure the TMTP remains appropriate to firms' risk profiles, while also simplifying and standardising calculations. The PRA considers the proposals would result in improved consistency in TMTP calculation between firms, including on amortisation and business transfers, while also allowing the legacy approach to be used by firms that would be significantly adversely affected by the change.

2.82 On balance, the PRA considers that the proposals would result in significant benefits in terms of simplifying the ongoing management of the TMTP, both for firms and the PRA. The changes would not be expected to have a significant impact on capital positions for most firms. Where individual firms' capital positions might have been impacted negatively to a more significant degree, the proposals mitigate this potential cost by allowing continued use of the legacy approach. The PRA does not expect that there would be any significant increases in the TMTP because of the proposals, but notes that there are existing supervisory tools in place to manage the risk of firms over-relying on the TMTP, including the phasing-in plan requirements. The benefits of the simplified processes and easier ongoing management of the TMTP would; therefore, be expected to outweigh implementation costs, and any impacts to policyholder protection, safety and soundness, or firms' ability to write new business arising from changes to firms' capital positions.

'Have regards' analysis

2.83 In developing these proposals, the PRA has had regard to the FSMA regulatory principles and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. The need to use the PRA's resources in the most efficient and economical way (FSMA regulatory principles): the PRA considers that the proposals in this chapter would support efficiency by: introducing greater consistency between firms in how TMTP is calculated; making the application of a firm's TMTP permission easier to supervise; removing onerous aspects of the current TMTP framework such as the need for the PRA to review recalculation applications; and reducing firm queries related to TMTP calculation and the FRR test. This would allow the PRA to reallocate some of the supervisory resource that is currently devoted to TMTP.

2. Proportionality (FSMA regulatory principles):

- The PRA considers that, taken together, the proposals in this chapter would reduce the resource burden associated with TMTP for firms while still ensuring that TMTP behaves appropriately and in line with the PRA's objectives. The PRA considers there is scope to achieve this given that TMTP has already reduced in materiality since the start of Solvency II,[23] will reduce substantially following the Government's RM reforms, and will continue to decrease until it reduces to zero in 2032.

- The proposed new TMTP method aims to be proportionate by focusing the calculation on the most material drivers of TMTP relief.

- The proposal to remove the FRR test recognises that the burden it places on firms is likely to become disproportionate to the resulting prudential benefit by the PRA's proposed implementation date.

- The need for firms to seek PRA permission for recalculations, and the expectation that the audit committee will oversee TMTP, are no longer considered proportionate so are proposed to be removed. In addition, the PRA is proposing to allow firms to maintain the 'legacy approach' in cases where the impact of the default new TMTP method would be disproportionately burdensome.

- The proposal to limit new TMTP permissions and only allow TMTP on business currently subject to it, could place a restriction on firms that try to seek TMTP relief on business not previously subject to it. However, the PRA considers that the proposal is proportionate as eight years into the regime any firms that require transitional relief would have already applied, and the PRA does not consider it appropriate to allow

[23] Aggregate industry TMTP at YE16 was £32.6 billion. At YE22 it was £12.9 billion.

firms that have successfully transitioned business to Solvency II to potentially gain a competitive advantage by applying TMTP when not required.

3. Responsibilities of senior management (FSMA regulatory principles): the PRA has considered the responsibilities of the audit committee and the Chief Actuary function in forming its proposals. The Chief Actuary has responsibility for the actuarial function, as noted in Rule 7.1 in the Insurance – Senior Management Functions Part of the PRA Rulebook. The actuarial function co-ordinates and oversees the calculation of technical provisions, of which TMTP is part. The PRA therefore considers that its proposal for the Chief Actuary to assume oversight of the TMTP calculation is appropriate, as well as being more proportionate than continuing to expect audit committee oversight of TMTP.

4. Recognising differences in the nature of businesses carried on by different persons (FSMA regulatory principles): the PRA considers that the proposed new TMTP method for calculating TMTP would likely be appropriately risk-sensitive for most firms. However, for some firms, under certain economic conditions and over time, the proposed new TMTP method has the potential to produce materially different results than the existing TMTP calculation approach. To recognise the particular situation of such firms, the PRA is proposing that firms meeting certain criteria would have the option to apply for permission to use the legacy approach.

5. Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006): the existing TMTP framework gives scope for firms to take significantly different approaches to their TMTP calculations, including their approaches to amortisation and to updates following business transfers. The PRA's proposals in this chapter would be expected to increase consistency in these areas, with the details of the approaches firms would need to follow (and the primary variations to its rules that the PRA would be willing to consider) being set out in PRA rules and policy material. The PRA considers that this would increase transparency around the operation of TMTP, and around the PRA's expectations of firms in this area.

6. Growth in the interests of consumers and businesses, and sustainable growth (HMT recommendation letter and FSMA regulatory principles): the PRA considers that the proposals in this chapter would reduce ongoing resource costs for firms, which may also create additional capital that could be invested. Further, the PRA considers that its TMTP proposals would give firms increased certainty about the operation of the TMTP over the remainder of the transitional period, and hence about how firms can manage the full transition of their balance sheets to Solvency II. This may support firms' ability to make longer-term business and investment decisions.

7. Competitiveness (HMT recommendation letter): the PRA considers that the proposals in this chapter would support the competitiveness of UK firms, primarily by reducing the resource costs required to maintain TMTP. The PRA does not consider that its proposal to remove eligibility of third-country branches to use TMTP and TMIR would have a material effect on the attractiveness of the UK as a place to do business, because no third-country branches have used these measures to date.

2.84 The PRA has had regard to other factors as required. Where analysis has not been provided against a ‘have regard’ for this set of proposals, it is because the PRA considers that ‘have regard’ to not be a significant factor for this set of proposals.

3. Internal models

3.1 This chapter sets out the PRA's proposed changes to the Solvency II internal model (IM) framework. It is expected that the FSM Bill will revoke the remaining retained EU law, including onshored Commission Implementing Regulation (EU) 2015/2012 and the SII CDR. Therefore, this chapter sets out the proposed new IM framework for the UK.

3.2 The policy proposals in this chapter would:

- streamline substantially the tests and standards (T&S) required to be met for new IMs and changes made to IMs, while ensuring appropriate internal modelling standards are maintained;
- introduce more flexibility when the PRA grants new, and variations to, permissions to enable firms to use IMs to calculate their SCR;
- implement a range of IM approval safeguards that could be used to bring an IM that is not wholly compliant into compliance with the calibration standards,[24] and/or mitigate the risks arising from such non-compliance in all other circumstances; and
- introduce an internal model ongoing review (IMOR) framework, building on many elements of the PRA's existing supervisory review processes.

3.3 The proposals in this chapter would:

- amend the Glossary Part of the PRA Rulebook (Annex A of Appendix 2);
- amend the Solvency Capital Requirement – Internal Models Part of the PRA Rulebook (Annex F of Appendix 2);
- introduce a new statement of policy (SoP) – Solvency II internal models: Permissions and ongoing monitoring (Appendix 5). This SoP sets out the approach for how the PRA will grant new, and variations to, permissions for IMs of individual firms and groups. This updates and replaces onshored Commission Implementing Regulation (EU) 2015/460, including amendments related to EU exit. It also updates and replaces

[24] In this chapter of the CP, the calibration standards refer to Solvency Capital Requirement - General Provisions 3.3 and 3.4.

SS12/16 – Solvency II: Changes to internal models used by UK insurance firms (Appendix 9);

- introduce a new SS – Expectations for meeting the PRA's internal model requirements for insurers under Solvency II (Appendix 6);
- make consequential changes to SS5/14 – Solvency II: calculation of technical provisions and the use of internal models for general insurers (Appendix 7);
- make consequential changes to SS15/15 – Solvency II: approvals (Appendix 8); and
- make consequential changes to SS17/16 – Solvency II: internal models – assessment, model change and the role of non-executive directors (Appendix 10).

3.4 This chapter focuses on the changes to the IM framework. The PRA may consider further aspects relating to the use of the new permissions power under section 138BA of FSMA, introduced by the FSM Bill, in future.[25] These aspects may impact on some of the operational aspects outlined in the proposed new SoP for granting IM permissions.

3.5 This chapter is most relevant to UK Solvency II firms, the Society of Lloyd's, its members and managing agents, where an IM is used to calculate the SCR. It will also be of interest to UK Solvency II firms seeking approval to use an IM, and to UK Solvency II firms that are part of the European Economic Area (EEA) or non-EEA groups with a group IM. The proposed changes to SS15/15 do not only relate to the IM framework, and are relevant to all firms considering applying for any of the approvals or permissions covered by that SS.

Approach to internal model approvals

3.6 Under the proposed new IM framework, the PRA would grant 'permission' to a firm to use an IM, rather than 'approve' an IM as it does under the existing framework. Firms would apply to the PRA for permission to use an IM, which would modify the PRA rules on the calculation of the SCR to allow the firm to use an IM. Subsequently, a firm could apply for a variation of an existing permission to enable the firm to make a major change to its IM. In this chapter, 'granting permission' to use an IM refers to the PRA's approach under the proposed new framework. Reference to 'approval' of an IM is made when describing the PRA's approach in the existing framework. Although this is a change in the legal mechanism by which the PRA would permit a firm to use an IM to calculate part or all of its SCR, it does not itself represent

[25] See Chapter 1 – 'Overview' for more background on this new permissions power.

a substantive change from the way in which the PRA currently engages with firms in considering applications to use IMs under the existing framework.

3.7 The proposals in this chapter on the PRA's approach to, and the procedure for, IM applications and granting of permissions are specific to the SCR IM framework. They are intended to be consistent with existing procedures for IM applications, with adjustments to reflect the new, more flexible IM permission framework. For the remainder of this chapter reference to IM should be taken to mean both full and partial internal models, unless explicitly stated otherwise.

Impact of the proposals on different firms

3.8 The proposals in this chapter apply to firms that calculate their SCR using a solo or group IM, including firms that calculate their group SCR using a group IM. The PRA does not expect that firms whose IMs were approved before these proposed reforms took effect would need to be granted new permissions. However, firms should consider any consequential changes to their IM change policies as a result of these proposals. In particular, firms should ensure their IM change policies set out the procedures for applying, reviewing, and removing model limitation adjustments (MLAs), before applying to the PRA for a variation of their IM permission.

3.9 To allow for this, the PRA proposes to introduce a transitional rule, Solvency Capital Requirement – Internal Models 6.6. This rule would allow firms that apply MLAs up to two years, from the effective date of the final rules, to make the consequential changes to their IM change policies to reflect MLAs.

3.10 Firms with existing approvals to use an IM will be affected by the proposals in this chapter, to the extent that they would be subject to fewer and amended T&S in future. The proposed IMOR framework would also affect these firms, although it is an evolution of the supervisory review process for firms under the existing Solvency II IM framework.

3.11 Under the proposed framework, where a firm submits an IM permission application to the PRA for a new IM or change to an IM, the relevant IM would be subject to all proposals in this chapter.

Streamlining internal model tests and standards

3.12 The UK transposed and onshored (as applicable) the EU's Solvency II framework for use of IM, which includes:

- the Solvency II Directive;

- the SII CDR;
- Commission Implementing Regulation (EU) 2015/460 – the implementing technical standards (ITS) with regard to the procedure to be followed concerning the approval of an IM; and
- Commission Implementing Regulation (EU) 2015/2012 – the ITS with regard to the procedures for decisions to set, calculate, and remove capital add-ons.

3.13 Under this existing framework, the PRA must approve an IM application if it meets the requirements of regulation 48 of the Solvency 2 Regulations 2015. This includes the T&S which an IM must meet in its development and operation. In addition, a firm must also satisfy the calibration standards, which require that the SCR calibration reflects all quantifiable risks at a 1-in-200 standard over one year, regardless of whether the firm uses an IM to calculate its SCR. In this chapter, the calibration standards refer to Solvency Capital Requirement – General Provisions 3.3 and 3.4.

3.14 The existing Solvency II framework for IMs includes a large number of highly prescriptive and detailed provisions, originally designed to promote harmonisation of regulation and supervision across multiple EU countries. The PRA considers that this framework contains a greater level of prescription than is appropriate for its needs as a single regulator supervising its own firms. The existing IM framework has presented a significant burden, both for firms to demonstrate that these provisions have been met, and for the PRA to review. The PRA considers this to be disproportionate to the benefit it delivers, in particular, for smaller firms where the burden is greater. Given the large number of firms with IM approval under Solvency II in the UK, the PRA has reconsidered the appropriateness of these provisions to UK firms, following the UK's exit from the EU.

3.15 The PRA continues to attach significant importance to firms demonstrating high standards of internal modelling of the risks which they are exposed to, particularly where these IMs are used to determine a firm's regulatory solvency requirements. However, the PRA considers that this outcome can be achieved with fewer prescriptive provisions than the existing framework.

3.16 The PRA has reviewed these IM provisions in Chapter VI of the SII CDR and the Solvency Capital Requirement – Internal Models Part of the PRA Rulebook. The aim of this review was to reduce the burden on firms as much as practically possible, without compromising the high internal modelling standards that the PRA expects of firms. As a result, the PRA proposes to transfer and restate in the PRA Rulebook some SII CDR provisions, not transfer or decouple some others, and include some SII CDR provisions as expectations in a proposed new SS (Appendix 6). In addition, the PRA proposes to amend or delete some provisions in the Solvency Capital Requirement – Internal Models Part and introduce one new requirement.

3.17 The PRA's proposed framework retains a smaller number of more principles-based requirements, alongside the expectations in the proposed new SS. The approach in the proposed framework supports the responses to HMT's Call for Evidence,[26] in which firms suggested the transition away from a prescriptive framework to a more principles-based framework and a reduction in documentation requirements as potential improvements to the existing framework.

3.18 The PRA considers that the proposed changes would permit greater flexibility and reduce burden, both for firms in the modelling approaches available, and for the PRA in its review of IM permission applications. In particular, the PRA expects that these proposed changes would facilitate more suitable modelling techniques and allow IMs to change and adapt more quickly (with permission granted by the PRA).

3.19 The PRA expects IMs to continue to meet high modelling standards as in the existing framework and does not expect that the proposed changes would lead to a dilution of prudential standards. In line with the existing framework, the PRA would continue to reject IMs with significant deviations from a firm's risk profile.

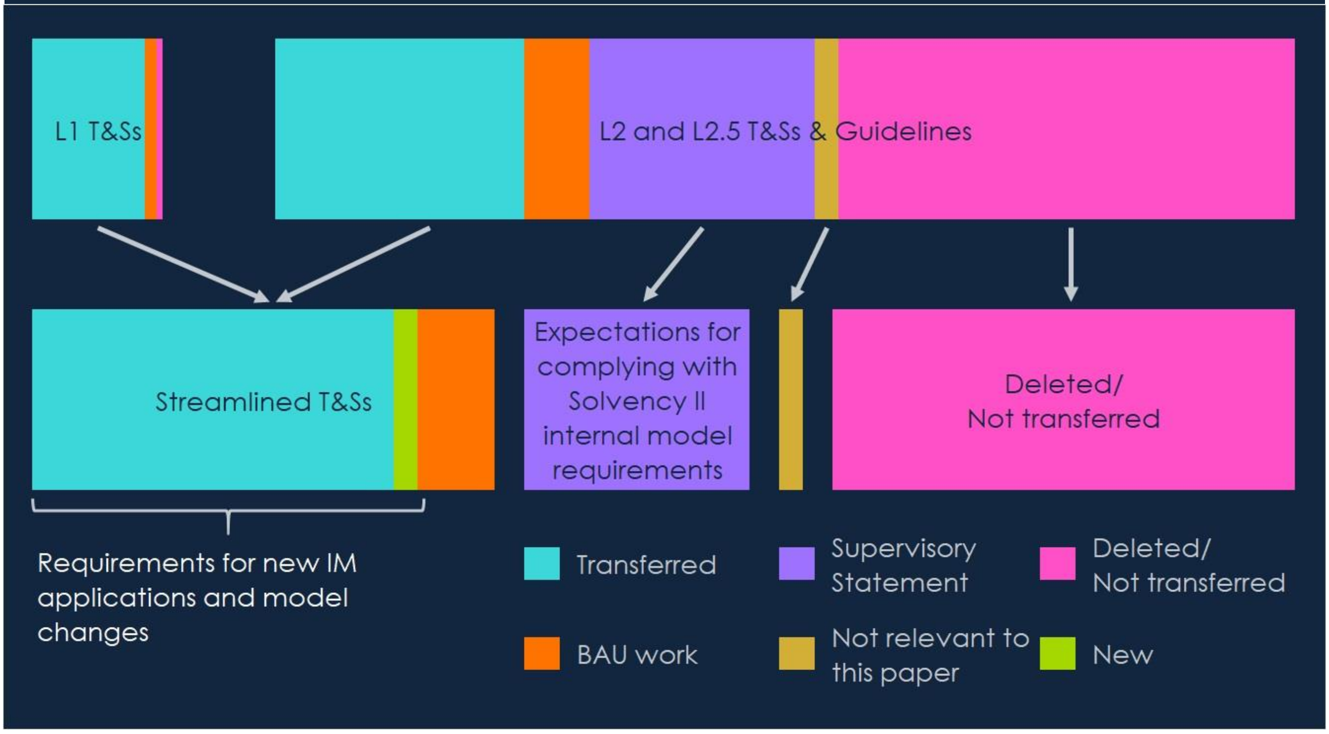
3.20 Chart 5 below illustrates the proposals for streamlining the existing IM T&S as referred to in the **EIOPA self-assessment template (SAT)** within the Common Application Package for IMs. The SAT convention is to refer to the Solvency II Directive as Level 1, the SII CDR as Level 2, and the ITSs as Level 2.5. The PRA proposes that these T&S would be either:

- transferred and restated in PRA Rulebook – these are provisions that the PRA considers would be necessary to retain the high modelling standards of the existing framework, with amendments where necessary to meet the aims of the proposed framework, as set out above;
- moved to expectations in an SS – those provisions from the SII CDR, amended where necessary, that would no longer be requirements but instead would form expectations of firms. These expectations would set out how firms might demonstrate compliance with the new set of internal model requirements, with the aim of improving flexibility in modelling approaches;

[26] See paragraphs C.11 and C.12 of the response to the Call for Evidence.

- not transferred – those provisions from the PRA Rulebook or SII CDR that would not be transferred and restated in the PRA Rulebook, as explained in paragraph 3.21;
- assessed through the PRA's 'business as usual' (BAU) supervisory work – those generally applicable governance and risk management requirements, either in the PRA Rulebook or the SII CDR, that the PRA will assess through its supervisory review work, rather than at the time of IM permission application. The generally applicable requirements will remain in the PRA Rulebook. However, there would no longer be an explicit requirement on firms to demonstrate how they are met at the point of seeking IM permission (expanded on in paragraph 3.23); or
- replaced by a new requirement – provisions in the PRA Rulebook related to the new analysis of change requirement (AoC, which replaces the current profit and loss attribution requirement,[27] discussed below).

Chart 5: Moving from the current approach (tests and standards assessed for new IM applications and model changes) to principles-based PRA Rulebook and subset of requirements assessed at applications



[27] Solvency Capital Requirement – Internal Models 13 (profit and loss attribution) is proposed to be replaced by Solvency Capital Requirement – Internal Models 13A (analysis of change).

3.21 As noted, the PRA proposes to not transfer many of the existing provisions where it considers that the provisions:

- add little value to either the review process or to modelling standards;
- duplicate existing rules; or
- are unduly prescriptive and could be better expressed with a principles-based approach.

3.22 Where these proposed internal model requirements are more principles-based, firms may be able to demonstrate to the PRA that they meet these requirements in alternative ways based on their individual circumstances. In such cases, the PRA considers it appropriate to include these as expectations, set out in the proposed new SS, of how a firm might demonstrate compliance with the overarching rules.

3.23 A number of the existing IM T&S relate specifically to risk management and governance requirements.[28] Several of these reflect standards that firms must meet when designing their risk management systems and defining their risk management functions. Therefore, these standards are assessed by the PRA in the context of wider BAU supervision work around risk management and controls. As described above, the PRA proposes to decouple these from the scope of the IM permission process and retain only the existing risk management requirements that are directly relevant to the scope of IMs. While these requirements would be decoupled from the IM permission process, they would remain requirements elsewhere in the PRA Rulebook, applicable to all firms in scope of this chapter.

3.24 The examples below illustrate the approach to the PRA’s proposed streamlining. As noted in paragraph 3.19, the PRA does not consider that the proposed changes would represent a reduction in modelling standards:

- **Documentation**: While it remains crucial that firms are able to articulate and document the operation of their IM, the PRA considers that the existing framework is unnecessarily prescriptive in how firms must achieve that standard. As an example, the minimum content of documentation – Article 244 (a) – (p) of the SII CDR prescribes the information that the documentation of the IM must include. In particular, Article 244 (g) of the SII CDR requires that a directory of the data used in the IM, specifying their source, characteristics, and usage, should be documented. Although good practice, the PRA recognises that in some cases, it may be disproportionate for firms to demonstrate compliance with this requirement. Therefore, the PRA proposes to not transfer to the PRA Rulebook the provisions in the minimum content of

[28] Conditions Governing Business - 3 to 4, and SII CDR articles 259, 269 and 266.

documentation of the SII CDR. Instead, most of those provisions would be included as expectations within an SS of how a firm might demonstrate compliance with the proposed internal model requirements. The high-level requirements on firms as regards documentation standards are those set out in Solvency Capital Requirement – Internal Models 15.1 to 15.2.

- **Data appropriateness**: Article 231 (3)(d) of the SII CDR requires that data used in the IM shall only be considered appropriate where the data reflects the relevant risks to which a firm is exposed. The PRA considers that this requirement is already covered implicitly in the existing Solvency Capital Requirement – Internal Models 11.4(1), in that the data used in the IM must be appropriate. In a more principles-based framework, the PRA intends to rely on firms to responsibly comply with the requirement of data appropriateness as it relates to risks, rather than specifying in detail within the PRA Rulebook or an SS how a firm should meet those provisions.

- **Management actions**: The PRA considers that the content of Articles 23 and 236 of the SII CDR relating to future management actions could be consolidated, without negatively impacting prudential standards. The PRA proposes to amend Solvency Capital Requirement – Internal Models 11.8(3) to simply cross-refer to Article 23, and for firms to comply with those requirements in the context of calculations within their IMs. There is no intended change of standards in this example. The PRA understands that the application of the provisions in Article 23 of the SII CDR may well result in a different management action that is reasonable in base to one that, in the context of an IM, is reasonable in stressed conditions.

- **Approximations**: The PRA also proposes to not transfer Article 238 of the SII CDR, relating to approximations where a firm is unable to meet Solvency Capital Requirement – Internal Models 12.2, which requires a firm to derive its SCR directly from the probability distribution forecast generated by its IM. Firms can continue to refer to paragraph 3.7 of SS4/15 – Solvency II: the solvency and minimum capital requirements, regarding applications to the PRA for a waiver or modification of Solvency Capital Requirement – Internal Models 12.2. The use of approximations in those circumstances will still be possible, subject to the prior permission of the PRA, and firms currently using such approximations will not be affected. The PRA considers that Article 238 of the SII CDR is not needed to cater for a situation in which a firm is unable to comply fully with Solvency Capital Requirement – Internal Models 12.2. The PRA can achieve equivalent outcomes to existing Article 238 of the SII CDR by continuing to consider such situations on a case-by-case basis, and via the specification of firm-specific rule waivers or modifications.

3.25 Appendix 11 provides detail on the proposed changes to each of the existing IM T&S.

3.26 Overall, the proposed approach would represent a significant reduction in the quantity of T&S applicable to IMs from the existing IM T&S.[29] If necessary, the PRA would continue to clarify expectations for meeting rules in the PRA Rulebook using future SSs. This could include, for example, any potential future decision to consult on the application of general model risk management principles to insurers.[30]

3.27 Under the proposed new UK framework, the PRA would no longer refer to 'tests and standards' or 'T&S' in the future, but to 'internal model requirements' or 'IM requirements'. 'Internal model requirements' is defined as Solvency Capital Requirement – Internal Models 10 to 16A. For the remainder of this chapter 'T&S' will only be used to refer to the existing framework when it is necessary to distinguish from the proposed new framework.

3.28 The proposed set of internal model requirements would rely on ongoing engagement between firms and the PRA, and potentially additional data submissions through the IMOR framework. The PRA would aim to minimise the level and frequency of requests from firms.

Validation of internal models

3.29 The PRA recognises the importance of robust validation of IMs to enable firms to better understand the capabilities and limitations of their IMs and to ensure that the IMs meet the high standards required. The PRA considers that understanding firms' IM changes and the causes of movements in SCR over time are a valuable part of the IM validation process.

3.30 The existing framework requires firms to complete a profit and loss (P&L) attribution exercise as part of firms' IM validation processes (eg, as set out in Article 242 (2) of the SII CDR). The PRA recognises the importance of analysing the evolution of firms' IMs as an important component to assess their ongoing adequacy. However, the PRA considers that firms could do this more effectively through an analysis of the movement in SCR produced by the IM over a period. Therefore, the PRA proposes to remove the rules relating to P&L attribution in the existing framework. Firms could choose to continue to complete a P&L attribution exercise internally if it adds value to their risk management processes or IM validation, but the PRA would not generally expect to review the outputs of this exercise in the future.

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[29] Speech by Sam Woods in February 2023, **'Fundamental Spreads'** referred to this representing 70% of the rows in the current EIOPA SAT.

[30] SS1/23 – **Model risk management principles for banks**. In addition, the PRA noted in CP 6/22 – **Model risk management principles for banks** that, while the proposals in that CP may be relevant to insurance firms, given the Solvency II review the PRA had decided not to extend the proposals to insurers at that time. CP 6/22 also noted that the PRA intends to consider at a later stage whether there is a need to strengthen model risk management practices for insurers.

3.31 The P&L attribution requirements will be replaced with a new internal model requirement for firms to carry out an AoC exercise for changes in SCR, and submit the results (including the reasons for changes) to the PRA. The PRA understands that many firms complete AoC exercises internally on a regular basis. Both the P&L attribution and AoC exercise provide information about the IM's adequacy and how it responds to changes in risks. However, the PRA considers that an AoC exercise would be a more efficient tool than a P&L attribution exercise to understand the changes in SCR, and that it would be a more valuable IM validation tool. Submission of the AoC exercise results would also help the PRA to inform its supervisory strategy by providing insight into changes in firms' risk exposure. The proposed internal model requirement would facilitate the introduction of the IMOR framework. Further details of the AoC exercise are set out below in paragraph 3.67 onwards.

Widening the circumstances where the PRA can grant internal model permission

3.32 The existing framework requires firms to comply with all of the detailed T&S to receive IM approval. IM approvals are therefore currently binary in nature, requiring the PRA to be satisfied that IMs meet all T&S in full, or otherwise to reject the IM for regulatory purposes. Therefore, the existing framework does not allow for the possibility of approval of a sound, but not wholly compliant, IM even if there is scope to mitigate non-compliance with a particular T&S through other means. In many cases, this has led to protracted approval processes and disproportionate resource burdens for firms and the PRA. The responses to HMT's Call for Evidence demonstrated that firms have similar views over the binary nature of IM approvals.

3.33 Instead, the PRA considers that it would be preferable to be able to apply a more flexible way for IMs to meet the required standard, backed up by safeguards where necessary to retain high modelling standards. This would allow the PRA to widen the circumstances under which it may be possible to grant permission to a firm to use an IM. The PRA would continue as now to grant a firm permission to use an IM without safeguards, where it has met all relevant standards. In addition, the PRA proposes that in future it would also grant permission to a firm to enable it to use an IM that has some residual model limitations (RMLs), so long as safeguards are used to either mitigate the effect of, or in some cases, correct those limitations. The proposed safeguards are described in paragraph 3.35. The PRA would consider granting permission to firms to use IMs, with safeguards, provided that the non-compliance with the internal model requirements and calibration standards stemming from RMLs, as judged by the PRA, are individually, and when considered overall, not significant, in all the circumstances in which the IM is to be used.

3.34 Under the proposed new framework, safeguards would be used to allow the PRA to grant permission for a firm to use an IM that had an RML. The PRA considers that this could allow a more proportionate route to granting permission to a firm to use a satisfactory IM compared to the existing approach where such RMLs would prevent PRA approval. This is because the existing approach can often involve significant resources, from both firms and the PRA, to ensure that every shortcoming assessed against each T&S and the calibration standards is corrected prior to approval.

3.35 To allow for this flexibility and move away from the binary nature of IM approvals, the PRA proposes to maintain modelling standards by introducing two types of safeguards where RMLs exist. Firms could accept the PRA’s use of these safeguards to support granting of a permission to use an IM, notwithstanding the existence of an RML. The PRA could set:

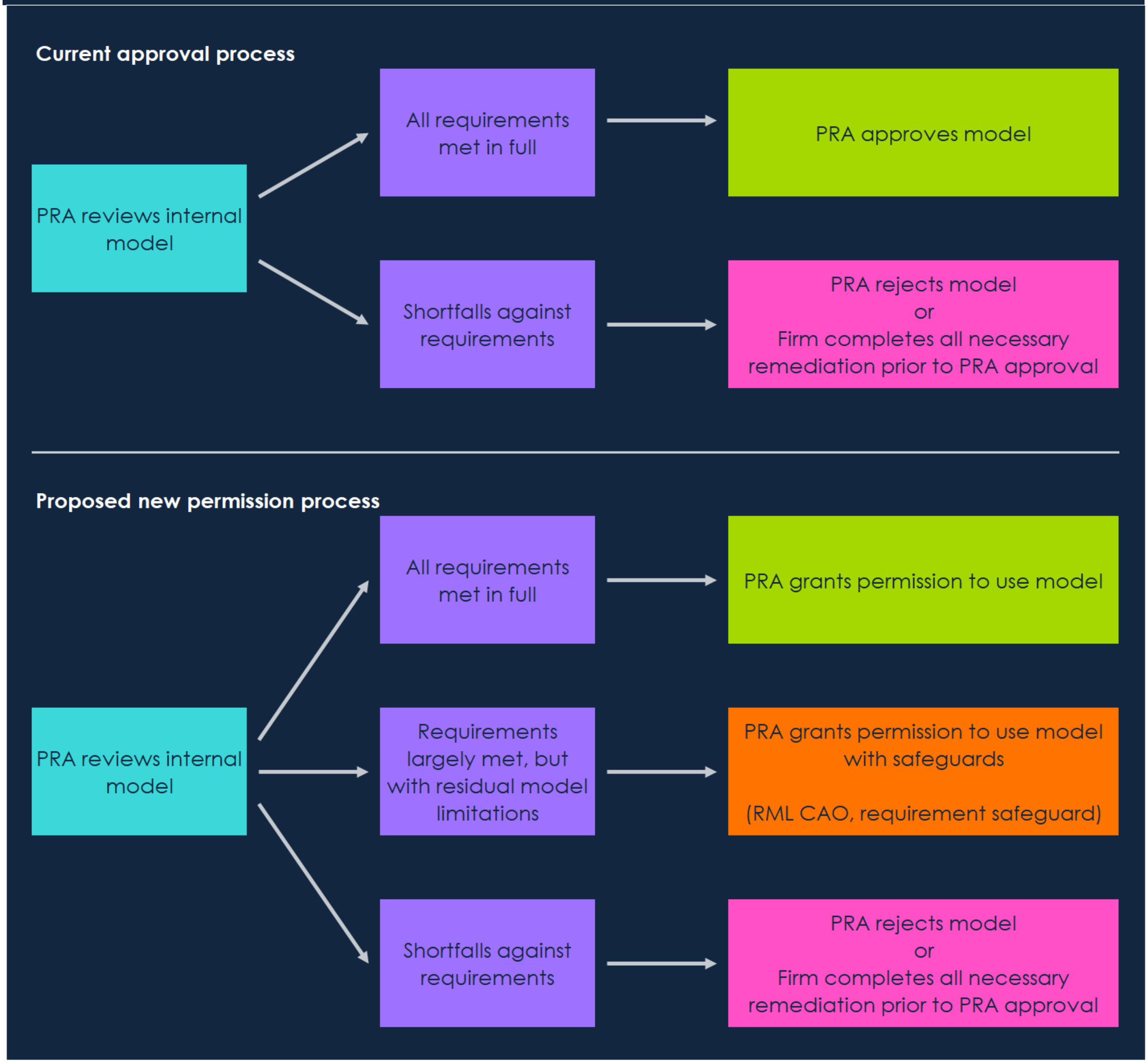
- an RML capital add-on (RML CAO), intended to mitigate the effect of non-compliance with the internal model requirements, and/or ensure compliance with the calibration standards. RML CAOs address an IM residual deviation. ‘IM residual deviations’ would be defined in the PRA Rulebook as a residual deviation in the risk profile of a firm from the assumptions underlying the SCR. In order to avoid lowering modelling standards, the PRA proposes to grant an IM permission with RML CAOs only where the deviation from a firm’s or group’s risk profile is not considered significant. Where the RML CAO mitigates non-compliance with internal model requirements, the PRA would waive or modify the relevant internal model requirements for the period during which this safeguard is in place, so that the firm would not be in breach of these requirements. RML CAOs are discussed further in Chapter 4 of this CP; and

- a requirement safeguard, which is a qualitative requirement that would apply to a firm’s business practices or IM use. A requirement safeguard would ensure that the IM is, and remains, appropriate for the firm’s (or group’s) risk profile, and would mitigate the risks of any non-compliance with the internal model requirements caused by the RML. Unlike RML CAOs, requirement safeguards are not expected to impact firms’ SCRs. The PRA may also waive or modify the underlying internal model requirements for the period during which this safeguard is in place.

3.36 Use of either safeguard is not intended to lower modelling standards. In particular, where use of the new RML CAO is considered, the PRA will continue to reject IMs which use assumptions that reflect significant deviations from a firm’s risk profile. However, an RML CAO may be used to expedite the PRA’s approval of sound but not fully compliant IMs. The proposed safeguards are discussed further in the proposed new SoP – Solvency II internal models: Permissions and ongoing monitoring. Where a safeguard is used to mitigate non-compliance with the internal model requirements as part of granting permission or variation of an existing permission to enable a firm to make a major model change, the PRA would waive or modify the relevant internal model requirements. In that case, the firm would need to comply with the internal model requirements, as waived or modified by the written notice issued to it by the PRA.

3.37 The PRA’s intention is that the availability of these proposed safeguards would allow IMs that are not wholly compliant (and therefore could not be approved under the existing framework) to be granted permission with a safeguard. It thereby expands the range of options available to firms to gain permission for an IM, and for the PRA to grant permission in a wider set of circumstances than is currently the case. The PRA would be able to use safeguards to facilitate granting of an IM permission more quickly than would be the case if a firm was required to address the limitation prior to permission being granted. As noted above, the PRA would continue to reject sub-standard IMs where modelling does not appropriately reflect firms’ risk profiles, or where safeguards cannot adequately mitigate or correct non-compliance, or where their use would be inappropriate. The proposed safeguards would be exogenous to the IM, and not part of the IM. The PRA would review all safeguards regularly using the IMOR framework outlined in paragraph 3.54 onwards. Chart 6 below demonstrates the range of outcomes from the new IM permission process.

Chart 6: Moving from the current approval process to the proposed new permission process.



3.38 Some examples where permission could be granted to use an IM with the proposed safeguards and illustrating what sort of IM limitations are considered 'residual' are shown in Table 1 of Appendix 12, alongside an illustration of the potential timeline for removal. These examples are not exhaustive of the actions the PRA may decide are appropriate to take. The timeline indicates the point at which the PRA would expect the firm to approach the PRA to assess progress in the remediation of the RML and decide whether to remove the safeguard, or the PRA may decide to escalate the safeguard. The examples illustrate individual safeguards that are geared at addressing RMLs. The PRA would consider the application of more than one safeguard, as necessary. In doing so, the PRA would consider whether the need for several safeguards is indicative of inadequacies in the IM, where the overall effect of such inadequacies goes beyond purely RMLs.

3.39 The PRA would only grant a permission where the firm complies with the calibration standards (either the IM on its own, or with an RML CAO safeguard) and where safeguards adequately mitigate non-compliance with the internal model requirements. This is demonstrated by the examples in Table 1 of Appendix 12. The PRA may also grant permission where an IM, even when combined with safeguards, does not comply with all of the internal model requirements, provided that the IM, combined with the safeguards, satisfies the calibration standards. The PRA considers this outcome may be appropriate, provided the non-compliance with each of the internal model requirements is not significant, nor is the non-compliance overall, and where safeguards mitigate any associated risks.

3.40 Once the firm had remedied the identified RML and demonstrated to the PRA that the remediation was appropriate, the safeguard would be removed. This is expanded on in paragraph 3.51. If the removal of the safeguard represented a major model change, firms would need to submit an application to the PRA for a variation of their IM permission.

3.41 In addition, given these proposals to extend the set of circumstances in which IM permission may be granted, the PRA proposes to formalise existing arrangements whereby firms address residual IM weaknesses, shortcomings, or uncertainty by incorporating MLAs into their IMs to ensure compliance with the calibration standards. Firms currently use MLAs, although they may refer to them by other names, such as ‘out-of-model adjustments’, ‘unmodelled adjustments’, or ‘loadings’. MLAs form part of a firm’s IM.

3.42 Under these proposals, an MLA would be defined, broadly, in the PRA Rulebook as a capital adjustment calibrated and applied in the IM which contributes to the calculation of a firm’s SCR (or a group’s SCR), and that is intended to ensure that it complies with the calibration standards. MLAs are not safeguards, and the PRA expects that firms will have plans in place to address the underlying issues over time.[31] MLAs would be considered by the PRA during the normal process of granting IM permissions and when reviewing AoC submissions as part of the IMOR framework. In addition, where these MLAs constitute minor or major changes within a firm’s IM change policy, they would be considered during the process of granting permissions for variations to IMs to enable a firm to make a major model change, or changes to the IM change policy as appropriate, and of reviewing submissions of quarterly model change information.

3.43 Firms should consider whether the use of MLAs could put them in breach of Solvency Capital Requirement – Internal Models 12.2, which requires a firm to derive its SCR directly

[31] Paragraph 3.29 of SoP – Solvency II internal models: Permissions and ongoing monitoring.

from the probability distribution forecast generated by its IM. In that case, firms should consider whether it would be appropriate to apply to use approximations in deriving their SCRs. Firms can refer to paragraph 3.7 of SS 4/15 regarding applications to the PRA for a waiver or modification of Solvency Capital Requirement – Internal Models 12.2.

3.44 The PRA expects that each MLA will be (or result in) a positive increase to the SCR. This is because negative MLAs (which reduce the SCR) could lead to a reduction in overall modelling standards, since it would allow a firm to benefit from a lower SCR due to a model limitation.

3.45 Non-exhaustive examples of where the PRA expects:

- it would be reasonable for firms to propose MLAs are highlighted in Table 3 of Appendix 12.
- it would not be reasonable for firms to propose MLAs are highlighted in Table 4 of Appendix 12.

3.46 The PRA proposes to make changes to its rules and policy to facilitate it granting permission under the new power in section 138BA of FSMA to waive or modify the PRA's rules on the calculation of the SCR to allow the use of an adequate IM, with safeguards to address RMLs. This would increase the range of IM permission application outcomes to:

- permission granted, where the PRA considers that the IM meets the calibration standards and internal model requirements (the internal model requirements would be defined as Solvency Capital Requirement – Internal Models 10 to 16A);
- permission granted in combination with a safeguard(s):
    - an RML CAO safeguard to ensure compliance with the calibration standards, where there is an RML that relates to these standards; and/or
    - a safeguard to mitigate the effect of non-compliance with the internal model requirements, where there is an RML that impacts the firm's compliance with those requirements. This safeguard could take the form of an RML CAO, (which could be the same RML CAO necessary for ensuring compliance with the calibration standards) or, a requirement safeguard;
- permission rejected, where the proposed IM would not meet the SCR calibration or internal model requirements, and safeguards would not adequately mitigate non-compliance with internal model requirements or enable the firm to meet the calibration standards.

3.47 Table 5 of Appendix 12 provides some concluding examples of the mitigating effects of proposed safeguards and MLAs on IM permissions.

3.48 The PRA proposes to amend the Glossary and Solvency Capital Requirement – Internal Models Part (Annex A and F of Appendix 2) to include definitions of the terms 'internal model safeguard', 'internal model residual deviation', 'residual model limitation' and 'model limitation adjustment'. The PRA also proposes to amend the Solvency Capital Requirement – Internal Models Part to reflect the proposed new framework.

3.49 The proposed new SoP – Solvency II internal models: Permissions and ongoing monitoring (Appendix 5) expands on the detail in this section:

- section 2 contains the proposals for how the PRA will grant permission for IMs of individual firms and groups;
- section 3 contains the PRA's proposals to grant permission for IMs with safeguards to address RMLs;
- section 4 contains the PRA's proposed approach for cases where the Standard Formula is not appropriate for a firm's risk profile. These proposals replace the equivalent text in SS4/15 – **Solvency II: the solvency and minimum capital requirements** without changing the policy intent; and
- section 5 contains the PRA's proposed approach to the IMOR framework.

Implementation of internal model permission safeguards

3.50 The PRA proposes to consider use of RML CAOs and requirement safeguards at the stages, for solo firms and groups, of new IM permissions or variations to existing permissions, and subsequently in reviews within the IMOR framework. The implementation of RML CAOs is expanded on in Chapter 4 of this CP.

3.51 The PRA proposes that, where they are needed, both RML CAOs and requirement safeguards would be set out in a written notice sent to the firm, and varied, where appropriate. The removal of either type of safeguard would require a subsequent PRA decision (as opposed to self-determination by the firm). Such decisions would engage the PRA's existing decision-making framework. For the safeguard to be removed, the firm would be required to demonstrate to the PRA that it had adequately remedied the underlying RML. The format of the firm's demonstration to the PRA could range from a written request by the firm, along with supporting information, to an application to vary permissions for a major model change. Using example A in Table 1 of Appendix 12 to depict this, after a suitable time period, during which the firm acquires additional external data spanning a sufficiently large time period, the firm could apply to the PRA to remove the safeguard, having remedied the lack of relevant data.

3.52 The proposed amendments to the PRA Rulebook to support this policy proposal are contained in Appendix 2.

3.53 The PRA proposes to regularly publish a report on safeguards (RML CAOs and requirement safeguards) and CAOs. The PRA would publish this information on an aggregate basis to preserve anonymity regarding requirement safeguards and any commentary around safeguards in general. CAOs would continue be disclosed by individual firms within their Solvency and Financial Condition Reports (SFCRs), and this would also apply to RML CAOs.

Supervisory review process: internal model ongoing review

3.54 Under the existing framework, the PRA carries out a programme of assessment of the continuing appropriateness of approved IMs. The PRA makes use of firm-specific 'deep-dives', supervisory engagement, thematic reviews, and model drift analysis to monitor IMs. In addition, Solvency Capital Requirement – Internal Models 10.3 requires a firm to ensure the ongoing appropriateness of the design and operations of its IM and that the IM continues to appropriately reflect the risk profile of the firm.

3.55 The review and assessment of ongoing compliance with the internal model requirements and calibration standards is therefore a well-established part of the Solvency II framework and PRA practice. Nevertheless, the PRA considers that it is appropriate to update its approach to reflect the changes set out elsewhere in this chapter (eg removal of the P&L attribution requirement, introduction of the AoC exercise, increasing the range of IM permission application outcomes) while also improving the transparency of the PRA's approach, as well as the consistency and regularity of the information gathered. The proposed IMOR framework, as set out below, aims to address this.

3.56 The IMOR framework would consist of four 'strands'. It would leverage the existing approach taken to monitor IMs, with adaptations derived from the reforms set out in this chapter. Chapter 5 of the proposed new SoP – Solvency II internal models: Permissions and ongoing monitoring (Appendix 5) describes the PRA's proposed approach to IMOR.

3.57 As is currently the case under the Solvency II supervisory review process, where the IMOR framework identifies RMLs in the IM, the PRA would expect firms to make all reasonable efforts to remediate the RML appropriately. For example, the RMLs could be remedied through use of CAOs.

The four strands of the internal model ongoing review framework

Strand 1 – PRA-driven thematic schedule

3.58 The PRA would continue to use **thematic work** as part of its approach to the supervision of firms and, in particular, to engage with firms on the ongoing appropriateness of their IMs. As is current practice, the PRA intends to take a proportionate approach to such exercises, taking into account market conditions and other regulatory requirements at the time.

3.59 These exercises could highlight potential areas of engagement with firms. When determining whether or not this engagement should be initiated, the PRA would consider information from the other strands of the IMOR framework, discussed below.

Strand 2 – Analysis of change exercise

3.60 As noted earlier in this chapter, the PRA proposes to require firms with IMs to complete an annual AoC exercise covering movements in their SCR, and submit the results of the exercise to the PRA. The AoC exercise would compare the change in their SCR as at firms' most recent financial year-end and their SCR as at their previous financial year-end. The proposed requirement would be included as Solvency Capital Requirement – Internal Models 13A.[32] Where appropriate, a firm could also be expected to carry out an AoC exercise and submit the results to the PRA where it sought a new IM permission or a variation of its existing IM permission from the PRA, as explained in section 10 of the proposed updated version of SS17/16 (Appendix 10).

3.61 Under these proposals, firms would be required to submit the results of the AoC exercise using a new reporting template, named AoC.01, and supporting narrative documentation providing reasons and documentary evidence to support those reasons, explaining any change in SCR. Further information on the PRA's expectations of firms in respect of the AoC template and supporting documentation is contained in SS17/16. The proposed AoC requirement is expanded on in paragraphs 3.67 onward. Appendix 25 contains the proposed template and log file of instructions.

Strand 3 – Assessment of ongoing internal model compliance

3.62 The PRA proposes that firms would be expected to provide an annual attestation that the firm satisfies the calibration standards and internal model requirements (subject to any waiver or modification of those requirements), and any additional requirements imposed by the PRA in relation to the firm's IM, unless otherwise agreed between the PRA and the firm.

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[32] The proposed requirement would also be set out in Articles 19 and 35 of Chapter 2A of the Reporting Part in the PRA Rulebook.

Firms would further be expected to attest that, where there is non-compliance with any of these requirements, the firm satisfies all other relevant requirements, and that the firm has a credible plan to address any non-compliance identified by the IM validation process.

3.63 The attestation would be completed by an appropriate individual in a Senior Management Function role, in most cases the Chief Risk Officer (SMF4). This expectation is included in paragraph 2.9 of the proposed new SS (Appendix 6). The attestation could form part of a firm's IM validation report. If necessary, the PRA would engage with a firm on any concerns over the stated IM non-compliance and may take action as appropriate. The proposed new expectation is similar to the banking approach where internal ratings are used to calculate regulatory capital requirements.[33]

Strand 4 – Monitoring of safeguards

3.64 As described in previous sections, under the proposals in this chapter, the PRA may set safeguards upon granting new IM permissions to address any RMLs, or variations to those permissions. Over time, there is a risk that these safeguards no longer achieve the purpose for which they were set, due to changes in the firm's business, risk profile, or IM. To address this risk, the PRA proposes to introduce the ongoing review of the appropriateness and effectiveness of these safeguards. This could include reviewing whether the safeguard continues to effectively rectify or mitigate the non-compliance it was set for.

Reporting amendments including the analysis of change

3.65 The PRA proposes to make changes to the reporting templates relevant to IM firms. In particular, the PRA proposes to introduce a requirement for firms to carry out an AoC exercise and submit the results in a new template, named AoC.01. Changes are also proposed to the QMC.01 reporting template that may be used for quarterly minor IM change submissions under the existing framework.

3.66 To support the proposed changes, (updated) log files of instructions will be published by the PRA for both reporting templates to support firms in the completion of the templates.

Analysis of change exercise

3.67 As set out in paragraph 3.60, to facilitate the ongoing review and assessment of compliance with the internal model requirements and calibration standards, the PRA proposes to introduce a requirement for IM firms to annually carry out an AoC exercise, covering their SCR movements between each financial year-end, commencing with the firm's first financial year end on or after 31 December 2024. Firms are required to submit their

[33] SS11/13 - **Internal Ratings Based (IRB) approaches**, October 2021, paragraphs 5.2-5.3.

results to the PRA. In addition, in some circumstances and where notified by the PRA, firms that seek permission from the PRA for the use of a new IM, or variations to an existing IM permission, would be expected to carry out and submit the results of an AoC exercise to the PRA. Reporting 2.5B specifies that the first AoC report would need to be submitted to the PRA commencing with the firm's or group's first financial year end on or after 31 December 2025 and the PRA therefore does not expect any submission before the beginning of 2026.

- This means that a firm with a 31 December financial year end would be required to carry out the analysis described in in Solvency Capital Requirement – Internal Models 13A for the first time for its 2024 financial year-end, comparing the SCR between year end 2024 and year end 2023, but would not be required to report this to the PRA. It is up to the firm when it does this analysis in the calendar year 2025, since the PRA does not require any submission in that year. The firm would use this analysis to prepare for submission in future years, for example, the firm may find it useful to discuss with the PRA any questions it has regarding the exercise, in advance of its first submission. In the following year, the firm would submit the first annual quantitative template AoC.01 and supporting narrative documentation within 70 business days of the 31 December 2025 year end, comparing the SCR between year end 2025 and year end 2024; in that year, the analysis aligns with reporting. The 70 business day period (or 100 business days in the case of a group) applies regardless of when in 2025 the firm carried out its previous analysis. The firm should then follow this process for every subsequent year.

- A firm with a non-December year end would also be required to follow this process.

    - A firm with a 30 June year end, for example, would submit quantitative reporting template AoC.01 and supporting narrative documentation for the first time in 2026 (within 70 business days of 30 June 2026), comparing the SCR between 30 June 2026 and 30 June 2025. However, this firm would still be required to carry out the analysis described in Solvency Capital Requirement – Internal Models 13A for the first time in the second half of 2025 or the first half of 2026, comparing the SCR between the 30 June 2025 (the firm's first financial year end on or after 31 December 2024) and 30 June 2024, but would not be required to submit this report to the PRA. Again, it is up to the firm when during that period it does the first analysis since there is no requirement to submit this to the PRA, and the 70 business day period (or 100 business days in the case of a group) applies regardless of when in 2025/2026 the firm carried out its initial analysis. The firm then follows this process for every subsequent year.

  - As another example, a firm with a 15 November year end, would submit quantitative reporting template AoC.01 and supporting narrative documentation for the first time in 2027 (within 70 business days of 15 November 2026), comparing the SCR between 15 November 2026 and 15 November 2025. However, this firm would still be required to carry out the analysis described in Solvency Capital Requirement – Internal Models 13A for the first time in 2025/2026, comparing the SCR between 15 November 2025 (the firm's first financial year end on or after 31 December 2024) and 15 November 2024, but would not be required to submit this report to the PRA. Again, it is up to the firm when during that period it does the first analysis since there is no requirement to submit this to the PRA, and the 70 business day period (or 100 business days in the case of a group) applies regardless of when in 2025/2026 the firm carried out its initial analysis. The firm should then follow this process for every subsequent year.

3.68 The PRA recognises the differences in preferred reporting styles between firms for their AoC exercises, reflecting both the differences in firms' risk profiles and the categorisation of the causes of SCR movements in the completion of the AoC exercise. Furthermore, the PRA understands that the structure of firms' internal AoC exercises may change and evolve over time. Considering this, the PRA proposes that the AoC.01 template would be largely free-form in structure, allowing firms to leverage their internal AoC exercises.

3.69 Alongside the submission of AoC.01, firms would be required to submit supporting narrative documentation to the PRA providing reasons, and documentary evidence to support those reasons, explaining any change in SCR. In the supporting narrative documentation, the PRA would also expect firms to submit information on:

- the governance process followed in the completion of the AoC exercise;
- the definition of material used in the AoC exercise;
- the reasons for any movement in diversification benefit over the period;
- any internal actions taken following the completion of the exercise; and
- an up-to-date list of MLAs and CAOs which contributed to the calculation of the most recently reported SCR.

3.70 The proposed AoC.01 template and associated log file of instructions are included in Appendix 25.

Quarterly model change logs

3.71 Under the existing framework, IM firms are expected to provide a quarterly summary of minor model changes to the PRA, as set out in SS17/16. Firms currently have the option to use the QMC.01 template to report minor model changes to the PRA, or may choose to report changes in an alternate way. The PRA proposes to streamline the content required in the QMC.01 template by reducing the number of entries required for each IM change. The PRA also proposes to require all firms to use the streamlined QMC.01 template and submit supporting narrative documentation to report both minor and major model changes over each quarter. The submission would include any changes in MLAs that are considered to be IM minor or major model changes, as described in paragraph 3.27 of the proposed new SoP – Solvency II internal models: Permissions and ongoing monitoring.

3.72 Chapter 7 in this CP sets out the PRA's proposals regarding the quarterly model change reporting requirements, including the proposals to transfer these into PRA Rules and SS17/16. The proposed QMC.01 template and associated log file of instructions are included in Appendix 25.

PRA objectives analysis

3.73 The proposals in this chapter do not include any weakening of the existing calibration standards in the PRA Rulebook and the PRA would therefore expect an IM firm's SCR to continue to comply with the 1-in-200 VaR requirement. The need for IMs to comply with all T&S has provided a key source of protection to advance the PRA's primary objectives of safety and soundness and policyholder protection in the existing framework. The PRA considers that: (i) the ability to grant IM permission with safeguards (where necessary); and (ii) the ability to assess an IM with safeguards (where necessary) against a streamlined set of more principles-based internal model requirements, would deliver a similar and equally appropriate level of protection as the existing framework.

3.74 In addition, the existing T&S contain many detailed, prescriptive provisions. This can provide clarity of what is required for both firms and supervisors, but limits flexibility for firms in their approaches to modelling risks and meeting the T&S. The PRA's proposals to not transfer some T&S, that provide limited prudential benefit, would give firms greater flexibility to adopt approaches aligned to their business and risk profiles. As a result, the PRA expects these proposals to advance its secondary competition objective.

3.75 Furthermore, the PRA expects that a more flexible framework could help make the existing IM approval process more efficient and create scope for a wider range of IMs to be granted permission for both current and future IM firms, thereby facilitating effective competition. However, any potential increase in the inconsistent treatment of firms arising from a more principles-based approach could have a negative impact on effective competition. The PRA plans to mitigate this risk through regular review of the use of safeguards in IM permissions and as part of the IMOR framework.

3.76 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter would facilitate, subject to aligning with international standards, the international competitiveness of the UK economy and its growth in the medium to long term. The PRA expects benefits to the competitiveness and growth of the UK economy through reduced compliance costs and burden of the IM permission application process, and greater flexibility in modelling approaches. The PRA has developed the proposals on changes to the IM framework to be consistent with the relevant existing insurance core principles and emerging international standards.

3.77 There is a risk that a significant reduction in prescriptive internal model requirements and an increase in scope for supervisory judgement could lead to inconsistent or weakened modelling standards. However, the PRA considers that this risk would be adequately mitigated by the proposals to supplement the requirements with supervisory expectations for firms. In addition, the PRA considers that the proposed use of safeguards to support wider IM permissions, where necessary, would ensure appropriate modelling standards are maintained without needing to retain the current prescriptive requirements. There is also a risk that safeguards to support IM permissions, where used, do not (fully) mitigate the non-compliance stemming from RMLs in practice. Post-permission monitoring of IMs and safeguards, as part of the proposed IMOR framework, would provide the PRA with additional information on these risks. It would also allow the PRA the opportunity to take timely supervisory action to ensure safeguards remain effective and appropriate in changing circumstances. Furthermore, any increase in model risk occurring while the underlying RML(s) remain in place would be mitigated by the PRA's proposed rules requiring firms to make all reasonable efforts to remedy the RML that led to the imposition of an IM safeguard, and regular review of safeguards.

3.78 The proposed IMOR framework would increase the PRA's assurance that firms' IMs remain appropriate and thereby advances the PRA's primary objectives. In particular, the PRA has previously found that information collated from thematic exercises (strand 1) undertaken in the existing framework provided valuable insight into emerging risks across the industry and identified areas of future regulatory focus. Furthermore, the introduction of the AoC exercise requirement (strand 2) would provide the PRA with insight, which is not currently available elsewhere, to improve the PRA's understanding of firms' risk profiles and to identify areas of regulatory focus for the future. The exercise would also enable the PRA to monitor firms' model drift through a top-down assessment of how firms' SCRs move over time. The expected attestation (strand 3) would align the Solvency II IM governance with similar practices followed by banks, as explained in paragraph 3.63. Furthermore, it could ensure that a firm's validation report has sufficient visibility within the firm, and improve the risk management within a firm and consistency of risk management across the industry. As described in paragraph 3.64, the ongoing monitoring of safeguards (strand 4) would ensure the appropriateness of them over time.

Cost benefit analysis

3.79 The baseline for the CBA is the current Solvency II rules and legislation.

3.80 There are currently 30 partial and full IMs with approval for use from the PRA, which would be affected by these proposals. Other firms that would seek permission for an IM in future would also be affected by the proposals.

Benefits

3.81 The PRA's proposals to move to a more principles-based framework would be expected to improve the efficiency of decisions made in the PRA's review of IM permission applications.

3.82 There are expected to be cost savings for firms with new IM permission applications and firms undergoing regular IM changes. From the **Quantitative Impact Study (QIS)** exercise, compliance costs were estimated to be £20 million on average for solo firms for a new IM application and £1.75 million for a major model change. However, firms recognised the potential for the proposed framework to reduce costs. The QIS responses suggested that the potential cost savings relating to IM applications under the proposed framework could be up to 25%. These estimated cost savings are expected to arise from less onerous documentation requirements and an overall less prescriptive framework. The PRA recognises that there are differences between the proposals in this chapter and firms' QIS responses. However, the PRA expects there to be lower overhead costs for firms when completing the SAT. In addition, the PRA expects lower overhead costs for firms in providing evidence against the consolidated internal model requirements under the proposed framework, rather than layered requirements sitting across legislation and PRA rules.

3.83 Under the new framework, the proposed removal of the binary nature of IM approvals should allow firms to benefit from more efficient and quicker IM permissions, and should allow some IMs to be granted permission (with safeguards) by the PRA in cases where approval is not currently possible. This is balanced with temporary impacts associated with the use of safeguards, where appropriate and where firms agree to the necessary safeguards in order for IM permissions to be granted.

3.84 Under the existing IM framework, the PRA must assess IM (change) applications against a large number of EIOPA T&S, as exemplified by the EU-wide assessment checklist which refers to 194 individual T&S. Reducing the number of T&S, in particular, the extensive and detailed documentation that firms are required to submit as part of their IM approval applications, could benefit firms by freeing up resource. This resource could instead be better allocated to focus on improving modelling in support of business initiatives, or increased investment in new, sustainable, and productive assets.

3.85 Less prescriptive and more principles-based internal model requirements, supported by the use of safeguards where needed to support the granting of permission for IMs with RMLs which could not currently receive approval, may make it more cost effective for a smaller firm to meet the required standards, rather than meeting all specified T&S under the existing framework. However, any increase in the number of new IM permission applications is expected to be modest.

3.86 Reduced compliance costs and quicker permissions granted for firms to tailor an IM to their risk profile may support investment in new asset classes.

Costs

3.87 The reform proposals would streamline the large number of the existing T&S, retain others, and only introduce one new internal model requirement for firms to complete an AoC in SCR movements. The PRA expects there would be some one-off costs for all firms in scope to review the updated internal model requirements and adjust their own processes and approach to demonstrating ongoing compliance with them. However, firms with existing IM permissions will already have processes in place to assess the ongoing compliance with the existing T&S. Therefore, the one-off compliance cost for firms with existing IM permissions is expected to be immaterial.

3.88 For example, following the removal of the P&L attribution T&S,[34] some firms may choose to simplify their P&L attribution analysis. The PRA expects the respective cost savings would heavily offset the additional costs arising from the proposed new AoC internal model requirement. In addition, the PRA expects that most firms already complete an AoC exercise internally. Due to the free-form nature of the reporting template, the PRA expects that firms would leverage this in the submission of the AoC exercise to the PRA. Therefore, the net ongoing compliance costs for the proposed new AoC internal model requirement is not expected to be significant (this is expanded on in Chapter 7 of this CP).

3.89 As described in paragraph 3.62, under strand 3 of the IMOR framework, the PRA would expect an appropriate individual within a firm to produce a written attestation that the firm's IM meets the calibration standards and internal model requirements. The PRA does not expect this to be an onerous expectation since firms' validation processes are already

[34] Solvency Capital Requirement - Internal Models 13.1, 13.2 and 13.3.

required to ensure that IMs meet the requirements on an ongoing basis under the existing framework. Therefore, firms will already have an annual process in place, where the output is the IM validation report, to support the proposed attestation expectation.

3.90 The PRA is not proposing to change the existing calibration standards in the PRA Rulebook, which is a 1-in-200 Value-at-Risk (VaR) measure over a one-year time horizon. Therefore, the PRA would not expect material incremental balance sheet and SCR impacts as a result of the proposed reforms to the existing framework.

3.91 The proposed new RML CAO, if set, would affect firms' SCRs. However, the PRA does not expect a material increase in SCR, and the RML CAO would only be in place while the underlying RML remains. The PRA does not intend to grant permission to use an IM in combination with an RML CAO where a deviation from a firm's risk profile as regards the SCR is significant. This approach is in line with the PRA's expectation that firms' IMs would continue to be of a high standard. Furthermore, the PRA generally expects a firm's RML CAOs in aggregate to be less than 10% of its total SCR, as described in paragraph 2.9 in the proposed new CAO SoP – Solvency II: Capital add-ons. Therefore, the PRA would not expect the use of RML CAO safeguards to lead to a material increase in SCR.

3.92 There is a risk that some firms could try to submit under-developed and under-calibrated IMs, under the assumption that the PRA would apply safeguards that did not sufficiently mitigate RMLs. This would be a risk to the PRA's primary objectives and result in additional costs to the PRA in reviewing such IMs. The PRA expects this risk to be mitigated by the increased scope for supervisory judgement in reviewing IM permission applications and the PRA's power to reject permission for an inadequate IM. The pre-application process will also ensure that these risks are mitigated.

'Have regards' analysis

3.93 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposal:

1. Growth in the interests of consumers and businesses (HMT recommendation letter), and sustainable growth (FSMA regulatory principles):

The PRA considers that the proposals in this chapter could have marginal benefits for sustainable growth. The proposals to streamline and increase the flexibility of the IM framework could make it easier and quicker for firms to apply for, and be granted permission for, new IMs and major changes to IMs. These proposals also give greater flexibility in how firms can meet the internal model requirements, including for assets for which there are limited historical data. Firms will benefit from additional flexibility as regards IM permissions, which may be granted for a wider range of asset classes, and possibly more quickly than under the current framework. This could encourage additional investment in such asset classes and finance for productive investment.

2. Competitiveness (HMT recommendation letter):

The proposed reforms may provide marginal benefits to the competitiveness of UK IM firms, or firms that intend to apply for an IM, with reduced compliance costs and greater flexibility in modelling approaches. Reducing the burden of the IM application process would enhance the attractiveness of the UK as a place for insurers to establish business, and therefore encourage inwards investment.

The ability to use safeguards to mitigate the effect of, or in some cases correct, RMLs could help support IM (change) permission applications associated with innovative asset classes. It could support such applications by helping to compensate for any RMLs associated with eg a lack of historic data. This could facilitate additional investment in such assets, supporting innovation and improving competition within the UK insurance industry. As a result, the PRA expects the competitiveness of UK firms to improve through encouraging new firms to enter the industry, and existing firms to grow.

3. Efficient and economic use of PRA resources (FSMA regulatory principles):

The proposals in this chapter are expected to improve efficiency in activities relating to IM permission applications and reviews. The PRA expects a reduction in the up-front resource burden relating to IM assessments. This might be offset, to some extent, by the regulatory processes associated with the increased application of safeguards, as well as the need to update internal guidance and provide training to PRA staff on the proposed IM framework. However, the PRA would expect a modest overall reduction in PRA resource burden through:

- consolidation and reduction of the existing set of IM T&S, which may increase the efficiency of the PRA's review of IM (change) permission applications;
- a shift from the existing set of IM T&S to a more principles-based set of internal model requirements. This would promote more proportionate reviews of IM (change) permission applications by increasing scope to apply supervisory judgement; and
- use of safeguards (where needed) to address RMLs, which could reduce protracted discussions between firms and the PRA on technical issues.

The PRA proposes the use of MLAs, rather than out-of-model adjustments, under the new framework, as described in paragraph 3.41. Firms' use of out-of-model adjustments in their IMs under the existing framework lacks transparency and consistency across the industry. This makes it difficult for the PRA to understand the output of approved IMs. The proposed use of MLAs would improve the PRA's understanding of firms' use of that tool to address model limitations, weaknesses, and uncertainty.

While the proposed reforms are intended to modestly reduce resource burden, they would need to be carefully implemented to deliver that expected benefit. Less prescriptive internal model requirements may lead to an increase in PRA resources needed for IM assessments, as there would not always be a specific way to demonstrate compliance with the internal model requirements. This greater flexibility could lead to increased supervisory dialogue with firms which would increase PRA resources required. Furthermore, greater scope for supervisory judgement in applying the requirements could also result in increased supervisory dialogue with firms.

The PRA would seek to mitigate such risks by providing expectations, in the proposed new SS, of how a firm might demonstrate compliance with the new set of internal model requirements. Firms may choose to follow the approaches set out in the proposed new SS when demonstrating compliance. Therefore, the PRA would also provide internal guidance to PRA staff setting out how firms should be supervised against the expectations in the proposed new SS. This would aim to mitigate the risk of increased supervisory dialogue between firms and the PRA.

The PRA may expect a modest increase in IM permission applications as a result of the proposals in this chapter. However, the continued pre-application process will allow a good lead time to understand and manage when applications are likely to be submitted and to ensure that they are of a suitable quality.

4. Proportionality (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):

By streamlining substantially the internal model requirements, the proposed reforms would focus the information required for IM (change) permissions on those requirements that are necessary to ensure the PRA can advance its objectives. More principles-based requirements would allow the PRA to take a more proportionate approach in the review of firms' IM (change) permission applications. In addition, a more flexible IM permissions would provide a more proportionate and flexible approach to granting IM permissions where RMLs are present in the IM.

5. Publishing information relating to persons on whom requirements are imposed, or requiring such persons to publish information (FSMA regulatory principles):

The PRA's proposed publication of a regular report on its use of safeguards, as described in paragraph 3.53, would provide transparency on its use of this new approach while preserving anonymity regarding requirement safeguards and any commentary around safeguards in general. The report would serve to communicate to industry and other stakeholders how the PRA makes use of the new safeguards, improving their understanding of the PRA's operation of the new IM permissions framework.

6. Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):

The proposed reforms would clearly set out the substantially streamlined set of internal model requirements against which the PRA would assess an IM (change) permission application. The PRA proposes to publish two separate SoPs to provide additional transparency on the PRA's approach:

- SoP – Solvency II internal models: Permissions and ongoing monitoring sets out how the PRA would apply the IM permissions framework. This would provide firms with additional clarity and help to mitigate the risk of inconsistency that could arise from moving to more principles-based requirements. It would also indicate the circumstances in which the PRA considered different capital adjustment tools (MLAs and RML CAOs) to be appropriate.

- SoP – Solvency II: Capital add-ons sets out the PRA's approach to the use, application, and calculation of CAOs and clarifies the circumstances in which the PRA considers the use of RML CAOs would be appropriate.

3.94 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this set of proposals, it is because the PRA considers that 'have regard' to not be a significant factor for this set of proposals.

4. Capital add-ons

4.1 This chapter sets out the PRA's proposed approach for setting capital add-ons (CAOs) which would, except as noted below, broadly reflect the current retained EU law applicable to CAOs. The changes are intended to support the PRA's proposed new flexible approach, as set out in Chapter 3 – 'Internal models', to grant permission to use a full or partial internal model (IM) to calculate all or part of the SCR, and to vary an existing permission for a full or partial IM. The PRA's approach to granting model permissions is described in greater detail in the proposed new statement of policy (SoP) 'Solvency II internal models: Permissions and ongoing monitoring' (Appendix 5).

4.2 The proposals in this chapter would:

- introduce a new type of CAO as a model permission safeguard, to support granting of an IM permission by the PRA (or variation of an existing permission in the case of a major model change application), in order to ensure compliance with the relevant calibration requirements and/or mitigate non-compliance with the internal model requirements (as defined in the PRA Rulebook), where a model on its own does not meet those requirements, due to the presence of a residual model limitation (RML). The PRA considers that this approach will introduce more flexibility in the model permissions process and allow permission to be granted for a wider set of IMs than is possible at present;

- introduce a new approach for calculating a CAO for an IM significant risk profile deviation in exceptional circumstances, where the PRA has concerns that part or all of a firm's IM is inadequate or the SCR that the IM generates no longer appropriately reflects the firm's risk profile better than if the Standard Formula (SF) were used. The PRA proposes that the new approach would involve setting a CAO as a proportion of the difference between the firm's SCR and the SCR that would be calculated if it reverted to calculating part of all of its SCR using the SF, described in more detail in the section, 'Methodologies for calculating capital add-ons';

- maintain the requirement for firms to disclose CAOs set by the PRA;

- change the frequency with which the PRA reviews CAOs, from (at least) annually to on a regular basis; and

- introduce the publication of regular reports by the PRA, summarising its use of CAOs at an aggregate industry level.

4.3 Following revocation of the retained EU law proposed by the FSM Bill, the proposals in this chapter would:

- amend the Glossary, Solvency Capital Requirement – General Provisions, and Group Supervision Parts of the PRA Rulebook (Annexes A, E, N of Appendix 2);
- introduce a new SoP Solvency II: Capital add-ons (Appendix 13), with material broadly based on the current CAO-related requirements in retained EU law;[35]
- amend supervisory statement (SS) 4/15 – Solvency II: the solvency and minimum capital requirements (Appendix 14);
- amend SS12/15 – Solvency II: Lloyd's (Appendix 15); and
- amend SS9/15 – Solvency II: group supervision (Appendix 16).

4.4 The PRA considers the proposals in this chapter would advance its primary objectives of safety and soundness and policyholder protection. In particular, the proposed new RML CAO aims to broaden the ways in which an IM firm can meet the calibration standards in Solvency Capital Requirements – General Provisions 3.3 to 3.4, in the case where a firm's model has RMLs that prevent it from meeting the calibration standards on its own. The PRA expects the proposal for the new RML CAO would provide additional flexibility in granting IM permissions and, where used, could reduce compliance costs for firms, thereby helping to advance the PRA's secondary competition objective. The proposals in this chapter would also facilitate the international competitiveness of the UK economy and its growth in the medium to long term, as described below in the sections on 'PRA objectives analysis' and 'Cost benefit analysis'.

4.5 This chapter is relevant to UK Solvency II firms, the Society of Lloyd's, its members and managing agents, and all UK holding companies.

4.6 As a result of the proposals set out in this chapter, the PRA proposes some consequential amendments to reporting requirements, set out in Chapter 7 – Reporting and disclosure.

[35] Which include SII CDR Chapter X, CAO Implementing Technical Standard (ie Commission Implementing Regulation (EU) 2015/2012), and the Solvency 2 Regulations 2015/575. The PRA also proposes to transfer paragraph 3.2 of SS4/15, which transposes Article 37 of the Solvency II Directive, to the proposed new SoP 'Solvency II: Capital add-ons' (Appendix 13).

Background on the existing approach to capital add-ons

4.7 The PRA may decide to exercise its power to apply a CAO. A CAO is currently defined in the PRA Rulebook as 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 in any of the following circumstances, where:[36]

- there is a significant deviation in the risk profile of a firm from the assumptions underlying the SCR, where the firm calculates its SCR using the SF;
- there is a significant deviation in the risk profile of a firm from the assumptions underlying the SCR, where the firm calculates part or all of its SCR using an IM;
- a firm's system of governance deviates significantly from the relevant requirements;
- there is a significant deviation from the assumptions underlying the matching adjustment, volatility adjustment, TMIR, or the TMTP; or
- a specific risk existing at group level leads to a risk profile deviation.

4.8 The existing framework also allows for CAOs to be set at the level of a group, as described in the 'Group capital add-ons' section. As is currently allowed for within the existing framework, a CAO may be set at the level of the group where the circumstances set out in the list in the previous paragraph arise at group level.

4.9 Under the existing framework, when assessing whether a risk profile deviation as regards the SCR is significant (ie the first two cases in the list above), the PRA must consider all relevant factors, including the following:

- the nature, type, and size of the deviation;
- the likelihood and severity of any adverse impact on policyholders and beneficiaries;[37]
- the level of sensitivity of the assumptions to which the deviation relates; and

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[36] The first four circumstances set out in this paragraph apply to the group SCR when they are relevant to a group.

[37] The current CAO-related retained EU law refers to 'policyholders and beneficiaries'. The PRA Rulebook definition of 'policyholder' includes reference to 'beneficiary'. As such, the PRA proposes to delete explicit reference to 'beneficiaries' when including CAO-related material from retained EU law in the proposed new SoP 'Solvency II: Capital add-ons' (Appendix 13). The PRA does not intend for this to change the substance of the policy intent, ie reference to 'policyholder' will continue to include a beneficiary.

- the anticipated duration and volatility of the deviation over the duration of the deviation.

4.10 The PRA assesses the size of a risk profile deviation pursuant to the first factor in paragraph 4.9 by comparing:

- the SCR of the firm, excluding any previous or simultaneous CAO, that would be calculated if the SF or IM, as appropriate, were modified so as to reflect the actual risk profile of the firm and to ensure compliance with SCR – General Provisions 3.3 and 3.4; and
- the SCR of the firm, excluding any previous or simultaneous CAO.

4.11 The PRA applies quantitative thresholds set out in Table 2 to the outcome of the calculation set out in the previous paragraph, as part of its determination as to whether a risk profile deviation as regards the SCR is significant.

Table 2: Quantitative thresholds applied as part of the PRA's determination as to whether a risk profile deviation as regards the SCR is significant

The PRA detects a risk profile deviation that is <10% of the SCR.	The PRA may determine that the risk profile of the firm deviates significantly from the assumptions underlying the SCR, based on the factors set out in paragraph 4.9.
The PRA detects a risk profile deviation that is >=10% (and <15%) of the SCR.	The PRA must conclude that the risk profile of the firm deviates significantly from the assumptions underlying the SCR, unless there is strong evidence to the contrary, based on the factors set out in paragraph 4.9.
The PRA detects a risk profile deviation that is >=15% of the SCR.	The PRA must conclude that the risk profile of the firm deviates significantly from the assumptions underlying the SCR.

A new capital add-on to facilitate internal model permissions where residual limitations remain

4.12 An aspect of a firm's IM that prevents it from demonstrating compliance with calibration standards in Solvency Capital Requirement – General Provisions 3.3 to 3.4 and/or internal model requirements in Solvency Capital Requirement – Internal Models 10 to 16A, is referred to in this CP as an RML (which the PRA proposes to define in the Glossary of the PRA

Rulebook). Under the current framework, a firm's IM must comply with all relevant requirements at the point of approval; therefore, the PRA cannot currently grant approval for an IM with an RML. Chapter 3 of this CP sets out proposals to remove this 'binary nature' of model approvals, to permit the PRA to grant a firm permission to use a full IM or PIM which has RMLs, provided safeguards ensure compliance with Solvency Capital Requirement – General Provisions 3.3 to 3.4 and mitigate any non-compliance with the internal model requirements (Solvency Capital Requirement – Internal Models 10 to 16A).

4.13 One of the safeguards that the PRA proposes to introduce is a new type of CAO, to address RMLs that lead to a risk profile deviation called an internal model residual deviation (to be defined in the PRA's Rulebook). The purpose of an RML CAO would be to:

- ensure compliance with calibration standards in Solvency Capital Requirement – General Provisions 3.3 to 3.4; and/or
- mitigate non-compliance with the internal model requirements stemming from RMLs.

4.14 This new type of CAO, combined with the removal of the binary nature of IM permissions, may enable the PRA to grant a model permission more quickly and/or in a wider range of circumstances than is possible under the current framework. The additional flexibility afforded by these proposals may also increase the number of firms with model permissions, thereby resulting in more firms with SCRs that more appropriately reflect their risk profiles, as compared with SCR calculation using the SF.

4.15 The PRA's proposed use of RML CAOs is not intended to result in lower modelling standards. The PRA does not expect to grant IM permissions for models with significant deficiencies, in particular those for which a firm's risk profile deviates significantly from the assumptions underlying the SCR. Where the PRA determines that an IM firm's risk profile deviation as regards the SCR does not constitute a significant risk profile deviation, but rather an internal model residual deviation, it may consider setting an RML CAO to support granting of the model permission,[38] provided the RML CAO achieves the outcomes set out above.

4.16 The PRA does not expect that use of RML CAOs to support model permissions would result in materially higher levels of capital requirements. Under the current framework, firms must comply with the calibration standards and all internal model requirements, ie any shortfall in meeting those requirements would have to be resolved through further model development by a firm prior to any consideration by the PRA of whether to approve an IM or

[38] Or variation of an existing permission, in the case of an application for a major model change.

major model change.[39] Such developments are often time consuming and require significant additional resource. Under these reform proposals, the PRA is not proposing to change the 1-in-200 calibration standard for IM firms, but rather introducing flexibility for an IM firm to meet those requirements either directly with its model calibration, or through the combination of model and RML CAO. This is particularly the case where the size and nature of the deviation means that the PRA considers the voluntary application of model 'loadings' or 'out of model adjustments' by a firm (or group) to be inappropriate.

4.17 The PRA intends that an RML CAO would be an option available in the future for firms seeking initial permission for using a full or partial IM, firms applying for a major model change, or firms with existing permissions where the supervisory review process reveals deviations in a firm's risk profile or deficiencies in its models.[40] In all other circumstances, where the PRA has not raised concerns in accordance with the supervisory review process, the PRA does not currently intend to set RML CAOs for existing approved IM.

4.18 In determining whether a firm's risk profile deviates from the assumptions underlying the SCR (as calculated using an IM), and the degree to which that is the case, the PRA will consider all relevant factors, including those listed in paragraph 4.9. Pursuant to the first factor in paragraph 4.9, after determining the size of a risk profile deviation, the PRA will apply the quantitative thresholds set out in Table 2 to assess whether the risk profile deviation is significant. Where the PRA determines that the risk profile deviation constitutes an internal model residual deviation, as opposed to a significant risk profile deviation, the PRA will consider setting an RML CAO. In deciding whether to set an RML CAO in those circumstances, the PRA will consider all relevant factors, including:

- those specified in paragraph 4.9;
- the likelihood that the firm is capable of remediating the underlying RML in a reasonable timeframe; and
- the factors set out in paragraphs 3.4, 3.15, and in the case of groups, paragraph 3.5 in the proposed new SoP 'Solvency II IM: Permissions and ongoing monitoring' (Appendix 5).

4.19 The PRA's approach to using RML CAOs is also described in the proposed new SoP 'Solvency II: Capital add-ons' (Appendix 13). The associated proposed changes to reporting

[39] Such model development may include voluntary application of 'out of model adjustments', which usually reside outside of a model's core calculation kernel, but which are defined within the scope of an approved IM.

[40] See the section on IM ongoing review (IMOR) framework described in Chapter 3.

requirements needed to enable the PRA to monitor and review RML CAOs are set out in Chapter 7.

Methodologies for calculating capital add-ons

4.20 The PRA proposes to broadly base the material in the new SoP Solvency II: Capital add-ons (Appendix 13) on the current CAO-related requirements within retained EU law. The PRA proposes to largely maintain the current methodologies for calculating CAOs as specified under those requirements. In particular, the PRA proposes to maintain the proportionate hierarchy of methodologies for calculating a CAO for significant risk profile deviation as regards the SCR (currently set out in Article 283 of the SII CDR). The PRA proposes to also apply that hierarchy for calculating an RML CAO to address an internal model residual deviation. The approaches for calculating a CAO are described in more detail in Chapter 3 of the proposed new SoP 'Solvency II: Capital add-ons' (Appendix 13).

4.21 The main change that the PRA proposes to methodologies for calculating CAOs is to introduce an alternative approach for calculating a CAO for an internal model significant risk profile deviation as regards the SCR in exceptional circumstances. This method would sit outside of the aforementioned hierarchy of methods to calculate a CAO for risk profile deviations as regards the SCR. Where a firm calculates part or all of its SCR using an IM, and the PRA has concerns that part or all of the firm's IM is inadequate or the SCR that the IM generates no longer appropriately reflects the firm's risk profile better than if the SF were used,[41] the PRA would consider setting a CAO calculated as a proportion of the difference between the SCR calculated using a firm's IM and the SCR that would be calculated if:

- the firm's IM permission was varied (so as to reduce the scope of the model) so that model components with significant limitations reverted to calculating the SCR using the SF; or
- the firm's IM permission was revoked so that it was required to calculate its entire SCR using the SF.

4.22 As this method would only apply to the calculation of a CAO for an internal model significant risk profile deviation, the PRA would only consider using this approach to address concerns with a firm's model that develop following the granting of an IM permission. In other words, the PRA would not consider using this approach at the point of granting an IM

[41] In that case, the PRA may no longer have confidence that the IM is appropriate to the nature, scale and/or complexity of the risks to which the firm is exposed.

permission, or varying an existing IM permission as part of approving an application for a major model change.

4.23 The PRA may consider this approach to be a proportionate supervisory action in particular scenarios, such as those described in paragraph 3.36 of the proposed new SoP Solvency II internal models: Permissions and ongoing monitoring (Appendix 5). This approach may be used in advance of the PRA considering exercising its powers to vary an IM permission (so as to reduce its scope), or to revoke IM permission. The PRA considers that the conditions relevant to 'set off' of aspects of risk profile deviations described in paragraph 3.9 of the proposed new SoP 'Solvency II: Capital add-ons' (Appendix 13) are not applicable when applying the proposed new alternative approach for calculating a CAO described above.[42]

Group capital add-ons

4.24 The PRA proposes to delete group CAO material from SS9/15 – Solvency II: Group supervision and restate it in the proposed new SoP Solvency II: Capital add-ons (Appendix 13). The PRA also proposes to consolidate **guidelines 23 to 27 from the EIOPA Guidelines** on group solvency which relate to Group CAOs into the SoP, to provide groups with more clarity on the PRA's approach.

4.25 The proposed consolidation of those specific guidelines and the group CAO chapter from SS9/15 into the SoP is not intended to result in any policy changes. As is currently allowed for within the existing framework, a CAO may be set at the level of the group where any of the first four circumstances listed in paragraph 4.7 arise at group level. This may arise in the case of:

- a specific risk at group level leading to a risk profile deviation; or
- where a corresponding CAO has been set at solo level – in this case, the PRA would consider, where appropriate, setting a group CAO if the reasons underlying the solo CAO also apply at group level.

4.26 The PRA intends for the approach described in the previous paragraph to also apply to the proposed new RML CAOs.

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[42] 'Set off' refers to the situation where aspects of the risk profile deviation which indicate that a lower SCR would better reflect the firm's actual risk profile, are set off against the other aspects which indicate that a higher SCR is appropriate. The PRA considers that this 'set off' of aspects of risk profile deviations is not appropriate in the exceptional circumstances where the alternative approach would be relevant.

4.27 Similarly, in circumstances where a CAO is set at the level of the group, the PRA would consider whether the rationale for the CAO also applies at the level of any firms. Where that is the case, the PRA would consider setting a CAO at that level in addition. This approach would apply to the proposed new RML CAOs as well as to the existing CAOs arising as a result of any of the first four circumstances listed in paragraph 4.7.

Ongoing monitoring, reporting, and removal of capital add-ons

4.28 The PRA is currently required to review any CAOs set on a firm or group at least once a year. The PRA proposes in future that it will review CAOs on a regular basis, with the timing of reviews depending on case-specific circumstances, including the materiality of the CAO. The rationale for this change is to provide the PRA with more flexibility in how it applies its supervisory resources in a proportionate and efficient manner. In addition, the PRA is also currently required to review a CAO if there is a material change in the circumstances that led to the setting of the CAO. The PRA proposes to maintain this approach in future. Following its review of a CAO, the PRA will maintain, change, or remove the CAO.

4.29 For the avoidance of doubt, the PRA generally expects to review CAOs annually as part of the supervisory review process. For example, a CAO may be reviewed in the following circumstances:

- alongside the PRA’s reconsideration of SF appropriateness assessment, eg where the PRA has previously set a CAO for SF significant risk profile deviation;
- as part of the PRA’s consideration of a major model change application; or
- as part of the PRA’s review of model permission safeguards, which is a strand of the IMOR framework, described in Chapter 5 of the proposed new SoP – Solvency II internal models: Permissions and ongoing monitoring (Appendix 5).

4.30 Individual firms and groups would continue to be required to disclose any CAOs set by the PRA within their Solvency and Financial Condition Reports (SFCRs), and the PRA also proposes to apply this requirement to the new RML CAOs.

4.31 The PRA recognises the importance of developing a consistent and transparent approach relating to CAOs. To that end, the PRA proposes to publish regular reports at an aggregate industry level summarising its use of CAOs.

PRA objectives analysis

4.32 The PRA considers that the proposals in this chapter would advance its primary objectives of safety and soundness and providing an appropriate degree of policyholder protection, as explained below. The proposals would also be expected to support both the international competitiveness and growth of the UK economy and the PRA's secondary competition objective, as explained below.

4.33 The PRA considers that its proposal to introduce a new SoP – Solvency II: Capital add-ons (Appendix 13), with material broadly based on the current CAO-related requirements in retained EU law, would advance its primary objectives by largely maintaining a consistent approach as under the existing framework, ie one that firms (and groups) are familiar with.

4.34 The PRA considers that the proposed new RML CAO would advance its primary objectives by helping to operationalise the proposals in Chapter 3 of this CP. RML CAOs would be expected to mitigate any RMLs to the extent that they relate to non-compliance with the internal model requirements and to ensure compliance with the calibration standards. As such, the PRA expects RML CAOs to help deliver a similar level of policyholder protection as the existing approach, but in a more flexible manner (ie by permitting IM firms to meet the unchanged calibration standards through the combination of model plus RML CAO, as described in the section 'A new capital add-on to facilitate internal model permissions where residual limitations remain').

4.35 To the extent that RML CAOs provide additional flexibility and expediency in granting of IM permissions by the PRA (or variation of existing permissions, to enable a firm to make a major model change), their use could result in more firms seeking and obtaining permission to use an IM. This would advance the PRA's primary objectives by increasing the number of firms with SCRs that more appropriately reflect their risk profiles, as compared with SCR calculation using the SF. The PRA considers that its proposal to regularly review all CAOs (including RML CAOs) adequately mitigates the risk that the effectiveness and appropriateness of an RML CAO deteriorates over time (eg where it may no longer ensure compliance with the calibration standards or mitigate non-compliance with the internal model requirements, due to changes in a firm's (or group's) risk profile).

4.36 The PRA considers that maintaining the existing disclosure requirements relating to CAOs and extending those requirements to apply to RML CAOs will promote effective market discipline and help to advance policyholder protection by ensuring transparency as regards the composition of a firm's (or group's) SCR.

4.37 The addition of a new alternative method for calculating a CAO for an IM significant risk profile deviation would give the PRA another option to consider in exceptional circumstances, as described in 'Methodologies for calculating capital add-ons'. That approach could provide a more proportionate option than the PRA considering exercising its powers to vary or revoke model permission.

4.38 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA considers that the use of model permission safeguards such as the proposed new RML CAO would be expected to lead to more pragmatic and proportionate outcomes for firms, allowing greater use of IMs that better reflect firms' risk profiles than the SF. This may remove a barrier to firms taking advantage of business and investment opportunities (where these are dependent on receiving permissions to use an IM or to make major changes to an IM). It would also help to level the playing field between larger and smaller firms, with the latter potentially finding a more manageable route to obtaining permission to use an IM. As such, RML CAOs would be expected to support both the international competitiveness and growth of the UK economy and the PRA's secondary competition objective. The PRA has developed its proposals on changes to the CAO framework to be consistent with the relevant emerging international standards and existing Insurance Core Principles (ICPs), including **ICP 17.9 regarding variations to the regulatory capital requirement**.

Cost benefit analysis

4.39 The baseline for the CBA is the current Solvency II rules and legislation, in particular:

- the current legal framework for IM approvals;[43] and
- the current requirements relating to CAOs, which do not include RML CAOs.

4.40 The proposals in this chapter will affect any firms or groups for which the PRA sets a CAO for any of the circumstances listed in paragraph 4.7. The proposals, when combined with those in Chapter 3, would also affect all firms and groups with PRA approval to use a partial or full IM to calculate part or all of their SCRs, and other firms and groups that apply for an IM permission in the future.

4.41 The proposal to introduce a new SoP – Solvency II: Capital add-ons (Appendix 13), with material broadly based on the CAO-related requirements in the current framework, is not expected to create any benefits or costs, compared to the baseline.

[43] Under which the PRA can only grant approval if an IM meets all the IM requirements. Consequently, currently the PRA cannot approve an IM with an RML, and the PRA cannot set a CAO in response to an IM residual risk profile deviation.

Benefits

4.42 The PRA considers that the combined reform proposals in Chapter 3 (on Internal Models) and this chapter would likely benefit firms (and groups) by reducing compliance costs relating to applications for IM permissions.[44] In particular, the proposals to remove the binary nature of model approvals and to use safeguards to support IM permissions mean that firms/groups would have the flexibility to accept an RML CAO to obtain a model permission. This could potentially reduce time and resource burdens incurred by firms (and groups) during the application process, by avoiding protracted technical discussions.[45] The PRA would also expect to see a corresponding reduction in the resources it devotes to discussions with firms/groups on technical issues relating to IM permission applications.

4.43 The use of RML CAOs in a more flexible model permissions framework (as proposed in Chapter 3) may encourage more firms (or groups) to apply for permission to use an IM. If that happens, the PRA expects that those firms would likely benefit from improvements in their ability to identify, measure, monitor, manage, control, and report risks to which they are exposed more accurately and with enhanced granularity than compared with calculation of their SCRs using the SF.

4.44 Where a firm (or group) accepts the PRA's use of safeguards (including RML CAOs) to achieve the outcomes described in paragraph 4.13, the PRA expects that the benefits above are likely to materialise.

4.45 The proposal to maintain the existing disclosure requirements relating to CAOs and to apply them to RML CAOs is expected to extend the current benefits of effective market discipline and transparency as regards the composition of a firm's (or group's) SCR to that new type of CAO.

4.46 The PRA's proposal to introduce a new alternative method for calculating a CAO for an IM significant risk profile deviation in exceptional circumstances (described in the section 'Methodologies for calculating capital add-ons') is expected to provide the following:

- a benefit to firms/groups from changes in capital compliance costs, relative to the possible alternative of the PRA exercising its powers to vary or revoke an IM permission; and

[44] Both an application for an initial permission and for variation of an existing permission, to enable a firm (or group) to make a major change to its model.

[45] For example, developments to strengthen the model's calibration so that it complies with the calibration standards, without relying on an RML CAO.

- an overall benefit to safety and soundness and policyholder protection, by ensuring that a firm's (or group's) SCR is more appropriate for the risks to which it is exposed.

4.47 The PRA expects that its proposal to regularly publish a report summarising its use of CAOs at an aggregate industry level will provide transparency for firms and groups relating to the PRA's general use of CAOs, and on its use of RML CAOs to support a more flexible approach to IM permissions.

Costs

4.48 The proposed new type of RML CAO, if implemented (along with the proposals set out in Chapter 3), would be used by the PRA to achieve the outcomes set out in paragraph 4.13. Where the PRA uses those IM permission safeguards, it would affect firm/group-specific SCRs over the duration that the underlying RML remains in place. However, compared to the baseline, the PRA does not expect the use of RML CAOs to result in a material increase in the SCR of IM firms/groups, for the reasons set out in paragraph 4.16. In particular, the calibration standard will remain at a 1-in-200 level. In addition, firms (and groups) would continue to have the choice to pursue further model development to resolve any RMLs identified during the IM application process, instead of accepting model permission safeguards.

4.49 The proposal to maintain the existing disclosure requirements relating to CAOs and to apply them to RML CAOs is not expected to create any costs, compared to the baseline.

4.50 The PRA's proposal to introduce a new alternative method for calculating a CAO for IM significant risk profile deviation in exceptional circumstances (described in the section 'Methodologies for calculating capital add-ons') is expected to bring forward capital compliance costs, although those costs may be less burdensome than the possible alternative of the PRA exercising its power to vary or revoke an IM permission, which would require a firm/group to make more use of the SF to calculate its SCR.

4.51 The proposal for the PRA to regularly publish a report summarising its use of CAOs at an aggregate industry level is not expected to lead to a material increase in its costs, compared to the baseline.

4.52 Overall, the PRA considers that the proposals in this chapter (along with those in Chapter 3) would likely reduce costs for firms and groups, while delivering the benefit of added flexibility in the granting of an IM permission (or the variation of an existing permission to enable a firm to make a major model change). This will facilitate effective competition and international competitiveness and growth, while ensuring that the SCRs of IM firms and groups meet the calibration standards and appropriately reflect the risks to which those firms and groups are exposed.

‘Have regards’ analysis

4.53 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government’s economic policy set out in HMT’s recommendation letter dated December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK’s net zero emissions target. The PRA has had regard to this matter. The PRA considers the following factors, to which the PRA is required to have regard, as significant in its analysis of the proposals:

1. Sustainable growth (HMT recommendation letter and FSMA regulatory principles):

The PRA considers that the proposals in this chapter could have marginal benefits for sustainable growth. The use of safeguards such as the new RML CAO could help support the granting of an IM permission (or the variation of a permission to enable a firm/group to make a major model change.) In particular, for applications associated with innovative asset classes, including investments in newer technologies and climate-related finance, by helping to compensate for RMLs associated with, for example, lack of historic data. This could facilitate additional investment in such assets by IM firms and groups.

2. The need to use the PRA’s resources in the most efficient and economical way (FSMA regulatory principles):

Wider use of CAOs could increase resource burden due to procedural and technical requirements associated with their use. However, the PRA expects this burden would be more than offset in many cases by the benefits of faster model permissions, as well as greater flexibility in achieving appropriate levels of safety and soundness of firms (and groups) and policyholder protection.

3. Proportionality (FSMA regulatory principles):

The proposal to introduce a new type of RML CAO (in conjunction with the proposals to introduce a more flexible model permissions framework in Chapter 3) would provide a more proportionate and flexible approach to granting model permissions in the case where a firm’s (or group’s) IM (on its own) does not comply with the calibration standards in Solvency Capital Requirements – General Provisions 3.3 to 3.4, and/or some of the internal model requirements. This is in comparison to the current framework, where in such situations the PRA would be required to reject a firm’s (or group’s) model application (or require further model developments by the firm/group to resolve any RMLs prior to submitting the application).

The proposal to introduce a new alternative method for calculating a CAO for an IM significant risk profile deviation (as described in the section 'Methodologies for calculating capital add-ons') would provide the PRA with an additional, proportionate option for supervisory action when it has concerns that part or all of a firm's (or group's) IM is inadequate, or that the SCR that the IM generates no longer reflects the firm's risk profile better than if the SF were used, such as in the scenarios described in paragraph 3.36 of the proposed new SoP Solvency II internal models: Permissions and ongoing monitoring (Appendix 5).

4. Publishing information (FSMA regulatory principles):

The PRA proposes to regularly publish a report on its use of CAOs, which is expected to form part of a broader report which also covers the PRA's use of IM permission safeguards (ie RML CAOs and requirement safeguards). The PRA proposes to publish such information at an aggregate level. Individual firms or groups would also continue to be required to disclose any CAOs set by the PRA within their SFCRs, and the PRA also proposes to apply this requirement to the new RML CAOs.

5. Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):

In addition to the points made above relating to publishing information, the PRA's proposals would also provide an appropriate degree of transparency, in particular through the publication of a new SoP setting out the PRA's approach to the use of CAOs ('Solvency II: Capital add-ons' (Appendix 13)). This SoP would inform firms and groups on the circumstances in which the PRA would expect to set CAOs and how they would be calculated. The SoP would also consolidate existing requirements relating to CAOs into one document, providing firms with additional clarity on the PRA's approach.

6. Competitiveness (HMT recommendation letter):

As mentioned above in the section on 'PRA objectives analysis', the PRA considers that the proposals in this chapter would lead to more pragmatic and proportionate outcomes for firms and groups seeking permission to use an IM, which would help support the international competitiveness of the UK economy, including the attractiveness of the UK to internationally active firms. For example, the proposals may help firms (or groups) take advantage of business and investment opportunities (where these are critically dependent on receiving permission for associated model applications). Faster model permissions with lower associated compliance costs compared with the current framework may also improve firms' (or groups') ability to tailor models to their risk profiles and invest in new asset classes, supporting innovation in financial markets.

7. Growth in the interests of consumers and businesses (HMT recommendation letter):

The proposals in this chapter are intended to deliver a similar level of safety and soundness and policyholder protection as the existing framework, but in a more efficient way for both IM firms, groups, and the PRA. To the extent that the proposals benefit competition (by levelling the playing field between smaller and larger firms in terms of routes to gaining permission to use an IM), this would be expected to lead to better outcomes for consumers.

4.54 The PRA has had regard to other factors as required. Where the PRA has not provided analysis against a specific 'have regard' for the proposals set out in this chapter, it is because the PRA considers that 'have regard' to not be a significant factor for those proposals.

5. Flexibility in calculating the Group SCR

5.1 This chapter sets out the PRA's proposals to allow insurance groups greater flexibility in the methods available to calculate the group SCR, to address certain situations where the existing calculation may lead to a higher group SCR than is necessary to adequately cover group risks.

5.2 The PRA proposes to:

- temporarily allow a group to add the results of two or more different calculation approaches when calculating the consolidated group SCR (eg IM and IM; or IM and standard formula);
- allow a group to bring in its overseas sub-group's group SCR under method 2[46]; and
- transfer and restate related regulations from the SII CDR and the Solvency 2 Regulations 2015 that will be revoked under the FSM Bill into either the Glossary or Group Supervision Part, or the proposed new SoP – The PRA's approach to insurance group supervision, without changing their substance and make consequential amendments to SS9/15 (Appendix 16).

5.3 The proposals in this chapter would:

- amend the Glossary and Group Supervision Part of the PRA Rulebook (Annex A and N of Appendix 2);
- amend supervisory statement (SS) 9/15 – Solvency II: group supervision (Appendix 16); and
- introduce a new SoP – The PRA's approach to insurance group supervision (Appendix 17).

[46] The method for calculating group solvency described in Group Supervision 12.1.

5.4 The proposals in this chapter are relevant to UK Solvency II firms, insurance holding companies, and mixed financial holding companies within the scope of the Group Supervision Part and to the Society of Lloyd's, its members, and managing agents.

5.5 The PRA considers that the proposals to allow additional flexibility in the group SCR calculation would be proportionate and aligned with the PRA's primary objectives of safety and soundness and policyholder protection. In anticipation of the passage of the FSM Bill, the PRA has also assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA finds that the proposals would reduce regulatory burden and frictional costs for insurance groups that seek growth through mergers and acquisitions, thereby supporting international competitiveness and growth of the UK economy in the medium to long term. Currently there are no international standards in force relevant to this assessment.

5.6 The PRA considers that the proposal to transfer and restate related regulations are in accordance with its statutory objectives having considered the 'have regards'. The proposals would consolidate existing requirements in the PRA Rulebook, and set out in PRA policy how the PRA intends to conduct group supervision in ways consistent with current regulations under the Solvency 2 Regulations 2015.

Calculation of the consolidated group SCR using different calculation approaches

5.7 The PRA proposes to allow a group temporarily to add the results of two or more different calculation approaches when calculating the consolidated group SCR (eg IM and IM; or IM and standard formula).

5.8 Currently, method 2 allows solo capital requirements to be added into the group SCR. Solo capital requirements for entities covered by method 2 are added into the group SCR separately, with no diversification benefits. However, the use of method 2 can have unintended consequences, such as potential double-counting of risks in an entity's SCR and in the calculation of the group SCR.

5.9 The PRA considers that this proposal would allow greater flexibility in the calculation of group SCR in certain scenarios, such as where a group enters the scope of group supervision and has one or more firms with solo IMs but no group IM with an IM permission, or where a firm or group with an IM with IM permission is acquired by another group. Respondents to HMT's **Call for Evidence** on the Review of Solvency II were supportive of allowing this greater flexibility.

5.10 In assessing whether the temporary use of more than one calculation approach may be permitted, the PRA's assessment would be based on the following factors:

- whether, where applicable, each IM has previously received a permission by the PRA and continues to cover the same entities it covered when the permission was granted;
- whether, where the PRA allows a group to add two or more different calculation approaches, each separate calculation would continue to reflect the material risks to which the group was exposed, and whether the assumptions underlying those separate calculations would not deviate significantly from the assumptions underlying the overall group SCR calculation for that group;
- whether intra-group transactions between group entities that are not covered by the same group SCR calculation approach would not be significant in terms of either volume or value of transactions; and
- whether the group has a clear and realistic plan to develop a group IM (or group-specific parameters) that covers all the group entities.

5.11 In determining whether to grant temporary permission to a group to use two or more calculation approaches in this way, the PRA would be exercising its power under section 138BA of FSMA, as amended by the FSM Bill to give or vary a permission to modify Group Supervision 11. The factors that the PRA proposes to take into account in its assessment are set out in section 5 of the proposed new SoP – The PRA's approach to insurance group supervision (Appendix 17).

5.12 The PRA proposes that where it allows the temporary use of more than one calculation approach, the modification would usually be granted for a period of two years while a single group IM (or group-specific parameters) is under development. The PRA continues to attach importance to a group developing a single approach to the group SCR calculation to provide a more holistic view of the group's risk profile, and in reducing the risk of regulatory arbitrage. The PRA would normally expect two years to be sufficient for a group to develop a single approach, although it may consider granting an extension taking into account the group's specific circumstances and the continuing applicability of the factors set out in paragraph 5.10.

Use of method 2 for overseas sub-groups

5.13 The PRA proposes to allow a UK group's overseas sub-group SCR to be included in the consolidated group SCR under method 2, thereby allowing diversification benefits between the method 2 entities within that sub-group.

5.14 Currently, groups using method 2 cannot add overseas sub-groups to the overall group SCR.

5.15 The PRA proposes that a group would be able to apply for this measure to apply method 2 to the overseas sub-group where that sub-group is subject to equivalent group supervision. This would be intended to ensure that firms are not incentivised to offshore UK risks to an overseas sub-group.

5.16 The PRA proposes that certain other factors would also be taken into account in assessing whether to give permission for the overseas sub-group's group SCR to be used in the consolidated group SCR. The factors are:

- whether the amount and quality of information available in relation to a related undertaking in the sub-group is sufficient for it to be subject to method 1;
- whether any of the related undertakings in the sub-group are not covered by a group IM (or group-specific parameters), in the cases where a group IM (or group-specific parameters), approved by the PRA, is used for the calculation of the consolidated group SCR;
- whether for the purposes of the previous factor, the risks that are not captured in the group IM (or group-specific parameters) are immaterial in relation to the overall risk profile of the group;
- whether the nature, scale, and complexity of the risks of the group are such that the use of method 2 in relation to the sub-group does not materially affect the results of the group solvency calculation;
- whether intra-group transactions between group entities that are not covered by the same group SCR calculation approach are not significant in terms of either volume or value of transactions;
- whether the sub-group is managed as a single economic unit distinct from the rest of the group; and
- whether the use of method 1 in relation to related undertakings that make up the sub-group would be overly burdensome.

5.17 In determining whether to grant this permission, the PRA would be exercising its power under s138BA of FSMA to give or vary a permission to modify Group Supervision 12, as amended by the FSM Bill. The factors that the PRA proposes to take into account in its assessment (described in this section) are set out in section 4 of the proposed new SoP – The PRA's approach to insurance group supervision (Appendix 17).

Transfer and restatement of retained EU law

5.18 The PRA proposes to transfer and restate certain group supervision regulations from the SII CDR and the Solvency 2 Regulations 2015 that will be revoked under the FSM Bill into the Glossary and Group Supervision Part and the proposed new SoP – The PRA's approach to insurance group supervision (Appendix 17) in order to give effect to the proposals in this chapter and make consequential changes to SS9/15 (Appendix 16).

5.19 Where regulations relate to transitional arrangements, or are no longer relevant following the UK's exit from the EU, the PRA does not propose to restate them in PRA rules or policy. The mapping table in Appendix 18 sets out provisions that the PRA has considered whether to include in rules or policy in proposing these reforms.

5.20 The PRA's approach to transfer and restatement was based on regulations needed to effect the changes proposed in this CP and any further group supervision regulations that would improve their context and readability.

5.21 Where firms are required to comply with the relevant regulations being transferred, the PRA proposes to restate these regulations into the Group Supervision Part. Where regulations being transferred currently set out how the PRA exercises supervision of groups, the PRA proposes to explain its approach in the new SoP – The PRA's approach to insurance group supervision (Appendix 17). The proposed consequential amendments to SS9/15 (Appendix 16) also include the incorporation of some group-related material that is proposed for deletion from SS15/15 (Appendix 8), and deletion of some material proposed for incorporation into SS15/15.

PRA objectives analysis

5.22 The PRA considers that the proposal to allow a group to temporarily add the results of two or more different calculation approaches represents a proportionate approach to safety and soundness and policyholder protection, since the group SCR calculated would be equal to the sum of the capital requirements that would have applied for the two parts of the group had they remained separate. In most circumstances, this would be a prudent approach in the short term, given that it would not recognise diversification benefit between the two parts of the group. Restricting the permission to be a temporary arrangement also recognises that the potential risks to safety and soundness would become more significant over time if a group did not have a single consolidated view of its risks profile.

5.23 The PRA considers that the proposal to allow a group to temporarily add the results of two or more different calculation approaches would also facilitate effective competition, since greater temporary flexibility in the calculation of the group SCR would remove an inefficient temporary increase in costs when performing a merger or acquisition during the interim period before a new or extended group IM has been approved. These changes would contribute to domestic market efficiency, therefore raising the attractiveness of the UK, and would potentially facilitate the competitiveness of UK acquirers in mergers and acquisitions.

5.24 The PRA considers that the use of method 2 for overseas sub-groups represents a proportionate approach to safety and soundness and policyholder protection. The use of the overseas sub-group's group SCR would only be permitted where it has been calculated under a prudential regime that has been determined to be equivalent to the UK's for the purposes of group supervision.

5.25 The PRA considers that allowing diversification benefits in the consolidated sub-group being brought into the group calculation using method 2 would reduce undue regulatory burden on a UK-headquartered group that has an overseas sub-group that is under equivalent group supervision. This would enable the group to compete more effectively domestically and internationally.

5.26 The PRA considers that the proposal to transfer and restate relevant parts of retained EU law represents a proportionate approach to safety and soundness and policyholder protection and facilitates effective competition. The PRA considers that the regulations being transferred and restated will continue to advance the PRA's objectives as part of a coherent Solvency II regime that the PRA and HMT helped to develop.

Cost benefit analysis

5.27 The baseline for the CBA is the current Solvency II rules and legislation.

5.28 The PRA considers that the proposal to temporarily allow a group to add the results of two or more different calculation approaches when calculating the consolidated group SCR would have been relevant to up to five acquisitions from 2016 to 2022.

5.29 The proposal to allow the use of method 2 for overseas sub-groups in equivalent regimes may be relevant to up to 50 groups. No analysis of the diversification effects groups may expect has been provided as its estimation depends on the specifics of which firms apply for this permission and receive approval.

5.30 The PRA considers the transfer and restatement of retained EU law would cause minimal change to the costs and benefits to firms or the PRA as firms are already required or expected to comply with the relevant regulations.

Benefits

5.31 The PRA considers that, in situations where the temporary calculation approach proposed in this section would be appropriate:

- the resulting group SCR would more accurately reflect the group's risk profile compared to the existing calculation options available to firms, which can cause potential double-counting of an entity's SCR in the calculation of the group SCR. This would remove an inefficient temporary increase in costs when performing an acquisition; and
- it would also enable the use of the accounting consolidation method for the business acquired or the entity added to the existing group calculation. This would result in better quality and transparency of reporting and disclosure, compared to the use of method 2.

5.32 The proposal to allow the use of method 2 for overseas sub-groups would allow a group meeting the relevant conditions to recognise diversification effects within the overseas sub-group. The PRA considers that this would set capital requirements at a level that better reflects the group's risk profile than is currently possible under method 2.

Costs

5.33 The PRA does not expect that firms will incur additional costs as a direct result of the proposals to increase flexibility in the calculation of group SCR given that the application for the relevant permission would be at the discretion of firms.

5.34 The PRA recognises that where firms choose to make use of the proposals to increase flexibility in the calculation of group SCR there may be some costs associated with implementing the consequential changes to reporting requirements. The PRA anticipates the costs to firms would not be material.

5.35 As set out in the 'PRA objectives analysis' in this section, allowing a group to temporarily add the results of two or more different calculation approaches represents a proportionate approach to safety and soundness and policyholder protection, since the group SCR calculated would be equal to the sum of the capital requirements that would have applied for the two parts of the group had they remained separate.

5.36 The PRA considers that the use of method 2 for overseas sub-groups represents a proportionate approach to safety and soundness and policyholder protection. Use of the overseas sub-group's group SCR would only be permitted where it has been calculated under a prudential regime that has been determined to be equivalent to the UK's for the purposes of group supervision and once the factors in paragraph 5.16 have been considered.

'Have regards' analysis

5.37 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. The desirability, where appropriate, of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (FSMA regulatory principles) and smart regulatory reform (HMT recommendation letter): The proposals to increase flexibility in the calculation of group SCR have been designed with particular scenarios in mind. Through the first proposal, the PRA recognises the unique circumstances of a UK group that does not yet have a single group IM in place after having recently come into scope of group supervision, undergone restructuring or a merger, or made an acquisition. Through the second proposal, the PRA recognises the unique situation of a UK group that has overseas subsidiaries that are under equivalent group supervision. The PRA considers that the factors proposed for assessment under each proposal would ensure the proposals are only used in cases where they are appropriate.

2. The need to use the resources of the PRA in the most efficient and economical way (FSMA regulatory principles): The PRA is publishing the factors it proposes to assess under the proposals to increase flexibility in the calculation of group SCR within this consultation and the proposed new SoP – The PRA's approach to insurance group supervision (Appendix 17). The PRA considers that this would result in more efficient engagement between firms and their supervisors.

3. Proportionality (FSMA regulatory principles): The proposals to increase flexibility in the calculation of group SCR seek to reduce the regulatory burden and related costs on firms in certain circumstances while ensuring that adequate capital requirements are held for safety and soundness and the protection of policyholders. The approach the PRA proposes to take in deciding whether to grant the relevant permission would support safety and soundness and policyholder protection where the permitted alternative calculation options are used. The PRA considers that the overall effect would be a reduction in regulatory burden and related costs in circumstances where this is appropriate.

4. Transparency (FSMA regulatory principles) and the future regulatory framework review (HMT recommendation letter): The PRA considers that setting out the factors it will consider for assessment under the proposals to increase flexibility in the calculation of group SCR is in line with a transparent approach to the PRA's approach to policy development. By transferring provisions in the SII CDR and the Solvency 2 Regulations 2015 into the PRA Rulebook and the proposed new SoP, the PRA considers that the proposals would enhance transparency and clarity on relevant requirements and policy.

5. Encouraging economic growth, trade and inward investment, better outcomes for consumers, UK attractiveness for international financial services, facilitating investment in productive assets (HMT recommendation letter), and sustainable growth (FSMA regulatory principles): The PRA considers that the proposals to increase flexibility in the calculation of group SCR would reduce regulatory burden and frictional costs when insurance groups seek growth through mergers and acquisitions. Facilitating the competitiveness of the insurance sector would help promote inward investment to the sector and the UK's attractiveness for international financial services.

5.38 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for the proposals, it is because the PRA considers that 'have regard' to not be a significant factor.

6. Third-country branches

6.1 This chapter sets out the PRA's proposal to remove the rules that require international insurers operating in the UK through a branch presence ('third-country branch undertakings') to calculate the branch solvency capital requirement (branch SCR) and branch minimum capital requirement (branch MCR), collectively referred to as 'branch capital requirements'. It also sets out consequential amendments to the rules relating to the branch risk margin (branch RM), and the requirement to hold assets in the UK to cover the branch SCR ('SCR localisation requirement').

6.2 In summary, the policy proposals included in this chapter are:

- the removal of the requirement for third-country branches to calculate and report branch capital requirements; and
- the consequential removal of the SCR localisation requirement for third-country branch undertakings, and the requirement to establish and report a branch RM for the purposes of ongoing supervision.

6.3 The proposals in this chapter would amend:

- the Glossary Part of the PRA Rulebook (Annex A of Appendix 2);
- the Third Country Branches Part of the PRA Rulebook (Annex K of Appendix 2);
- the Run-Off Operations Part of the PRA Rulebook (Annex M of Appendix 2);
- the Insurance – Supervised Run Off Part of the PRA Rulebook (Annex L of Appendix 2); and
- supervisory statement (SS) 44/15 – Solvency II: third-country insurance and pure reinsurance branches (Appendix 19).

6.4 The proposals in this chapter reflect the PRA's approach to the authorisation and supervision of branches, as set out in SS2/18 – **International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision** which emphasises the overall 'supervisability' of a firm (the third-country branch undertaking) that operates in the UK through a branch. The PRA expects the whole firm (third-country branch undertaking) to meet Threshold Conditions, relevant PRA rules, and have sufficient financial resources.

6.5 When authorising and supervising third-country branch undertakings, the PRA also takes into consideration the nature and scale of the insurance activities that the firm proposes to carry out, including through its UK branch. Given that the PRA's approach takes into account the position of the legal entity as a whole, the PRA considers that compliance with existing branch capital requirements and the branch RM offers limited protection and creates a burden that is not proportionate to the benefits for branch policyholders, particularly since they are not guaranteed specific protection in a winding-up scenario. Accordingly, the PRA considers that removal of these requirements would allow it to continue to advance its primary objectives, while also facilitating entry into the UK, promoting effective competition and enhancing the UK's competitiveness.

6.6 As stated in SS44/15, the PRA currently expects third-country branches to comply with the **Guidelines on the Supervision of branches of third-country insurance undertakings ('Branch Guidelines')** that are relevant to them. As a consequence of the proposals in this chapter, a significant number of branch guidelines would no longer be relevant. Certain other branch guidelines are also no longer relevant because they relate to transitional arrangements, are redundant following the UK's exit from the EU, or there is existing material in PRA rules or policy.

6.7 The mapping table in Appendix 20 sets out the Branch Guidelines which the PRA has considered in proposing the reforms in this chapter. Where a row entry sets out a mapping location, the PRA has considered the guideline and decided to set out provisions as requirements in PRA rules or expectations in SSs. The majority of these are reporting-related – see Chapter 7 – Reporting and disclosure for further discussion, as well as the PRA's proposals for third-country branch reporting requirements. Where entries do not include a mapping location in Appendix 20, the PRA has considered the guideline and does not propose to include it in PRA rules or SSs.

6.8 Given the importance of the Branch Guidelines in setting out expectations for operations of third-country branches, the PRA also proposes to document which Branch Guidelines would still be relevant in an appendix to SS44/15 to provide greater clarity for firms. In addition, within SS44/15, the PRA proposes to delete paragraph 3.2 and restate it as paragraph 4.1A to improve readability.

6.9 The proposals in this chapter are relevant to all third-country branch undertakings, except Swiss general insurers, and all third-country insurance undertakings seeking authorisation to operate as a branch in the UK.

Removal of branch capital requirements and the branch risk margin for the purposes of ongoing supervision

6.10 This section sets out the PRA's proposals to remove the rules that require third-country branch undertakings to calculate branch capital requirements, and to remove the SCR localisation requirement. The proposal to remove branch capital requirements was consulted on as part of **HMT's Call for Evidence** in their review of Solvency II. The majority of respondents strongly supported the proposals. Most respondents asserted that the reform would not reduce policyholder protection given that a branch cannot fail independently of its legal entity as a whole, and many respondents also suggested it would make the UK more attractive to new business, boost competition, and bolster the UK's reputation as a global insurance hub.

6.11 As a consequence of the proposed removal of branch capital requirements, the PRA also proposes to remove the requirement to establish a branch RM for the purposes of ongoing branch supervision.

PRA objectives analysis

6.12 The PRA considers that the proposals in this chapter represent a proportionate approach to firm safety and soundness and policyholder protection given that a branch cannot fail independently of the third-country insurance undertaking. Furthermore, the SCR localisation requirement does not guarantee specific protection for branch policyholders in a winding-up scenario. The RM is also less relevant in the context of a branch because branch assets are not ring-fenced to cover the RM. Therefore, the PRA considers branch capital requirements and the branch RM offer limited protection for branch policyholders beyond entity-level regulatory requirements.

6.13 The PRA further considers that the proposals would continue to advance firm safety and soundness given that in a winding-up scenario, the valuation of the legal entity's assets and liabilities (including those of the branch) would be carried out at the level of the third-country undertaking. The PRA also considers that its approach to authorising a third-country branch acts as a safeguard, since the PRA needs to be satisfied that the home jurisdiction of the legal entity has a similar approach to valuing assets and liabilities.

6.14 The primary safeguard for protecting branch policyholders from being treated less preferentially in a winding-up scenario is the PRA's approach to branch authorisation (whereby the PRA needs to be satisfied that the home jurisdiction's prudential supervision regime is 'broadly equivalent') and supervision (eg where the overseas regime is not broadly equivalent, then the PRA will assess the adequacy of the financial resources using the methods applicable to firms whose head office is in the UK).[47] Additionally, the third-country branch undertaking has to maintain adequate worldwide financial resources to meet the requirements for branch authorisation and ongoing supervision in any case.[48] When authorising branches, the PRA also needs to be satisfied that branch policyholders will be given the appropriate priority in an insolvency and that there is no discrimination against branch policyholders in the event of a winding up. Furthermore, when considering applications for authorisation of third-country branches, the PRA takes into account a range of factors including the scale of UK branch activity covered by the UK Financial Services Compensation Scheme (FSCS) and the potential impact of failure on the wider UK insurance market and financial system. [49]

6.15 The PRA considers that the proposals outlined in this chapter would allow it to continue to advance its primary objectives, while also facilitating effective competition. This is because the proposals would facilitate entry into the UK market, a key driver of effective competition. Additionally, by removing branch capital requirements and the branch RM on an ongoing basis, third-country branches would no longer be subject to dual capital requirements (given that the third-country insurance undertaking would already be subject to home state capital requirements at legal entity level) or the associated additional administrative burdens. The PRA considers that this would contribute to a more level playing field between third-country branches and UK firms, and thus enhance effective competition. However, the PRA recognises that the competition impact in retail markets is likely to be immaterial, given the PRA's expectation that third-country branches will have under £500m of insurance liabilities covered by the FSCS when operating as a branch.

6.16 The PRA considers that the safeguards within its existing approach to authorising and supervising branches, including the expectations regarding a firm operating in the UK through a subsidiary under certain conditions, and the fact that third-country branch undertakings would already be subject to broadly equivalent home state prudential requirements at the legal entity level, means that the proposals would deliver an appropriate level of policyholder protection. Furthermore, as stated in SS44/15, where the overseas regime is not broadly equivalent, then the PRA will assess the adequacy of the financial resources using the methods applicable to firms whose head office is in the UK.

6.17 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. The PRA

[47] SS44/15 – **Solvency II: third-country insurance and pure reinsurance branches**, February 2023.
[48] Paragraph 13.1 of the Third Country Branches Part of the PRA Rulebook.
[49] SS2/18 – **International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision**, March 2018.

considers that the proposals in this chapter would allow it to continue to advance its primary objectives, while also facilitating the international competitiveness of the UK economy. Third-country insurance undertakings are required to adhere to home state prudential requirements in any case and given that a third-country branch cannot fail independently of its legal entity as a whole, the PRA considers that it would not be proportionate to continue to impose separate capital requirements on the branch, or the requirement to calculate a branch RM on an ongoing basis. Removing these additional requirements would therefore raise the attractiveness of the UK as a destination for branches of third-country insurers by making it easier and less costly to set up a UK branch. Furthermore, the PRA considers that the safeguards in the PRA's third-country branch regime constitutes an appropriate level of oversight for the PRA to assess a firm's risk to financial stability in the UK, which is a pre-requisite for strong and balanced growth.

Cost benefit analysis

6.18 The baseline for the CBA is the current Solvency II rules and legislation.

6.19 The PRA expects that the proposals set out in this chapter would affect approximately 130 third-country insurance branches, including those in supervised run-off. The proposals would also affect any third-country insurance undertakings that receive authorisation to operate as a branch in the UK in the future.

Benefits

6.20 The PRA considers that the compliance with the requirements regarding branch capital and the branch RM on an ongoing basis creates ongoing costs for third-country branch undertakings, despite their limited prudential benefits. Therefore, by removing these requirements, there are benefits associated with ongoing cost savings, as branches would no longer need to maintain processes to calculate the actual and forecast branch capital requirements, branch own funds, and the branch RM on an ongoing basis.

Costs

6.21 The PRA recognises that there might be some one-off costs to firms associated with implementing the necessary changes to internal processes and systems as a result of the reduced requirements. The PRA anticipates the costs to firms would be minimal.

6.22 The PRA recognises that removal of the SCR localisation requirement may mean that there are more steps that need to be taken, and hence more time taken, to bring assets back into the UK where they are available to pay branch policyholders in a winding-up scenario. However, as set out in the 'PRA objectives analysis' section of this chapter, the PRA notes that there is no guarantee that localised assets will be distributed to branch policyholders in a winding-up scenario.

6.23 The PRA recognises that the risks to policyholder protection may be higher if branch capital requirements act as a deterrent against third-country insurance undertakings that are less-adequately capitalised applying to set up a branch. To the extent that some third-country insurance undertakings fail, this could increase pay-outs from the FSCS to covered branch policyholders. This could also have a cumulative impact on the FSCS and the insurance industry, given the possibility of more failures and also increase in difficulty in recovering assets from failed firms. Since the PRA was established in 2013, there have not been any cases where an established UK branch of a third-country insurer has failed, such that it has resulted in pay-outs from the FSCS.[50] Furthermore, the PRA considers that the risks associated with an increased number of branches in the UK are adequately mitigated by the safeguards in the PRA's third-country branch regime, such as the indicative £500 million threshold of FSCS-protected liabilities for subsidiarisation and the consideration of whether there is broadly equivalent home state supervision.

'Have regards' analysis

6.24 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. **The need to use the PRA's resources in the most efficient and economical way (FSMA regulatory principles):** Supervising firms' compliance with branch capital and branch RM requirements consumes PRA resources, despite these requirements only offering limited prudential benefits for branch policyholders beyond entity-level regulatory requirements. Removing these requirements would result in a more efficient use of the PRA's resources.

2. **Proportionality (FSMA regulatory principles) and smart regulatory reform (HMT recommendation letter):** the PRA recognises that compliance with branch capital requirements and the requirement to establish a branch RM on an ongoing basis

[50] This does not include insurers based in the EEA that previously operated on a cross-border services passport, rather than via an established UK branch. Since 2013, the FSCS has been involved in 16 insurer insolvencies, including insurers that provided cross-border services.

creates upfront and ongoing costs for third-country branches. The PRA considers this is not justified given that the requirements offer limited benefits for branch policyholder protection beyond entity-level requirements. Furthermore, the PRA already considers whether the home jurisdiction's prudential supervision regime is 'broadly equivalent', and branch capital requirements and localisation of assets to cover the branch SCR do not guarantee specific protection for branch policyholders in a winding-up scenario in any case. The proposals would streamline regulatory requirements and are therefore consistent with these principles.

3. **Growth, trade, and inward investment into the UK (HMT recommendation letter), and the desirability of sustainable growth in the UK economy in the medium or long-term (FSMA regulatory principles):** the PRA considers that the removal of the requirement to establish a branch RM on an ongoing basis, branch capital requirements, and the SCR localisation requirement would facilitate entry into the UK, which is a key driver of effective competition and growth. The PRA acknowledges that the removal of the branch capital requirements may also remove a deterrent for less-adequately capitalised third-country insurance undertakings applying to set up a branch in the UK. However, the PRA considers that the safeguards in the PRA's third-country branch regime leaves an appropriate level of oversight for the PRA to assess a firm's risk to financial stability in the UK, which is a prerequisite for strong and balanced growth.

4. **Competitiveness and UK attractiveness for international financial services (HMT recommendation letter):** the PRA has had regard to this principle by acknowledging that the removal of branch capital requirements and the requirement to establish a branch RM on an ongoing basis would improve the attractiveness of the UK as a domicile for third-country insurance branches.

5. **Better outcomes for consumers (HMT recommendation letter):** the PRA considers that an expected increase in the number of third-country branches applying for applications in the UK could lead to greater choice for UK policyholders and hence, better outcomes for consumers.

6. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** the PRA considers that the proposals would lead to a more transparent application of the prudential framework. By setting out which Branch Guidelines the PRA has considered in proposing the reforms in this chapter, the PRA would provide greater clarity in setting out expectations for operations of third-country branches.

6.25 The PRA has had regard to other factors as required. Where analysis has not been provided against a ‘have regard’ for this proposal, it is because the PRA considers that ‘have regard’ to not be a significant factor for this proposal.

7. Reporting and disclosure

7.1 This chapter sets out the PRA's proposed changes to supervisory reporting applicable to Solvency II firms. The proposed changes seek to both improve the efficiency of reporting for firms and the relevance of reported data in advancing the PRA's objectives. The PRA considers that the proposals would result in an overall reduction of reporting for all Solvency II firms, while aligning reporting and disclosure with the proposals set out elsewhere in this CP and the overall HMT **Review of Solvency II** scope.

7.2 The proposals included in this chapter would:

Remove:

- the requirement for all Solvency II firms, including UK branches of international insurers ('third-country branches'), to submit the regular supervisory report (RSR); and
- requirements for third-country branches to report a range of templates relevant to branch capital requirements, the branch risk margin, and the localisation of assets to cover the branch SCR;

Amend:

- the requirement for third-country branches to submit information on their home state resolution arrangements from the RSR to a standalone narrative report;
- the requirement for insurance groups to report the SCR separately by the calculation approach, through new reporting aggregating SCR calculation approaches;
- reporting requirements on the Transitional Measure on Technical Provisions (TMTP);
- Quarterly Model Change reporting requirements, including the transfer of the existing reporting expectation to the PRA Rulebook; and
- various other reporting requirements to reflect the proposals set out elsewhere in this CP.

Introduce:

- new reporting requirements on the change in internally modelled SCR through the year;

- a new requirement for insurance groups to report SCR at the level of the approved IM, where multiple models are permitted;
- new reporting requirement for third-country branches on legal entity solvency and financial position, as a consequence of the proposals in Chapter 6 to remove branch capital requirements; and
- an extended scope of application of certain 'national specific templates' (NSTs) to cover third-country branches.

7.3 The proposals in this chapter would result in amendments to:

- the Reporting Part of the PRA Rulebook (and minor amendments to Third Country Branches, Group Supervision, External Audit, and Fees Parts) (see Appendix 2);
- the reporting and disclosure templates and LOG instructions files as set out in this chapter (see Appendix 25) that are currently contained in the European Insurance and Occupational Pensions Authority (EIOPA) Third Country Branch Guidelines;
- SS11/16 – Solvency II: External audit of, and responsibilities of the governing body in relation to, the public disclosure requirement (see Appendix 22);
- SS17/16 – Solvency II: internal models – assessment, model change and the role of non-executive directors (see Appendix 10);
- SS44/15 – Solvency II: third-country insurance and pure reinsurance branches (see Appendix (see Appendix 19);
- SS6/18 – National Specific Templates LOG files (deleted);
- SS11/15 – Solvency II: Regulatory Reporting and exemptions (deleted);
- SS40/15 – Solvency II: reporting and public disclosure options provided to supervisory authorities (see Appendix 23); and
- SS7/17 – Solvency II: Data collection of market risk sensitivities (see Appendix 24).

7.4 The PRA also proposes to introduce a new SoP on reporting limitations (see Appendix 21) and delete SS11/15 – Solvency II: Regulatory Reporting and exemptions.

7.5 The proposed changes to the Reporting Part of the PRA Rulebook (Annex O of Appendix 2) amend the proposed changes to the PRA Rulebook in the 'PRA Rulebook: SII Firms: Reporting and Disclosure Instrument' consulted on in CP14/22 – **Review of Solvency II: Reporting phase 2**. Appendix 2 shows the changes being consulted on in this CP against the proposed rule instrument in CP14/22.

7.6 This chapter sets out a final set of reform proposals to update reporting and disclosure requirements as part of the current review of Solvency II. HMT's **response to its Call for Evidence** for the Solvency II review highlighted general support across respondents for reforms to Solvency II reporting to reduce the volume of data submitted to the PRA. It also recognised that a small number of respondents requested either no change to regulatory reporting (to limit regulatory divergence with other jurisdictions), or increased reporting on products and business that were reported before Solvency II was first implemented[51]. Reforms suggested by respondents included:

- reducing the frequency and granularity of existing reporting;
- reviewing reporting submission deadlines;
- deleting reporting that is duplicative or not useful to the PRA; and
- reviewing the PRA's ad-hoc data requests

Background

7.7 On Monday 31 December 2021, the PRA implemented a first phase of reforms to insurance supervisory reporting requirements by amending the onshored Solvency II technical standards on reporting in PS29/21 – **Review of Solvency II: Reporting (Phase 1)**. This phase sought to streamline insurance reporting requirements by removing certain reporting templates for all firms. This included deleting summary asset reporting, deleting financial stability reporting for larger firms, and expanding the quarterly reporting waiver to the PRA's 'Category 3' firms.

7.8 On 7 November 2022, the PRA published a second consultation with additional reforms in CP14/22. Phase 2 proposed further improvements to Solvency II reporting and disclosure with a primary focus on solo firms of all sizes and business lines. The proposals included the permanent deletion of some templates, amendments to retained reporting and disclosure templates, and a number of new reporting requirements where the PRA has previously had

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[51] Solvency II entered into force on 1 January 2016.

to rely on ad-hoc data requests to supervise important elements of insurer’s businesses (such as cyber risk policies, capital generation supporting large annuity books).

7.9 CP14/22 also proposed to transfer the amended onshored Solvency II technical standards on reporting and disclosure to the Reporting Part of the PRA Rulebook. The PRA intends to combine the final policy published for the proposals in this CP with the final policy over the proposals in CP14/22.

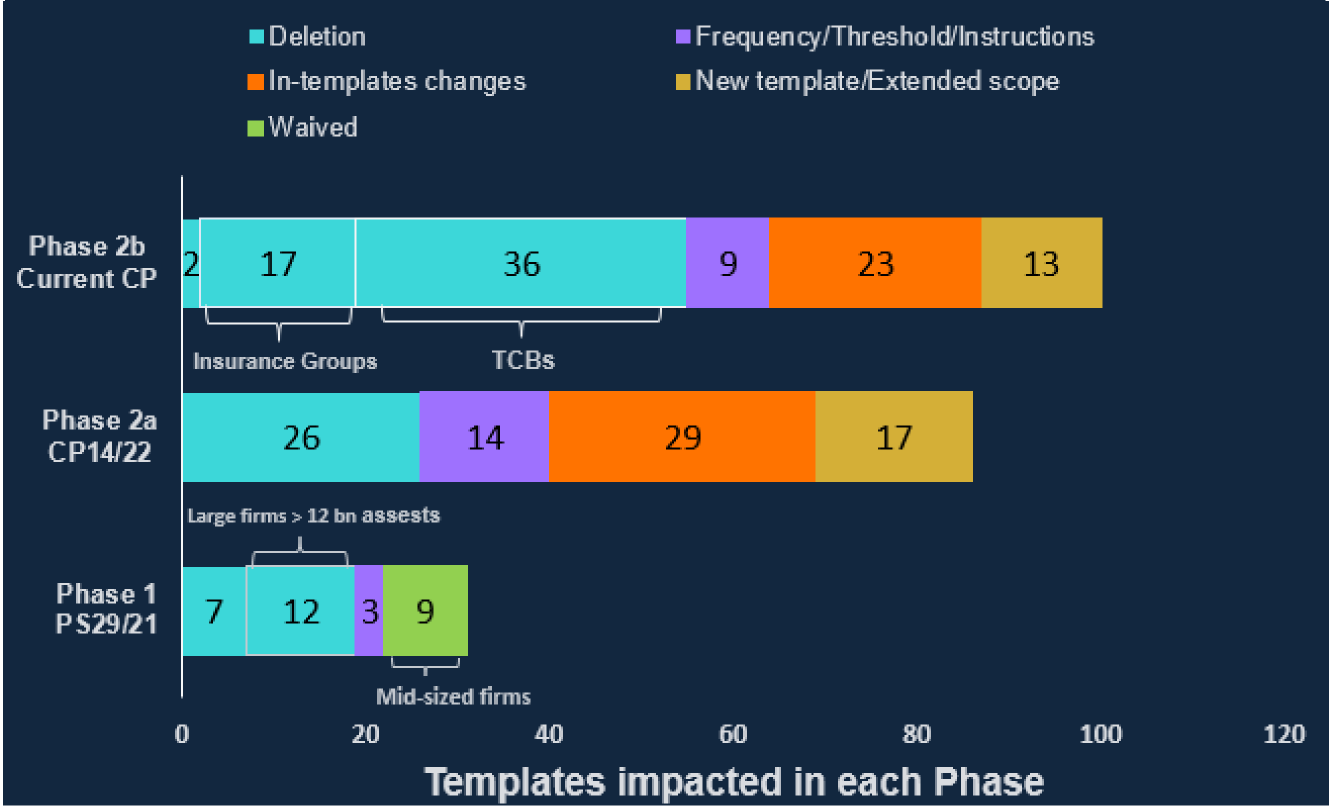
7.10 The PRA considers that timely, relevant, and reliable regulatory reporting provides the foundation of effective supervision and underpins the PRA’s forward-looking, judgement-based supervisory approach. The proposals set out in the rest of this CP would, when implemented, change certain elements of the Solvency II requirements, so the corresponding reporting requirements need to be updated to be consistent with other proposed policy changes. The PRA requires accurate and timely information to supervise how individual insurers and industry are complying with the proposed changes to Solvency II. For example, the existing third-country branch reporting, left unchanged, would require third-country branches to report information related to outdated capital and asset requirements. As a result, third-country branch reporting would no longer support the supervisory assessment of legal entity financial strength upon which the soundness of the UK branch and its policyholders rely.

7.11 There are some aspects of the onshored Solvency II reporting that could better reflect the composition and activities of the UK insurance market. The existing reporting on group SCR, for example, makes it challenging for the PRA to understand the results across different SCR calculation methods. The proposals set out in this chapter seek to increase the relevance of reporting to the PRA in advancing its objectives.

7.12 The proposals in this chapter build upon the reforms set out in PS29/21 and CP14/22 by removing some further reporting requirements, and updating additional reporting and disclosure requirements and expectations to reflect the broader proposed policy changes set out in this CP, in particular changes in insurance group and third-country branch reporting requirements. While the majority of reforms are aimed at all insurers, regardless of size or business model, elements of each reform phase feature some reforms targeted at certain firms.

7.13 Chart 7 illustrates the package of reporting reforms proposed (and delivered in the case of PS29/21) across the three phases of the current review of Solvency II reporting. Overall, the PRA has proposed a net reduction in the volume of templates that would be reported by all firms, including large firms and those with complex corporate and SCR calculation structures. While the current review programme has primarily focused on reforms to supervisory reporting, and the resulting consequential changes to the public disclosure templates, the PRA may review other aspects of reporting and disclosure, including the Solvency and Financial Condition Report (SFCR) in due course.

Chart 7: Reporting reforms by phase



7.14 The PRA has assessed the benefits of the proposals, and the estimated cost to firms of the proposals set out in this chapter. Overall, the PRA considers that the benefits of the proposals to its objectives, and the annual cost savings for firms, outweigh the one-off implementation costs involved. The cost estimates have been based on historical cost information submitted by those firms who responded to the PRA's reporting cost survey, where sufficient granular information was provided.

7.15 The proposals in this CP are intended to be delivered using the PRA's general rule-making power under section 137G FSMA to make new PRA rules to be included in the PRA Rulebook, and its power under section 192J FSMA to require the provision of certain financial information from the parent undertakings. The proposals set out in this chapter are relevant to UK Solvency II firms, the Society of Lloyd's and its members and managing agents, insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings), firms within the PRA's Temporary Permissions Regime (TPR) for (re)insurers, and firms and UK holding companies required to publicly disclose or report group information to the PRA.

7.16 The PRA expects the proposals set out in this chapter, together with the proposals set out in CP14/22 and the policy in PS29/21, to lower the reporting burden for firms, by reducing the overall volume of information submitted to the PRA, while enhancing the efficiency of supervisory oversight through better alignment of the reported data to the PRA's supervisory needs. The proposed transfer of the onshored supervisory reporting templates for third-country branches contained in EIOPA Third Country Branch Guidelines (once amended) to the PRA Rulebook would enhance the transparency of reporting requirements.

7.17 The following sections describe the PRA's proposed changes to Solvency II reporting and disclosure requirements and expectations, and explain the most significant matters to which the PRA has had regard, including an explanation of the ways in which having regard to these matters has affected the proposals. The 'have regards' matters which the PRA considers are key to the development of the proposals set out in this chapter include the principle that a burden imposed on firms should be proportionate to the benefit resulting from the imposition, the need to use the PRA's resources in the most efficient and economic way, and the transparent exercise of PRA functions. The PRA has had regard to other factors as required.

Deletion of the Regulatory Supervisory Report (RSR)

7.18 All Solvency II firms are currently required to submit the free-form narrative-based RSR to the PRA on a triennial basis, and report on material changes to the full report on an annual basis. The RSR is intended to set out information on a firm's business performance, governance and risk profile, capital management, and solvency valuation of Solvency II insurers in more detail than required in public disclosure.

7.19 However, the design and triennial frequency of the RSR makes routine and comparable analysis of content more challenging. The narrative free format and qualitative descriptions of risk management policies and approaches have resulted in very lengthy RSRs which may be burdensome for firms to prepare, and time consuming for the PRA to analyse. The triennial frequency of the full report results in the PRA prioritising other reports to gain timely insight into the risk profile of Solvency II insurers, and the preparation of the RSR at the level of the subsidiary can also lead to duplication of content submitted by insurance groups. The PRA considers that the proposed changes to other aspects of Solvency II reporting set out in this chapter and in CP14/22 may render the RSR less important to the supervision of Solvency II firms.

7.20 The PRA proposes to delete the requirement to produce a RSR for all Solvency II firms (both the triennial report and annual summary of material changes) by not restating the RSR requirements into the PRA Rulebook once HMT revokes the relevant articles.[52] The PRA cannot currently waive the requirement to submit an RSR because it is a requirement arising from onshored EU legislation that does not allow for a broad exemption by the regulator, as opposed to a requirement in the PRA Rulebook. However, the PRA considers that the majority of insurers will have submitted the full triennial RSR for their 2022 financial year[53], and therefore would not be required to submit an additional full RSR before the proposed implementation date of 31 December 2024. Insurers are required to submit a summary of changes for 2023 only where there has been material change since the 2022 submission.

Narrative reporting on home state resolution arrangements

7.21 While the PRA proposes to delete the RSR as a whole, the existing expected reporting on home state winding up arrangements, and the impact on a UK third-country branch and its policyholders remain important for the PRA to collect on a routine basis from third-country branches, and will become even more so given the other changes proposed in Chapter 6.

7.22 Third-country branches are currently expected to report an analysis of the home state resolution regime within the RSR, including a description of the applicable laws relating to winding-up in the home state jurisdiction, the order of priority of claims which would apply to the distribution of available assets, and any arrangements that provide certain policyholders with protection upon resolution.[54] As set out in Chapter 6 on branches, the PRA's proposals to remove branch capital requirements are predicated on it being able to maintain assurance about the nature of the supervision of the whole entity, and the position of branch policyholders in a winding-up scenario.

7.23 Accordingly, the PRA proposes to continue to collect the same type of information set out in the existing EIOPA Guidelines on the supervision of branches of third-country insurance undertakings ('Branch Guidelines') via the introduction of a short standalone resolution-focused report applicable to all third-country branches. Third-country branches would continue to report in a free-format analysis of the distribution of branch assets upon resolution of the legal entity, and a legal analysis and a description of the applicable laws relating to winding-up in the relevant jurisdiction. The PRA proposes to maintain a similar frequency of the proposed third-country branch resolution report to the existing RSR. That would result in triennial submission of the new resolution report by third-country branches, commencing from the proposed effective date of 31 December 2024. Where there has been a significant development in the winding up regime applicable to the branch in the intervening

[52] Articles 304 to 311 and Article 372.2.

[53] Solvency II has entered into force on I January 2016

[54] See **Technical Annex I** of the Branch Guidelines.

period, third-country branches would be required to resubmit an updated version of the proposed resolution report reflecting the significant developments.

7.24 The PRA proposes to give effect to this proposal through the inclusion of this new requirement in the Reporting Part of the PRA Rulebook. The PRA also proposes to transpose the existing reporting expectations on home state winding up arrangements from Technical Annex I of the EIOPA Branch Guidelines to SS44/15, to provide supplementary guidance to third-country branches on how to complete the proposed resolution report.

Reporting on the SCR by insurance groups

Consolidation of group SCR reporting by calculation method

7.25 Understanding how insurance groups are calculating the SCR, and the SCR result, are important to the PRA's supervision in line with its general objective of promoting the safety and soundness of PRA authorised firms, and the PRA's insurance objective of contributing to the securing of an appropriate degree of protection for policyholders. At present, the SCR result for insurance groups is reported separately in templates S.25.01 to S.25.03 depending on the method by which firms calculate capital requirements (eg using the standard formula, a partial IM, or a full IM).

7.26 Consistent with the PRA's proposals for solo firms in CP14/22, the PRA considers that reporting of the SCR by insurance groups could be simplified to provide a centralised view of overall SCR calculation, which reduces the extent of data transformation that the PRA has to perform over SCR reporting to support meaningful analysis.

7.27 The PRA proposes to delete the existing SCR templates S.25.01, S.25.02, S.25.03, SR.25.01, SR.25.02, and SR.25.03. Insurance groups would instead:

- report new templates S.25.04 and SR.25.04 (applicable to ring-fenced funds (RFF)) on all bases of SCR calculation (eg standard formula, partial IM, and IM). The reported data would be consistent with the contents of the existing template S.25.02 for partial IM firms, S.25.03 for IM firms, and existing S.25.01 and S.26 series for standard formula firms;

- report a new template S.25.05 that would show the SCR components for both partial IM and IM firms to replace the SCR information currently reported in S.25.02 and S.25.03; and

- disclose a new S.25.04.04 disclosure template, reflecting the proposed new S.25.04 reporting template, and cease disclosing the group level S.25.01.22 to S.25.03.22 templates.

7.28 The PRA proposes to update SS11/16 – **Solvency II: External audit of, and responsibilities of the governing body in relation to, the public disclosure requirement** to reflect the proposed changes to the group templates disclosed in the SFCR. The elements of the proposed group S.25.04.04 template calculated using an approved full or partial IM would remain exempt from External Audit 2.2(3) and 2.2(4).

Deletion of Group SCR reporting by risk module

7.29 Templates S.26.01 to S.26.07, and S.27.01 on the SCR result risk module (and related SR.26 and SR.27 at the fund level) report information that is similar to the proposed new S.25.04 template, and for groups information that is similar to the information reported in the S.26 and S.27 series by subsidiary firms.

7.30 To remove the overlap with the proposed S.25.04 template and equivalent reporting by subsidiary firms, the PRA proposes to remove the requirement for insurance groups to report templates S.26.01 to S.26.07 and S.27.01 at the level of the group. Reporting of S26.01 to S.26.07 and S.27.01 by solo firms is outside the scope of this proposal.

Group SCR reporting for ring-fenced funds, Matching Adjustment Portfolios and the Remaining Part

7.31 Solvency II requires that both solo firms and insurance groups also report SCR at the level of RFF, Matching Adjustment Portfolio (MAP) and Remaining Part where these portfolios exist, using templates SR.25.01 to SR.25.03, the SR.26 series, and SR.27.01. However, as the RFF and MAP are not consolidated in the group SCR calculation, the reporting on the RFF and MAP by groups in templates SR.25, SR.26, and SR.27.01 is not unique to the group consolidated SCR, and duplicates the information reported at the subsidiary level.

7.32 The PRA propose that groups with RFF, MAP or Remaining Part no longer report SR.25.01 to SR.25.03, SR.26.01 to SR.26.07, and SR.27.01 templates, and report the new SR.25.04 template instead. The PRA further proposes that when reporting the new SR.25.04 template, groups that have an RFF should combine the SCR results for the Remaining Part and embedded MAPs, as well as combine the results for the RFFs and embedded MAPs combined, to provide the PRA with a separate view of the 'shareholder' SCR and the 'policyholder' SCR. Where a group has separate IM and standard formula parts, the PRA proposes that groups report the combined results for the Remaining Part and embedded MAPs, as well as the RFF and embedded MAPs separately for each part.

Reporting of overseas sub-group under group SCR calculation method 2

7.33 The PRA's proposal in Chapter 5 of this CP to permit certain overseas sub-groups to be included in the calculation of the group SCR under method 2 would require an additional breakdown relating to the overseas sub-group within group SCR reporting. The PRA proposes to include this within a group version of the proposed new S.25.04 SCR template. This proposal would allow the PRA to supervise how firms are calculating the SCR under the group SCR Method 2 under the proposed permitted approach.

Reporting of the consolidated group SCR using multiple calculation approaches

7.34 The PRA's proposal in Chapter 5 of this CP to temporarily permit groups to use multiple calculation approaches to calculate the group SCR under method 1 would create the need to supervise SCR calculation results at the level of each permitted model. Existing SCR reporting, including the proposed new S.25.04 template aggregates SCR results at the level of the calculation method. For a group permitted to use multiple calculation approaches, this would result in a combined result, leaving the PRA unable to supervise SCR results at the level of the individual approach.

7.35 The PRA proposes that groups with temporary approval to use more than one calculation approach report the proposed template SR.25.04 separately for each approach. This proposed additional reporting would allow supervisors to have visibility of the results of the SCR, with the same level of detail as reported in S.25.04, for the parts of the group using different calculation approaches.

Third-country branch reporting

7.36 The current third-country branch reporting requirements reflect the existing requirements for branches to calculate on an ongoing basis the branch SCR, MCR, and risk margin, as well as the current third-country branch eligibility to use TMTP and TMIR (collectively referred to in this chapter as branch capital requirements). Additional information on the legal entity financial position and solvency is collected at the point of branch authorisation, and often on an ad-hoc basis. The proposals in Chapter 6 – Third-country branches to remove the rules relating to the calculation of branch capital requirements on an ongoing basis would render some existing reporting obsolete. At the same time, the changes would increase the importance to the PRA of regular reporting regarding the financial strength of third-country insurance undertakings (the legal entity) that are authorised by the PRA to establish a branch in the UK.

7.37 As a consequence of the proposed removal of the rules that require third-country branches to report and calculate branch capital requirements and risk margin on an ongoing basis, the PRA proposes to amend third-country branch reporting requirements.

Templates no longer reported by third-country branches

7.38 The PRA proposes to remove the current expectations for third-country branches to report the following templates as a result of the proposed removal of branch capital requirements:

- S.22.01.01 Impact of long-term guarantee measures and transitionals
- S.22.04.01 Information on the transitional on interest rates calculation
- S.22.06.01 Best estimate subject to volatility adjustment by country and currency
- S.23.01.07 Own Funds
- S.23.03.07 Annual Movements on Own funds
- S.24.01.01 Participations Held
- S.25.01.01 to S.25.03.01 on Solvency Capital Requirements undertakings (Standard formula, partial internal model and full internal models)
- S.26.01.01 to S.27.01.01 on Solvency Capital Requirements by risk components
- S.28.01.01 to S.28.02.01 on Minimum Capital Requirements
- SR.22.02.01 Projection of future cash flows (Best Estimate – Matching portfolios) [RFF/MP/RM]
- SR.22.03.01 Information on the matching adjustment calculation [RFF/MP/RM]
- SR.25.01.01 to SR.25.03.01 on Solvency Capital Requirements undertakings for RFF/MP/RM (Standard formula, partial internal model and full internal models)
- SR.26.01.01 to SR.27.01.01 on Solvency Capital Requirements by risk components for RFF/MP/RM

7.39 The PRA's proposal to remove branch capital requirements would result in the consequential removal of the requirement to hold assets in the UK to cover the branch SCR. Furthermore, the management of investments supporting the solvency of the branch and UK policyholders usually occurs at the legal entity level. Therefore, the PRA proposes to remove the expectation that third-country branches report detailed asset-side templates (as set out below), which would have the effect of streamlining branch reporting. The PRA considers that the key information reported in these templates is reported in other templates, in particular the branch balance sheet (S.02.01):

- S.02.02.01 Assets and liability by currency
- S.03.01.01 Off-balance sheet items – general
- S.03.02.01 Off-balance sheet items – List of unlimited guarantees received by the undertakings
- S.03.03.01 Off-balance sheet items – List of unlimited guarantees provided by the undertakings
- S.06.02.07 List of assets
- S.06.03.01 Collective investment undertakings – look-through approach
- S.08.01.01 Open derivatives
- S.09.01.01 Income/gains and losses in the period
- S.10.01.01 Securities lending and repos
- S.11.01.01 Assets held as collateral

7.40 The PRA proposes to remove these templates by removing the associated reporting expectations currently contained in the Branch Guidelines and referred to in SS44/15 – **Solvency II: third-country insurance and pure reinsurance branches**.

Amendments to existing templates reported by third-country branches

7.41 The PRA's proposal to remove branch capital requirements (including eligibility for TMTP and TMIR) will render certain rows in several templates obsolete for third-country branches. The PRA's proposal to remove the requirement to calculate the branch risk margin on an ongoing basis would also mean third-country branches are no longer able to report 'technical provisions' as currently defined in reporting instructions.

7.42 Therefore, the PRA proposes to amend the templates set out below, as well as update the references to branch technical provisions in all template instructions in order to effect the proposals:

- S.01.01 Content of the submission
- S.01.02 Basic Information – General
- S.02.01 Balance sheet
- S.12.01 Life and Health SLT Technical Provision
- S.17.01 Non-Life Technical Provisions
- S.14.01 Life obligations analysis (log amendment)
- S.16.01 Information on annuities stemming from Non-Life Insurance obligation (log amendment)
- S.31.01 Share of reinsurers [including Finite Reinsurance and SPV's] (log amendment)
- SR.12.01 Life and Health SLT Technical Provision [RFF/MAP/RM]
- SR.17.01 Non-life Technical Provisions [RFF/MAP/RM]

New reporting by third-country branches

Reporting by third-country branches on legal entity financial position

7.43 As set out in Third Country Branches 13.1 of the PRA Rulebook, a third-country branch must maintain adequate worldwide financial resources. **SS44/15** sets the expectation that third-country branches provide sufficient information so that the PRA may form an opinion on the adequacy of these worldwide financial resources of the legal entity undertaking. Furthermore, as set out in **SS2/18**, the level of protected liabilities under the FSCS is a strong indicator of the impact of failure of a branch to both policyholders and FSCS levy payers. However, even if an insurer's FSCS liabilities are below the £500 million indicative threshold for consideration of subsidiary operation, it could still pose significant risks to the financial stability of the UK. As such, the PRA also considers other relevant factors when reviewing the potential impact of a third-country branch on financial stability. These factors can include aspects that are managed by the third-country branch undertaking as a whole, rather than by the branch independently – such as asset portfolios and reinsurance arrangements.[55] The PRA also considers that the legal entity capital and solvency, and the management of operations on behalf of the UK branch by the third-country branch undertaking to be

[55] In particular, substantial reinsurance cessions by the branch undertaking may undermine the independence of the branch, while significant intra-group reinsurance may indicate that, in substance, the third-country branch undertaking operates like a branch that is dependent on an intra-group entity (a 'branch of a branch').

important to the PRA's regulation of the safety and soundness of third-country branches, and the protection of branch policyholders.

7.44 The PRA currently collects information relating to the third-country branch undertaking as a whole in a non-standardised format as part of the authorisation of third-country legal entities to operate in the UK as insurance branches, and on an ad hoc basis following authorisation. The current absence of standardised reporting on the legal entity financial position increases the burden on third-country branches and supervisors to meet and analyse ad-hoc data requests. As set out in Chapter 6 of this CP, the PRA's proposals to remove the requirement to calculate branch capital requirements are also predicated on it having an appropriate level of understanding about the adequacy of financial resources for the whole entity.

7.45 Therefore, the PRA proposes to introduce a new annual template S.01.04.07: Basic Information – Branch Legal Entity to be reported by all third-country branches including pure reinsurers. S.01.04.07 would collect information on the capital and solvency position of the branch legal entity, including the reporting of own funds, SCR, best estimate, and premiums written. The PRA proposes that third-country branches would report the information in S.01.04.07 on both a year-end and a three-year forecast basis. The information in the proposed new template would enable the PRA to monitor a third-country branch's compliance with the PRA's requirements and expectations over the adequacy of the financial resources supporting UK branch policyholders on a forward-looking basis, and would replace the need for the current ad hoc non-standardised reporting currently received by the PRA. The PRA considers that the high-level data proposed in the S.01.04.07 template would be calculated by the third-country branch legal entities on a forecast basis as part of business planning purposes.

Reporting of National Specific Templates (NSTs) by third-country branches

7.46 The NSTs were introduced by the PRA for insurance firms to report on UK specific risk or business models which are not covered by Solvency II reporting. These NSTs are currently applicable to solo firms and not third-country branches.

7.47 With the significant increase in the number of third-country branches operating in the UK after its departure from the EU, insurance business written through third-country branches has increased in materiality, especially in non-life insurance lines. The PRA proposes to extend the scope of application of the NSTs to third-country branches to obtain a whole market view of certain products or exposures of a firm, which aids the PRA in cross-firm analysis.

7.48 The PRA proposes to extend the following NSTs to third-country branches:

- NS.00 Basic Information
- NS.01 With-profits value of bonus
- NS.02 With-profits assets and liabilities
- NS.03 Material pooling arrangements
- NS.04 Assessable mutuals
- NS.07 Business model analysis (non-life)
- NS.08 Business model analysis (financial guarantee insurers)
- NS.10 Projection of future cash flows (best estimate – non-life: liability claim types)
- NS.11 Non-life claim development information (general liability sub-classes)

7.49 The information collected from these templates would assist the PRA in conducting periodic risk assessments on lines of business that the PRA considers to be higher risk, as well as cross-product analysis. Currently, NS.01 and NS.02 are only required to be reported by life firms exceeding £500 million in net best estimate liabilities for with-profit insurance business. The proposed extension would support PRA supervision in the event that any life third-country branches would grow to be significant in the future. The existing scope of application of NS.03 and NS.04 to firms with a material pooling agreement or a firm that is an assessable mutual respectively would also extend to third-country branches.

Implementation of third-country branch reporting proposals

7.50 The EIOPA Third Country Branch Guidelines currently list the templates and instructions that third-country branches are required to submit to the PRA, and SS44/15 sets out the PRA approach to waiving aspects of this reporting for certain third-country branches. To give effect to the proposals within this CP, the PRA proposes to set out the full list of templates that third-country branches would be required to report in the Reporting Part of the PRA Rulebook, setting out separately the templates to be reported by pure reinsurance branches, and other third-country branches. To support the consistent implementation of the third-country branches reporting requirements, the PRA proposes to transfer the additional reporting related requirements in the EIOPA Third Country Branch Guidelines into the Reporting Part of the PRA Rulebook and the reporting-related expectations into SS44/15. This would support the transparent exercise of the PRA policy and enhance the clarity of the PRA's expectations supporting third-country branch reporting.

7.51 The reporting-related Branch Guidelines proposed for transfer and restatement are set out in Annex 20 of this CP. Where the PRA is proposing to transpose the requirement for third-country branches to report templates and instructions into the PRA Rulebook without making any changes to those templates and instructions, the templates and instructions themselves are not appended to this CP. Final forms of these templates and instructions as they will form part of the Rulebook will be published in a future consultation.

7.52 The proposed transfer of the existing list of reporting templates applicable to third-country branches to the PRA Rulebook by itself would not result in a material change to the scope of reporting that is applicable to third-country branches. Third-country branches already submit the majority of templates set out in the proposed edits to the Reporting Part of the PRA Rulebook (Annex O of Appendix 2) on an ongoing basis. However, the proposed transfer of third-country branch reporting to the PRA Rulebook would change the legal form of third-country branch reporting from a PRA expectation to a PRA rule, which impacts how the PRA supervises non-compliance. The proposed transfer of general reporting guidance from the Branch Guidelines to SS44/15 would maintain the PRA expectation status of this content.

7.53 To maintain the existing supervisory approach of limiting the scope of reporting expected to be submitted by third-country branches classified by the PRA as Category 3 and 4 firms under its supervisory approach, the PRA proposes to merge the existing content on the PRA's approach to waiving branch reporting with the existing content related to the waiver of quarterly reporting for solo firms that is set out in SS11/15. The PRA proposes to repeal SS11/15 and replace this with the new SoP – Solvency II regulatory reporting waivers, which restates the current content of SS11/15 and the reporting limitation sections of SS44/15.

Other reporting changes

Reporting the TMTP

7.54 Firms currently report on the overall calculation of TMTP in template S.22.05 which includes detail on the technical provisions (TPs) subject to TMTP, the amortisation rate for TMTP, and the TMTP amount after applying a FRR test. The reported data are often inconsistent because firms apply different and complex methods for determining the TMTP.

7.55 The PRA's proposal in Chapter 2 of this CP to introduce a new, simplified method for calculating TMTP will reduce the value of the information captured by S.22.05. As such, the PRA proposes to delete S.22.05 for all firms currently required to report this return.

7.56 To enhance the reporting of TMTP, the PRA proposes to delete several rows in S.12.01 and replace them with new rows to capture the individual elements of TMTP, divided between static and dynamic components relating to the best estimate and technical provisions calculated as a whole, a risk margin component, and an adjustment for any additional amortisation as required. Firms would report TMTP as a positive value in S.12.01, rather than a negative value as currently required by the template. The PRA also proposes to delete several rows in S.17.01 relating to TMTP because it does not apply to any non-life insurance firms. Combined with the proposed deletion of S.22.05, this proposal would simplify TMTP reporting and better align the information submitted with the PRA's supervisory approach to TMTP following the proposed changes set out in this CP.

7.57 TMTP is also included in the PRA's market risk sensitivity reporting. The PRA proposes to simplify the market risk sensitivity template (MR.01.02) by removing redundant data items owing to the new calculation approach to TMTP and the removal of the FRR cap. This consists of the deletion of Section 1 and Section 3 which relate the further TMTP recalculations to the balance sheet data and the removal of the column on TMTP post cap. The PRA proposes to update SS7/17 to reflect these proposed changes.

Reporting on best estimate liabilities subject to volatility adjustment

7.58 The PRA uses the information reported in the existing S.22.06 template reports on the best estimate liability (BEL) subject to volatility adjustment (VA) when setting the volatility adjustment for firms. S.22.06 provides the PRA with insight to the amount of liabilities calculated using non-GBP currencies, which is important for the PRA to understand as part of its review of its VA calculation process. However, the current design of the template requires additional transformation of data by the PRA, in particular data reported on the BEL subjected to volatility adjustment across each currency.

7.59 The PRA considers that S.22.06 could be restructured to simplify the reporting of VA relevant information. The PRA proposes to delete template S.22.06 and replace it with a new simplified S.22.07 template featuring a closed template structure that will focus on the BEL subjected to VA for each of the currencies for which the PRA calculates a volatility adjustment.

Reporting on minor model change (QMC.01)

7.60 Solvency II firms that use a full or partial IM to calculate their SCR currently report minor model changes to the PRA on a quarterly basis, with the option of using the QMC.01 template set out in SS17/16 – **Solvency II: internal models – assessment, model change and the role of non-executive directors**. However, the use of this template varies between firms. Many firms make use of the QMC.01 template when demonstrating compliance with the expectation, and some choose to report the IM changes in a different format. This inconsistency makes it difficult for the PRA to review the IM change information submitted.

7.61 The PRA proposes to require all firms to use the streamlined QMC.01 template to report both major and minor IM changes over each quarter, thereby removing the option to report

IM changes in an alternate format. Firms would also be required to submit supporting narrative documentation containing an explanation for each IM change. To promote the consistent reporting of QMC.01, the PRA proposes to move the relevant reporting policy from SS17/16 to the Reporting Part in the PRA Rulebook. SS17/16 would support the PRA's review of QMC.01 by setting out the PRA's expectations of firms' supporting narrative documentation. The PRA considers that this proposal would improve consistency in the information reported across the industry. It would also increase the efficiency of the PRA's review process and reduce the need for ad-hoc PRA information requests to firms.

7.62 Further, the PRA considers that the QMC.01 template could be simplified. The PRA proposes to streamline the structure of the QMC.01 template by reducing the detail required to be explained for each IM change.

Reporting on internal model SCR change

7.63 The existing IM oversight framework requires firms to undertake profit and loss attribution testing. This testing does not provide the PRA with sufficient insight into firms' changing and emerging risks and how these impact the SCR. The PRA has relied on ad hoc data requests for this purpose.

7.64 As set out in Chapter 3, the PRA proposes to delete all the tests and standards (T&S) relating to profit and loss attribution and instead introduce a new requirement for firms using a full or partial IM to report an analysis of change (AoC) exercise on the SCR, which would replace the previous ad hoc requests. IM firms would be required instead to submit an AoC on an annual basis for movements in its SCR between each financial year-end. In addition, firms who seek a new, or variations to, IM permissions from the PRA, may be expected to submit an AoC exercise to the PRA, where discussed with the firm and deemed appropriate by the PRA.

7.65 The proposed new requirement would facilitate the PRA's proposed internal model ongoing review (IMOR) framework to allow the PRA's ongoing monitoring of firms' IMs. In particular, the introduction of this requirement would provide the PRA with more targeted information to understand the reasons behind firms' SCR movements.

7.66 To facilitate this proposal, the PRA proposes to introduce a new reporting template, AoC.01, to report on the quantitative impact of each of the material causes of SCR movement. Alongside the AoC.01 reporting template, firms would also be required to submit supporting narrative documentation containing a granular explanation of the causes of the SCR movements, including information on the 'balancing item' of the exercise. Firms would be expected to provide the material causes of the SCR movements.

7.67 As set out in SS17/16, in the supporting narrative documentation, firms are also expected to provide: a summary of any material actions taken or considered as a result of the AoC exercise; the reasons for any movement in diversification benefit over the period; the definition of material used in the AoC exercise; the internal governance surrounding the analysis of change exercise; and an up-to-date list of MLAs and CAOs incorporated within its most recent SCR. The format of the narrative documentation would be at the discretion of firms. Firms would be encouraged to include any additional information to that listed above where they feel it is relevant to explaining the movements in its SCR and appropriate to do so.

7.68 The PRA expects that many firms already undertake exercises similar to that proposed in the AoC reporting as part of internal risk management. Furthermore, the AoC.01 template will be a largely free-form in structure, allowing firms to submit and carry out the AoC exercise in their preferred structure and order. The PRA proposes that AoC.01 is not reported in eXtensible Business Reporting Language (XBRL) or incorporated into the Solvency II Taxonomy. Therefore, the PRA expects that firms could leverage the documentation of their internal AoC exercises in complying with this requirement.

7.69 Firms would submit the AoC exercise to the PRA commencing from year-end 2025 onward. The PRA considers that this will provide firms with sufficient time to update its internal processes to undertake the AoC exercise.

7.70 In addition to amending the Reporting Part of the PRA Rulebook to implement this annual reporting requirement for IM firms, the PRA also proposes to update SS17/16 with the PRA's expectations on how firms would complete the AoC.

Internal model output (IMO) reporting

7.71 Firms permitted to use an IM and partial IM to calculate the SCR are expected to report IM output data as set out in SS25/15 – **Solvency II: Regulatory reporting, internal model outputs**. The PRA uses this reporting as an important part of its IM supervision to help identify the potential weakness in IM risk calibrations and significant movements in outputs. The data collected not only inform the PRA about a firm's application of their IM, but also act as a trigger for supervisory investigations.

7.72 The existing reporting features certain data gaps which include granular information on zero coupon bond spot yield and spread widening calibrations, which makes it difficult for the PRA to assess the strength of a firm's IM calibration. The PRA has only addressed this issue for template IM.01, IM output (life) in CP14/22 and has yet to address this issue for the non-life IM output templates.

7.73 Therefore, the PRA proposes to amend the IMO templates and instructions as follows:

- amend IM.03, internal model output (non-life), to:
  - make 'IM.03.07 – Market Risk Outputs' consistent with the proposed changes for IM.01 – Internal model risk output (life) in CP14/22, which includes:
    - introduction of an additional term of 40 years for the risk-free zero-coupon bond spot yield;
    - introduction of an additional term of 25 years for zero coupon bond (ZCB) spot yield spread (over risk-free) for ratings: AAA, AA, A, BBB, B;
    - clarifying the instructions for implied interest rate volatility and for implied inflation; and
    - amending some of the existing row labels and instructions to improve clarity and consistency of submissions.
  - correct references to other templates in IM.03 instructions;
  - remove the expectation to convert to GBP amounts reported and other items in IM.03 instructions which are no longer reflected in the template; and
  - combine non-life annuities relating to health and other than health into a 'non-life annuities' column in IM.03.02, MO.03.02 and IM.03.10 templates, and
- amend IM.00, internal model output – content and basic info, to enhance clarity of the information provided and make reporting of IMO submissions at ring-fenced fund level consistent throughout the reporting package.

Asset reporting

7.74 The PRA uses data collected in the S.06.02 and S.06.03 template series to supervise firms and in particular to understand potential trends and risks in firms' investment portfolios. The PRA has previously consulted on the reduction of the reporting frequency of the line-by-line asset reporting (S.06.02) and look-through reporting (S.06.03) for some insurance entities in CP14/22.

7.75 To improve the utility and consistency of the remaining asset data across all firms, the PRA proposes to make minor amendments to the S.06.02 instructions, in particular to:

- allow separate identification of exposures to equity release mortgages by introducing a new asset code (CIC 83);

- improve the reporting of credit ratings by requiring firms to report internal credit ratings whenever it is relevant to the SCR calculations and by clarifying when external credit ratings should be reported; and
- improve the reporting of sector classifications by requiring firms to report the letter identifying the Section followed by the four digits code for the class, for all Sections and not just financial and insurance activities.

Reporting of the Solvency II balance sheet

7.76 The reporting of technical provisions as a whole by firms in the S.02.01 and the related SR.02.01 balance sheet templates returns tends to be inconsistent, which leads to equivalent products being reported differently, and results in a varying ability to monitor best estimate liability calculations from the balance sheet.

7.77 The PRA proposes the following changes to the S.02.01 and SR.02.01 templates for all entities (solos, groups, and third-country branches):

- remove the separate data item for TP as a whole and simplifying it to a split between the TP for life and non-life;
- amend the reporting of best estimate liabilities (BEL) by introducing separate data entries for the split of BEL for life and non-life and improving clarity in the calculation of BEL S.02.01 instructions;
- introduce new rows splitting the sum of risk margin for life and non-life;
- introduce a new row to report TMTP for life insurers;
- simplify the reporting of reinsurance recoverables from life and non-life; and
- remove the Statutory Accounts columns in SR.02.01 as reporting at the RFF/MAP/RM level is not a statutory accounting requirement in the UK.

7.78 Solvency II does not currently require firms to submit balance sheet data for MAP, which makes it challenging for the PRA to derive the individual MAP balance sheets for firms with a MAP in both ring fenced-funds (RFF) and the Remaining Part. Given the significance of some firms' MAP portfolios, this is a material gap. To address the gap in the information collected, the PRA proposes that firms with a MAP report SR.02.01 for each MAP as well as the remaining part.

Best estimates assumptions for life insurance risks

7.79 The PRA uses NS.09 template on best estimate assumptions for life insurance risks to identify gaps within a firm's best estimate assumptions and to show industry trends on claims experience in the life insurance sector.

7.80 The PRA proposes to limit the requirement for solo undertakings to report NS.09 by introducing a threshold where a firm only reports this template when their gross best estimate liabilities for direct business exceed £50 million or their gross written premiums for direct business exceed £10 million. The PRA proposes that reinsurers are also exempted from reporting NS.09. For group reinsurers, reporting NS.09 would duplicate data reported by ceding firms. For non-group reinsurers, the basis and experience vary by cedant and collecting summarised data would not be meaningful to the PRA.

Business model analysis – financial guarantee insurers

7.81 The PRA uses NS.08 template on business model analysis for financial guarantee insurers to collect information about portfolio of securities against the financial guarantees which have been used to facilitate a firm's business model analysis.

7.82 The PRA proposes to make minor amendments to instructions to enhance the clarity of the requirement to report external and internal ratings. Once amended, these instructions would be consistent with the instructions used in the Shares of reinsurers template, S.31.01.

Reporting remittance deadlines

7.83 Firms are required to submit solo quarterly reporting five weeks after the reporting reference date. However, following the UK's withdrawal from the EU, the PRA has taken on the responsibility of publishing technical information on risk-free rates (RFR) term structures and fundamental spreads for the calculation of the matching adjustments. This information is frequently used by insurance firms to calculate technical provisions. As the publication of this technical information occurs during the reporting preparation period for 31 December quarterly reporting, the PRA proposes to extend the solo and third-country branch quarterly reporting deadline by one working week (five business days) to provide firms with additional time to process the technical information.

7.84 Reporting remittance deadlines are currently specified in weeks. During periods with a higher number of non-working days (eg bank holidays), firms may have less time to prepare reporting. The PRA proposes to restate all remittance deadlines in business days to ensure that firms have a consistent reporting remittance period across the year. For example, the PRA proposes to restate the existing five weeks solo quarterly reporting deadline to 30 business days.

Changes to other policy materials

7.85 The reporting changes proposed in this chapter and in CP14/22 would alter a number of aspects of Solvency II reporting requirements. Further, the PRA's proposed transfer of relevant reporting content from the onshored ITS 2450 and ITS 2452, and EIOPA Branch Guidelines to the Reporting Part of the PRA Rulebook has consequential impacts on the continued relevance of existing PRA policy material. In addition to the proposed SS changes set out in this chapter, the PRA proposes to amend additional SSs to align with the broader changes proposed to the reporting expectations and the Reporting Part of the PRA Rulebook.

7.86 The PRA proposes to revoke SS6/18 which sets out the instructions accompanying the existing NST templates. The PRA proposes to restate the instructions in the PRA Rulebook. This proposal would not result in a material change to the NST instructions beyond the proposed changes set out in this chapter and CP14/22. Under this proposal, the legal form of the NST instructions would be changed from an expectation to a rule, which impacts how the PRA supervises non-compliance. The PRA considers that centralising the location of key Solvency II reporting material supports the clarity of reporting requirements.

7.87 The PRA proposes to amend SS40/15 to remove guidance on templates that the PRA has proposed to delete, and remove guidance on the exercise of reporting options contained in ITS 2450, for which the PRA expects firms to apply the default approach in the Solvency II reporting instructions.

Taxonomy implementation

7.88 Solvency II insurers report to the PRA using two different taxonomies. QRT-based reporting is submitted using the EIOPA authored Solvency II taxonomy (currently on Taxonomy version 2.6). The Bank's Insurance Taxonomy (currently on version 1.3.1) is used for the reporting of the NSTs, IMO, market risk sensitivities and the Standard Formula SCR templates (for firms with an approved IM).

7.89 The PRA intends to publish a single taxonomy package which encompasses proposals listed in this CP, CP14/22 and the deletions published in PS29/21. As such, the PRA expects all UK Solvency II insurers would cease reporting to the PRA using an EIOPA authored taxonomy from the implementation date (See 'Implementation' section in chapter 1 - Overview of this CP).

7.90 The PRA is also considering how to import the EIOPA authored Solvency II taxonomy and maintain it with the existing Bank's Insurance Taxonomy.

7.91 Furthermore, the PRA intends to revise all prefixes (eg S, SR, NST) for the whole insurance taxonomy. However, in order to maintain traceability around which templates would change as a result of a proposal, the PRA has used the current prefixes to Solvency II reporting templates when listing the proposed changes to the reporting in this chapter.

7.92 The PRA is not proposing changes to the data collection system for Solvency II reporting, which is currently collected using the Bank of England Electronic Data Submissions (BEEDS) portal, or the format of reporting, which is currently submitted using XBRL templates.

PRA objectives analysis

7.93 The PRA considers that the proposals in this chapter would advance its primary objectives of safety and soundness and policyholder protection. The proposed amendments to reporting requirements, including the deletion of the RSR and reduced third-country branch reporting requirements, would lower the reporting burden on firms without compromising the PRA's ability to monitor risks to its objectives. Existing reporting requirements and the proposed amendments would continue to ensure that the PRA receives adequate information to support supervision while enhancing the efficiency of its supervisory activities.

7.94 Given the significant number of third-country branches authorised by the PRA following the UK's withdrawal from the EU, the proposed extension of the application of certain NSTs to third-country branches would ensure that the PRA has important information on the drivers and relevant exposures underlying a branch's prudential and financial risks. The new legal entity reporting template advances branch safety and soundness, and policyholder protection through facilitating more effective monitoring of the strength of the financial resources supporting UK branch policyholders on a proactive and forward-looking basis.

7.95 The PRA also considers that the proposals in this chapter would ensure that it has the necessary information to understand the results of individual SCR calculations before diversification and enable the PRA to better assess overall group solvency. By improving existing SCR reporting for groups, the PRA expects these proposals could enhance its ability to supervise how firms are calculating the SCR across different methods, which would advance the PRA's primary objectives of promoting the safety and soundness of PRA-authorised persons and policyholder protection.

7.96 The PRA has assessed whether the proposals facilitate effective competition. The PRA expects that the proposals would enhance the overall proportionality of the reporting requirements, remove unnecessary administrative burdens on firms, and support more efficient utilisation of resources.

7.97 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. The PRA considers that the proposals would lead to better allocation of resources by Solvency II firms, contributing positively to the UK's international competitiveness. The proposals would contribute to a regulatory regime that is open to international business and provides clear and accessible rules. This, in turn, would facilitate competitiveness and help maintain trust in the UK as a good place to do business.

Cost benefit analysis

7.98 The baseline for the CBA is the current Solvency II rules and legislation.

7.99 In developing the reporting and disclosure proposals set out in this chapter, the PRA has considered the costs and benefits of the proposed changes. The costs of reporting change may materialise as one-off operational costs to firms to implement changes to the taxonomy and reporting systems, and once implemented, changes to reporting requirements could lead to either a cost saving or increase depending on how the proposals alter a firm's ongoing resource effort involved in compiling, validating, and submitting the reported data. Qualitative benefits are expected to centre on the advancement of the PRA's ability to identify and respond to threats to its primary objectives by enabling the PRA to understand how firms complying with the Solvency II framework, and inform supervisory action. The relevance and quality of the information reported, and the efficiency with which the PRA can obtain the data it needs to supervise both firms and the industry, are key factors underlying its ability to carry out its objectives.

7.100 All Solvency II firms would be affected by the proposals, but some proposals are only relevant to certain populations, including:

- 29 IM users
- 24 TMTP users
- 130 third-country branches

Benefits

7.101 The proposals in this chapter have the collective aim of ensuring that the data collected by the PRA is better aligned to the PRA's firm level, and cross industry supervision needs, in support of our objectives, while reducing both the volume and complexity of the reporting submitted across the industry.

7.102 By collecting the proposals set out in this chapter in a formalised, consistent, and routine manner, the PRA is able to make less use of ad-hoc data requests in areas of key supervisory interest (eg legal entity financial strength, SCR analysis) which can involve higher costs and less predictability for firms, and which can generate data of a lower quality, limiting its comparative usefulness. The PRA expects that the efficiency, quality, and analytical value of proposed reporting would be enhanced through incorporation into the PRA's insurance taxonomy and Rulebook, allowing both firms and the PRA to continue to leverage off the existing collection and analytical capabilities of the BEEDS collection system, validation architecture and analytical tools.

7.103 The proposed changes to third-country branch reporting would enable the PRA to effectively implement the proposals set out in Chapter 6 for branches and provide more insightful and streamlined data on activities conducted by third-country branches operating in the UK. The proposed new reporting on the third-country entity financial strength, NSTs, and resolution arrangements allows the PRA to monitor more efficiently, and respond to risks to the stability of the branch, and the protection of UK branch policy holders.

7.104 The proposed changes to SCR reporting by groups, including internally modelled SCR reporting in the AoC and QMC templates, collectively aim to provide the PRA with a more targeted view of changes in the SCR measures, and provides a better picture of the overall SCR at the point of submission, thereby reducing the need for the PRA to undertake unnecessary data transformation, and improve the consistency of risk detection to obtain meaningful insight into firms' SCR.

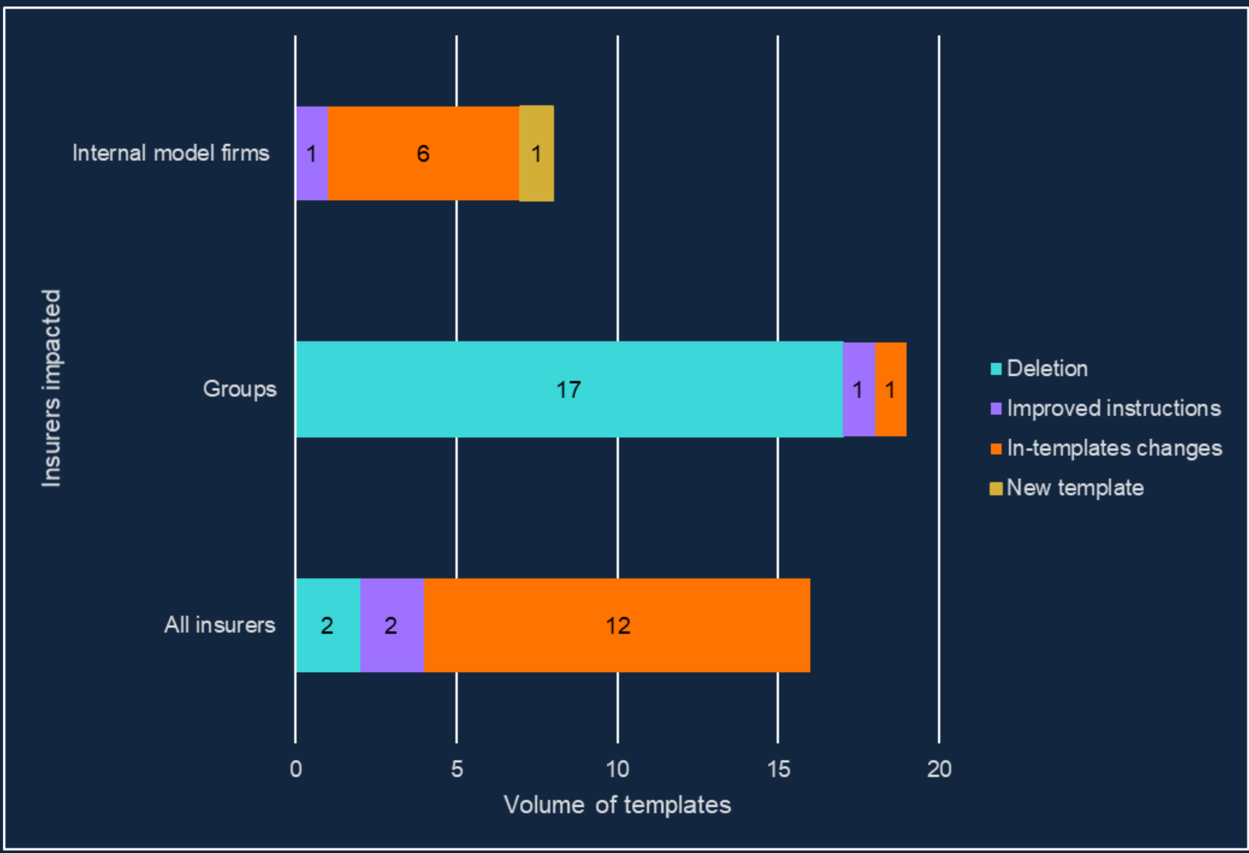
7.105 The proposals set out in the rest of this chapter collectively aim to streamline and better align the data reported to the PRA with areas of key supervisory interest. The proposed changes to TMTP reporting both reduce the volume of information submitted on TMTP, by deleting S.22.05 and replacing this with a more targeted and streamlined collection of the major components that the PRA considers to be most relevant under the proposed TMTP calculation approach by amending existing reporting. The proposed changes to IM output reporting aim to refine the information reported on IMs to close out data gaps and strengthen the PRA's understanding of IM calibration.

7.106 The proposed changes set out in this chapter seek to build upon PS29/21 and CP14/22 to reduce the overall volume and the complexity of Solvency II reporting, and reduce the need for firms to meet ad hoc data requests in areas of key supervisory interest (eg legal entity financial strength for branches, SCR analysis). These reporting proposals are not targeted to an insurers' size, but reflect the specific nature of group and branch business models owing to the corresponding proposed changes to group and third-country branch requirements set out in this CP.

7.107 Accordingly, the PRA expects that the proposals in this CP will benefit insurance groups, by reducing the volume of SCR reporting required, through the deletion of risk module level SCR reporting, and the centralisation of SCR data in a handful of templates. Chart 8 illustrates the distribution of the proposals impacting all insurance firms (excluding branches) and those that impact specific business model or permissions.

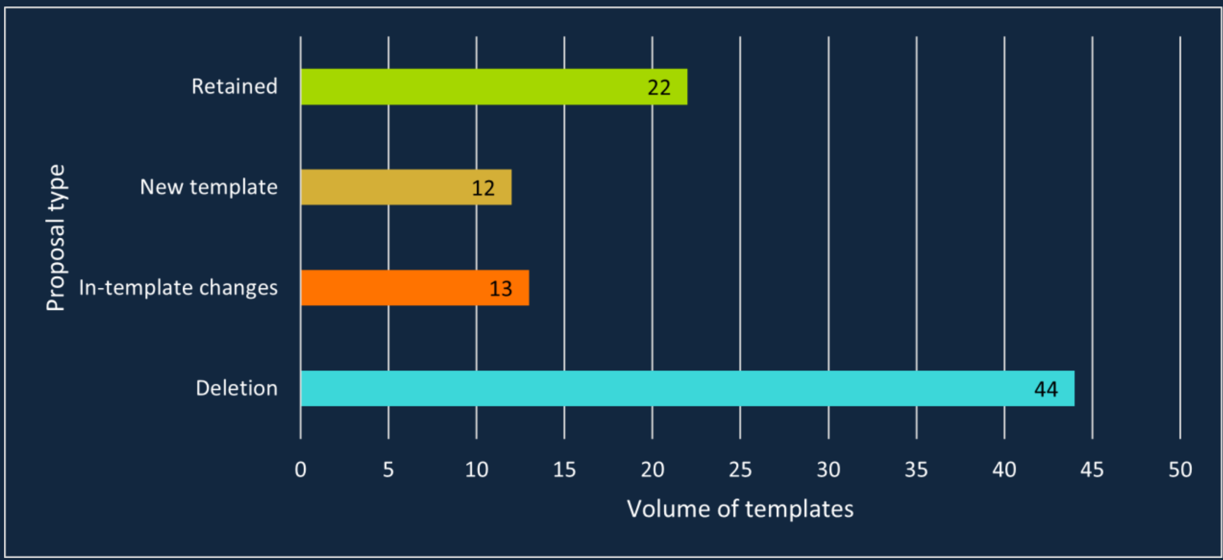
7.108 The proposed deletion of the RSR is expected to benefit all insurers. The free-form narrative format of the RSR is considered to be particularly burdensome to prepare, requiring manual compilation and lengthy review by firms.

Chart 8: the distribution of proposals in this CP to insurance companies



7.109 The reporting proposals impacting third-country branches would deliver a net reduction in the number of templates reported, and the complexity of reporting with the removal of reporting on capital requirements, TMTP, the risk margin, and detailed asset reporting. Chart 9 illustrates the distribution of the proposal types for branches, which lead to a net reduction in the volume of branch reporting.

Chart 9 – Distribution of proposals to third-country branches



7.110 The PRA estimates that once implemented, the proposals set out in this CP may result in a median reduction to ongoing Solvency II reporting and disclosure compliance costs across the industry, in addition to those estimated in CP14/22. The estimated industry-wide cost reduction could translate to a median saving of around £36 million per annum across the four insurer types set out in Table 3. This projected reduction reflects the proposed further net reductions to the volume of reporting proposed in this CP and based on survey data on historic annual Solvency II reporting cost of respondents between 2019 to 2021.

7.111 The PRA considers that the deletion of the RSR should result in cost savings for all firms. Due to the limited cost data associated with narrative reporting requirements, the PRA has treated the proposed deletion as equivalent to deleting one quantitative template, per firm, for cost estimation purposes. However, the PRA considers that this is highly likely to underestimate the benefit to firms from removing this report, due to the length and narrative format of the RSR, and also does not capture the likely cost savings from the multiple RSR submissions made by insurance groups covering each insurance entity.

7.112 Regulatory reporting enables the PRA to use its resources efficiently and proportionately and informs supervisory judgements on key risks and potential policy responses as part of day-to-day supervision at a firm, cross firm, and at an industry-wide level.

7.113 Relevant, insightful, and easy to analyse data advances the PRA's ability to identify potential issues to firms' financial resilience, outlier practices, and exposures, and support detailed thematic review work to identify market themes or areas of focus that could provide the PRA with insight into increasing levels of risk. Recent examples of work undertaken include the PRA's thematic review on general insurance reserving and capital modelling which focused on the effect of claims inflation on general insurance claims. The PRA used regulatory data to run its own claims inflation scenarios on firms' claims cashflow projects. The findings were shared with the industry in a Dear Chief Actuaries **letter** last year with additional follow-up work underway.

7.114 During periods of stress or anticipated changes in the external environment and economic and market conditions, regulatory data provides the PRA with critical information on firms' potential exposure and financial resilience. For example, asset reporting at the counterparty level has been a crucial resource to the PRA in the identification of insurers' exposure to distressed counterparties and instruments, and the assessment of possible areas of contagion. Recent examples of Solvency II reporting supporting supervision in times of stress include the assessment of exposures to counterparties such as Greensill Capital, Silicon Valley Bank (SVB), and Credit Suisse AT1 exposures.

7.115 Data reported to the PRA by Solvency II firms also supports horizon scanning by allowing the PRA to monitor trends in how risks are evolving and in identifying new and emerging risks. Solvency II reporting is used, along with other data sources, to assess financial stability by the Financial Policy Committee (FPC). More widely, insurance data enables other authorities and non-governmental bodies, including the Financial Conduct Authority (FCA) and the Office for National Statistics (ONS) to analyse the activities of the UK insurance industry as a whole, and understand the connections between insurers and the wider financial system.

Costs

7.116 The PRA has provided quantitative estimates for those proposals that are expected to have the most material impact on firms, and for which the PRA has sufficient granular information on firms' likely responses. The estimated costs and benefits in this analysis only reflect the incremental changes that the PRA anticipates affected firms would make to prepare and transmit data to the PRA under the specific proposals set out in this chapter. The estimates do not reflect the cost to report existing unchanged reporting and disclosure requirements, or the internal calculations that firms undertake to monitor compliance with existing, or proposed Solvency II capital and own funds requirements, or meet other PRA requirements (eg external audit).

7.117 Quantitative estimates for some proposals in this analysis have not been included where the PRA anticipates that the aggregate cost to all firms will not be material. This includes where the proposals do not result in a change to the content of the baseline regulation, such as the proposed restatement of existing ITS requirements and the relevant content of EIOPA Branch Guidelines on the supervision of branches of third-country insurance undertakings into the PRA Rulebook and policy material.

7.118 As many of the proposals set out in this chapter specifically impact insurance groups and third-country branches, estimates are also separately provided for this sub-population of Solvency II firms. The estimated costs for a median firm in each category was derived by calculating the template level cost of change, from the survey of the cost of similar historical changes. These template level costs have been applied to the proposals in this chapter to calculate the median firm impact, and then projected to the population of affected firms to estimate the total cost to all firms. Where the underlying data permits, a range of the costs has been provided to better account for and reflect the variation of insurance and reinsurance firms both in terms of size and business models, and account for the variation in survey responses.

7.119 The PRA has used the same basis for estimation for the proposals set out in this chapter as was used for CP14/22, using data drawn from a voluntary **survey** to all insurers on Solvency II reporting costs in April 2022. Using these historical costs as a basis and projecting to the proposals set out in this CP, the PRA has estimated the potential one-off implementation cost, and the likely impact to ongoing compliance costs of the proposals set out in this chapter. The estimates reflect the response rate and quality of the data shared with the PRA, and should be treated as indicative, subject to uncertainty and sensitive to the underlying assumptions. Table 3 sets out the estimated costs to firms to implement and run the proposals set out in this chapter only. Table 3 should be read in conjunction with the cost benefit analysis published by the PRA in CP14/22.

Table 3: Estimated median operational compliance cost by type of firm[b]

Type of firm[d]	Estimated one-off implementation costs (£ 000's)	Estimated implementation cost (as % of operational costs)	Estimated ongoing costs/(savings) per year (£ 000's)[c]
Small insurer[a]	3 to 10	0.003%	(10)
Large insurer[a]	160 to 290	0.046%	(20)
Insurance group	450 to 830	0.013%	(520)
Third-country branches	17 to 690	0.107%	(30)
Industry total	**34,000 to 64,000**		**(36,000)**

Source: PRA

(a) Small entities fall within PRA designated Category 3 to 4 and mutuals. Large entities fall within PRA designated Category 1 to 2. This population covers solo firms that are not subsidiaries in an insurance group.
(b) Table shows the incremental costs for the median firm in each type of firm category in the survey sample.
(c) The deletion of the RSR is treated in this table as the deletion of one quantitative template. In practice, the PRA considers that this is likely to underestimate the savings involved, given the likely costs involved for firms to produce the narrative RSR report.
(d) Firms with an approved IM are a sub-set of the firm types set out in the table, and proposed changes to IM reporting have been incorporated into the small and large insurer as well as insurance group estimates.

7.120 Table 3 above sets out the expected one-off implementation cost of the reporting and disclosure proposals contained in this CP. The one-off cost for a median solo firm, based on the survey responses, is estimated to range approximately between £10,000 and £290,000 for small and large firms respectively. The one-off cost for a median third-country branch, using solo firm survey responses as an estimation base, is estimated to range up to £17,000 and £690,000 for small and large branches respectively. The one-off cost for a median group, based on the survey responses, is estimated to be approximately £830,000. On an industry level, the PRA estimates that the aggregate one-off cost to implement the proposals in this chapter could range from approximately £34 million to £64 million.

7.121 Some proposals may incur higher or lower costs and savings for different firms dependent on the scope of a firm's own existing reporting requirements, and the relative change that the proposal may bring about. The potential costs and savings would also be impacted by the nature of firms' own internal reporting arrangements (eg degree of automation, use of outsourced services for implementation and ongoing reporting preparation etc). The estimated costs do not reflect the potential interactions with the implementation of the PRA's proposals set out in CP14/22 (eg economies of scale).

'Have regards' analysis

7.122 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. **Proportionality (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposals in this chapter would tailor and streamline reporting requirements in a way that is proportionate to the scale and complexity of firms, as well as the benefits of the information collected. The proposals introducing a new AoC reporting template, amendments to IM reporting, and additional data points required for balance sheet reporting are also proportionate given the current gap in the information collected by the PRA.

2. **UK attractiveness for international financial services (HMT recommendation letter):** The proposals in this chapter are intended to improve the overall efficiency of the market by streamlining existing reporting requirements while still ensuring sufficient supervisory oversight in line with the PRA's objectives. The PRA considers that these proposals would reduce the costs and burdens of some reporting and enhance the attractiveness of the UK market.

3. **The need to use its resources in the most efficient and economic way (FSMA regulatory principle)**: The proposed changes to existing reporting requirements seek to make efficient and economic use of PRA resources by deleting requirements that are no longer relevant and including only those necessary to enable effective supervision. The proposal to introduce a new legal entity reporting template and the proposed reporting under multiple permitted SCR calculation methods would reduce the need for the PRA to issue ad hoc reporting requests and allow third-country branches to submit information in a timely, uniform, and consistent way.

4. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposals in this chapter promote the clarity of reporting

requirements and expectations. The proposed changes in third-country branch reporting requirements, including the proposal to transfer and restate the Branch guidelines, would lead to a more transparent application of the prudential framework by clarifying the reporting-related requirements and expectations that apply to third-country branches.

5. **Smart regulatory reform (HMT recommendation letter):** The proposals set out in this section would be consistent with the Government's aim to deliver smart regulatory reform because they would streamline reporting requirements and make them target potential risk areas more effectively.

7.123 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this proposal, it is because the PRA considers that 'have regard' to not be a significant factor for this proposal.

8. Mobilisation

8.1 This chapter sets out the PRA's proposals to introduce an optional mobilisation stage for new insurers. It also sets out related proposals for amendments to the Minimum Capital Requirement Part of the PRA Rulebook (MCR Part) and the Composites Part of the PRA Rulebook.

8.2 Under the proposals in this chapter, mobilisation would be an optional stage of up to 12 months, beginning at the point of authorisation, during which a new insurer would operate with business restrictions while it completes the final aspects of its development. The PRA would apply proportionate regulatory requirements to firms that choose to go through a mobilisation stage, which includes a proposal to lower the absolute floor to the MCR (MCR floor) to £1 million for the purpose of mobilisation.

8.3 The PRA expects to transfer and restate retained EU laws into its Rulebook following their revocation by the Government. To ensure it can modify rules to lower the MCR floor for firms choosing mobilisation, the PRA proposes to transfer and restate Articles 248 to 253 of the SII CDR into either the MCR Part or the Composites Part. The PRA proposes to make the following amendments after transferring and restating Articles 248 to 253:

- Redenominating the MCR floor from EUR to GBP, given that GBP is the domestic currency of the UK and the reporting currency for most firms that are supervised by the PRA (Annex C of Appendix 2). This proposal is detailed in Chapter 10 – Currency redenomination. It will not be discussed further in this chapter.

- Moving a reference to the MCR being calibrated at an 85% confidence level over a one-year period from the MCR Part of the PRA Rulebook to the glossary definition of the MCR in the PRA Rulebook.

- Aligning the MCR floors for all types of composite insurers for a more consistent application of the PRA Rulebook (Annex D of Appendix 2).

8.4 The proposals in this chapter would result in changes to the MCR Part of the PRA Rulebook (Annex C of Appendix 2) and the Composites Part of the PRA Rulebook (Annex D of Appendix 2).[56] The PRA proposes to enable the mobilisation stage using its modification powers under FSMA. The PRA invites feedback on mobilisation, as described in the

[56] Proposed changes to the Composites Part of the PRA Rulebook would reflect the transfer and restatement of provisions relating to MCR from retained EU law.

proposals section of this chapter. Guidance on the final regime will be published on the PRA's website.

8.5 FSMA currently constrains the PRA from amending the MCR floor for firms in mobilisation, because some sections within Part 4A of FSMA would require the PRA to remove effecting permissions from firms that do not comply with MCR provisions as defined in EU law.[57] The Government stated in November 2022, in its **response** to its Solvency II review consultation, that it would work with the PRA to enable legislative changes that would allow for the introduction of a new mobilisation stage for insurers, enabling the PRA to lower the MCR floor in line with the proposals in this chapter. This would include removing the relevant parts of FSMA through the FSM Bill.

8.6 The mobilisation proposals aim to facilitate entry into insurance markets by enabling prospective insurers to apply for authorisation at an earlier stage in their development, for the limited purpose of mobilisation. The PRA expects that mobilisation would benefit new insurers by giving them the certainty of being authorised as they complete the final aspects of their set up, including securing further investment, recruiting new personnel, and strengthening operational capabilities. The PRA considers that its proposals would facilitate effective competition while continuing to promote the PRA's primary objectives of safety and soundness and policyholder protection.

8.7 This chapter is primarily relevant to prospective insurers interested in applying for authorisation as UK Solvency II firms.[58] Where the PRA proposes amendments to its Rulebook, this chapter is relevant to all UK Solvency II firms, the Society of Lloyd's and its members and managing agents, and insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings).

Background

8.8 The PRA has authorised a number of new insurance firms in recent years, consistent with its commitment to support competitive and dynamic markets in the sectors it regulates.[59] It has also established New Banks and Insurers Start-Up Units with the FCA to provide information and support to those thinking about setting up a new bank or insurer in the UK. However, the PRA is aware that start-up and other prospective insurance firms may face

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[57] Sections 55J(7B) and 55KA of FSMA would require the PRA to vary or remove effecting permissions from insurance undertakings that fail to comply with Solvency II capital requirements as defined in retained EU law, rather than in the PRA Rulebook.

[58] As defined in the **PRA Rulebook**.

[59] The PRA authorised seven new insurers in 2021/22. This brought the total number of new UK insurers authorised since the creation of the PRA to 44. Source: **PRA Annual Report 2021/22**.

challenges when trying to enter the market. In particular, new insurers may find it more difficult to attract investment and to recruit senior staff before they have been authorised, and as a result may also find it more challenging to meet some of the standards for financial and non-financial resources required for authorisation. The PRA considers that this circular problem is an unwelcome barrier to entry into insurance markets, particularly for start-up firms.

8.9 Respondents to HMT's **Call for Evidence** on the Solvency II Review in 2020 noted the difficulty new insurers can face in raising the necessary capital ahead of authorisation and said there should be no 'cliff-edge' requirements for new insurance firms. They suggested that newly authorised firms could be subject to more limited regulatory requirements in exchange for initial restrictions on their activities, which is in line with the PRA's proposals for a mobilisation stage in this chapter.

8.10 The UK has had a mobilisation stage for new banks since 2013. The PRA and the FCA introduced the framework as an alternative route into the banking sector, with the aim of facilitating entry and effective competition. Once authorised, mobilisation gives new banks up to 12 months to finalise the development of their businesses. The PRA and the FCA restrict the amount of deposits (usually £50,000) that firms can hold during this period. The proposed mobilisation regime for new insurers borrows some of the principles of the banking regime, but adapts the framework to fit the distinct nature of insurance risks and business models.

8.11 Any firm that wants to be an insurer (which includes the activities of effecting contracts of insurance or carrying out contracts of insurance) must be authorised to do this by the PRA. The PRA may only agree to authorise a firm if the FCA is also content for it to be authorised.

Insurer mobilisation

8.12 The PRA proposes to introduce a mobilisation regime for new insurers. Mobilisation would be a new, optional, and time-limited stage at the point of authorisation, following the pre-application and application stages (see Chart 10).[60]

8.13 For the purpose of mobilisation, the PRA would authorise firms with business restrictions at an earlier stage of their maturity.[61] Firms would then have a period of up to 12 months to finish building out their businesses. The proposals are aimed at facilitating entry into insurance markets for new insurers, particularly start-ups, which may find it difficult to

[60] Further details on the PRA's existing approach to authorisation, including the distinct stages of the process, are available in the **New Insurer Start-Up Unit Guide**.

[61] The PRA would only agree to authorise a firm if the FCA is also content for it to be authorised.

secure all the capital, infrastructure, and resources that would be required for authorisation without mobilisation.

8.14 The PRA proposes to restrict the nature, scale, and complexity of the business that firms can write during mobilisation using its powers under Part 4A of FSMA (mobilisation restrictions).[62] A restriction on business is a standard regulatory tool that is currently applied to many firms. The mobilisation restriction would lower the risks that firms can pose to policyholders and the PRA's objectives during the mobilisation period.

8.15 Firms taking the mobilisation route would generally not have fully developed operational capabilities, but they would need to meet the Threshold Conditions and applicable standards set out in the PRA Rulebook and the FCA Handbook at all times. The PRA would expect regulatory requirements to remain proportionate for firms in mobilisation, considering the restrictions on their business. The PRA also proposes to lower the MCR floor to £1 million for firms in the mobilisation stage, which it considers to be appropriate in light of the restricted nature, scale, and complexity of firms during mobilisation.[63]

8.16 Where a mobilisation regime is available for insurers, consent to authorisation of a new insurer would still be needed from the FCA. The PRA understands that the FCA would look to assess new applications against the key regulatory requirements considering the applicant's business model. The FCA would determine whether applicants would meet the FCA threshold conditions, both at authorisation and on an ongoing basis, together with any applicable ongoing conduct requirements taking account of the activities they proposed to carry on within the mobilisation period. This would include identifying whether additional specific restrictions, in addition to those proposed by the PRA below in the 'Mobilisation restrictions' section, may be appropriate to address any potential conduct risks considering the firm's stage of development and the business they intend to carry on in mobilisation.

8.17 The PRA provides further detail on the proposals in this chapter following the structure below:

- entering mobilisation
- mobilisation restrictions
- regulatory expectations

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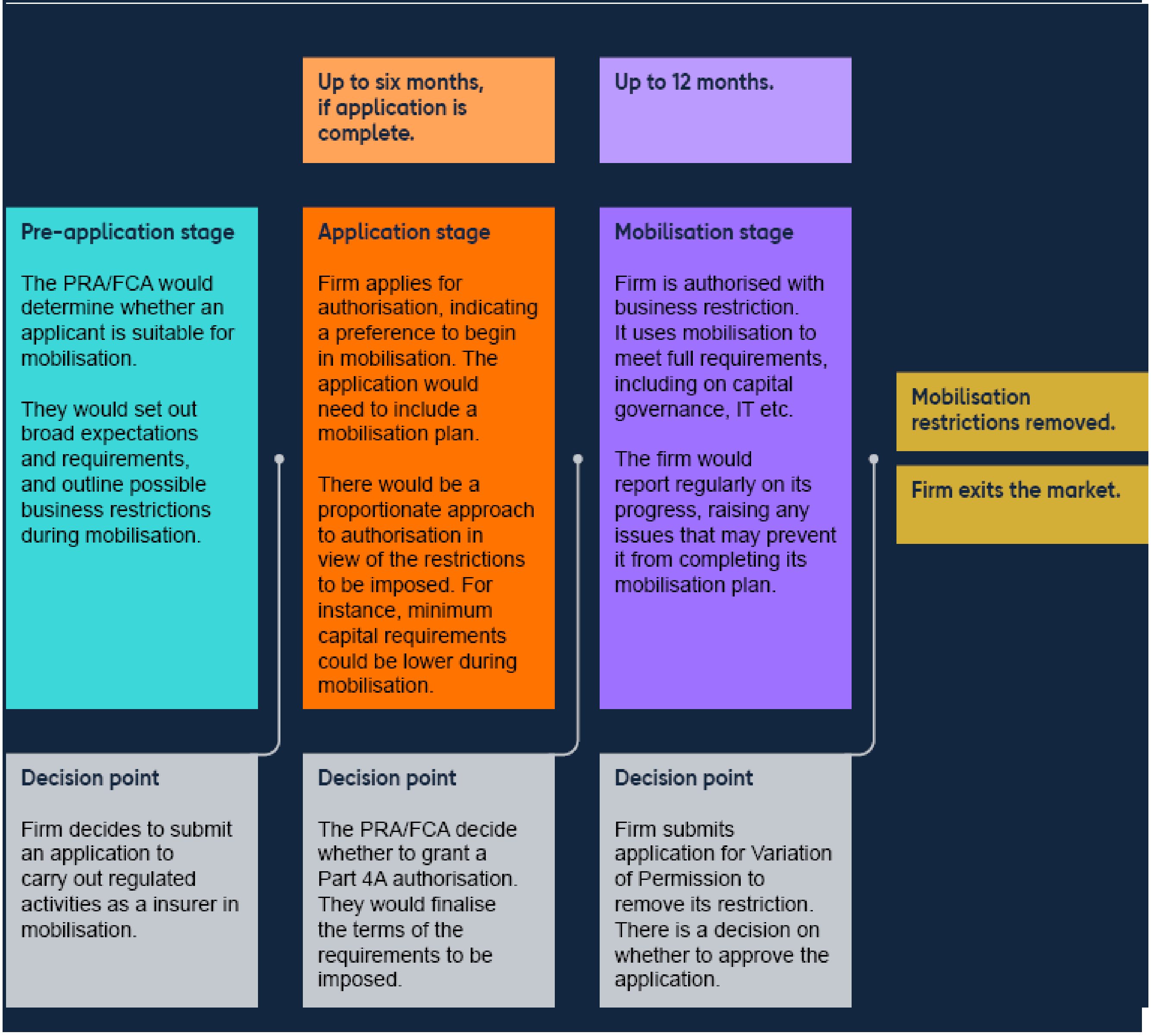
[62] **Section 55M of FSMA** enables the PRA to impose requirements on firms, taking effect on or after the giving or variation of permissions, as the PRA considers appropriate.

[63] The PRA proposes to redenominate the MCR floor from EUR to GBP, as set out in Chapter 10 – Currency redenomination. Following these proposals, and without modification, the MCR floor would be £3.5 million for life insurers and £2.4 million for general insurers (or £3.5 million where they cover general insurance business classes 10 to 15).

- activities to complete in mobilisation
- exiting mobilisation

Chart 10: The proposed mobilisation stage
Mobilisation would be an optional stage after authorisation for new insurers



Entering mobilisation

8.18 Under this proposal, mobilisation would be optional for firms. The PRA and the FCA would determine whether a firm is eligible for mobilisation at the pre-application stage, retaining discretion over whether to permit a firm to use mobilisation.

8.19 Firms would be suitable for mobilisation where they have a short list of activities to complete before they can meet full regulatory requirements. This could include filling senior management positions, developing IT systems and controls, and securing more capital from investors. Given that the mobilisation proposals are intended to give firms some extra time to develop their businesses, the PRA considers that mobilisation may not be suitable for firms that have sufficient resources to establish themselves fully from day one of authorisation, for instance a well-established insurance group seeking to establish a UK subsidiary.

8.20 The PRA proposes that applicants would need to submit a mobilisation plan before being accepted into the proposed mobilisation stage**.** The mobilisation plan would need to set out clear and realistic targets for the mobilisation stage, which could include milestones for when funding rounds will be completed and when key personnel will be recruited. The plan would also need to demonstrate how the firm could exit the market in an orderly and timely way if it failed to meet its targets before the end of the mobilisation stage.

8.21 After reviewing a firm's proposed mobilisation plan, the PRA would assess its feasibility and determine whether the firm should be permitted to enter mobilisation. The PRA would only approve a firm's application when, after reviewing the mobilisation plan, it considered the firm would be able to meet the Threshold Conditions at the point of entry and would be able to exit mobilisation within 12 months.

Mobilisation restrictions

8.22 The PRA would not expect firms to write a material amount of business in mobilisation, if any. When firms propose to write new business in mobilisation, they would need to provide the PRA with a fully developed and credible plan for this business, including how it will be serviced, and a run-off plan showing how the firm can ensure policyholder protection if its operations were discontinued.

8.23 The PRA proposes to limit risks to policyholders during the mobilisation stage by restricting the business a firm can carry on during mobilisation. The details of any restrictions would be discussed with firms during the application process for mobilisation.

8.24 In recognition of the varied nature of insurance risks and business models, the PRA would consider the precise details of individual mobilisation restrictions on a case-by-case basis. Generally, the restrictions would ensure that firms could only write policies that cover short-term and short-tail risks and produce a cumulative net exposure below a maximum limit set individually for firms by the PRA.

8.25 When assessing mobilisation restrictions, the PRA's proposed starting position would be that firms should be limited to effecting contracts of insurance only to the extent that:

- after effecting the contract, the firm's total net exposure remains below an aggregate sum insured/assured of £50,000;

- the contracts are short-term, with a maximum policy term of two years; and
- only policies on a ‘claims-made’ basis, and no liability insurance, are permitted, such that firms are not exposed to large or long-tail risks in respect of potential claims.

8.26 The PRA would consider firms’ proposed reinsurance arrangements for mobilisation on a case-by-case basis.[64]

8.27 The PRA and the FCA would assess each application and would be able to impose different and further restrictions on firms in mobilisation, depending on the precise nature of the applicant’s proposed business model.

8.28 The restrictions proposed in this chapter reflect the PRA’s judgement that a mobilisation phase is more likely to be appropriate for new insurers with simpler business models focused on short-term insurance products, which are less likely to compromise safety and soundness and policyholder protection, and pose less of a risk to FSCS. Conversely, the restrictions would prevent firms from writing many classes of general insurance and life insurance business during mobilisation. This is to limit the risk that firms encounter difficulties in meeting long-term obligations to policyholders should they need to exit the market at the end of the mobilisation stage, as well as to ensure liabilities can be run off quickly where necessary. Generally, the PRA expects the proposed restrictions would reduce the potential risks from authorising firms at an earlier stage in their development before they have full operational capabilities.

Regulatory expectations

8.29 The PRA proposes to lower the MCR floor to £1 million for firms in mobilisation, which would facilitate entry into the proposed stage while safeguarding risks to PRA objectives. The PRA would be able to lower the MCR floor using modification powers under FSMA and following the legislative changes described above. The PRA would assess on a case-by-case basis whether firms meet the relevant statutory tests set out in FSMA, but it would generally expect to be able to lower the MCR floor to £1 million for firms in mobilisation. Firms would be required to always cover their applicable capital requirement while in mobilisation. Because they would be writing little if any new business, the PRA would expect the reduced MCR floor to remain the binding capital constraint for firms choosing mobilisation.

8.30 The PRA proposes to take a proportionate approach to regulatory expectations for firms entering mobilisation. The PRA proposes that the approach in Table 4 would be part of the

[64] As noted in the ‘Mobilisation restrictions’ section, the PRA would not expect firms to write a material amount of business in mobilisation.

mobilisation framework, which except for lowering the MCR floor, can be enabled without changes to rules or legislation. The table represents the minimum requirements that could apply to firms in mobilisation, in accordance with the PRA Rulebook. Firms would also be required to meet any FCA expectations.

Table 4: Proposed minimum PRA expectations for firms in mobilisation
The PRA may have different expectations, depending on a firm's business proposal

Assessment area	**Authorisation without restrictions**	**Authorisation for mobilisation**
Business plan/viability	Fully developed.	Fully developed.
Financial resources	Fully developed — the new insurer would need to meet their capital requirements.	Fully developed — the new insurer would need to meet MCR and SCR requirements during mobilisation. However, the absolute floor to the MCR would be lowered to £1 million for the duration of the mobilisation period.
Sources of funding	Fully developed.	Fully developed for the mobilisation period.
Corporate governance Board structure Senior management	Fully developed governance framework, including key functions of risk management, compliance, actuarial, and internal audit, some of which could be outsourced or combined. All key senior management staff in place. Appropriate number of independent non-	Fully developed governance framework, including key functions of risk management, compliance, actuarial, and internal audit, some of which could be outsourced or combined. Key 'guiding minds' in place with senior roles critical to mobilisation identified and ready to be recruited.

Assessment area	**Authorisation without restrictions**	**Authorisation for mobilisation**
	executive directors. Established good practice is at least two. Chair must not perform an executive function and there is a strong expectation that they should be independent.	Minimum board chair, CEO, and one other executive.
Customer journey including details of products, pricing, and on-boarding arrangements	Fully developed.	Near final, but fully developed if firm intends to write retail business during mobilisation.
Recovery plan	Fully developed recovery plan. Credible solvent wind-down plan.	Draft recovery plan.
Business continuity plan (BCP)	Fully developed BCP.	Draft BCP.
Risk management and control structures	Fully developed.	Near final framework with the necessary controls in place.
IT infrastructure and systems	Fully developed.	Draft implementation plan.
Material outsourcing arrangements	Fully developed.	High level outline, but fully developed where a firm intends to write business during mobilisation.

Assessment area	**Authorisation without restrictions**	**Authorisation for mobilisation**
Policies and procedures	Fully developed.	Not required but development should be planned. Fully developed where a firm intends to write business during mobilisation.
Mobilisation plan	N/A.	Fully developed and signed off by the board.

Mobilisation activities

8.31 During mobilisation, a firm would work towards meeting the full regulatory requirements that would apply for authorisation without mobilisation restrictions (see Table 4). As noted in the ‘Entering mobilisation’ section, firms would be required to submit a mobilisation plan before being accepted into the proposed mobilisation regime**.** The PRA proposes that the mobilisation plan would need to set out clear and realistic targets for activities to complete during mobilisation, which would minimise the risk that firms breach the 12-month limit on the mobilisation stage.

8.32 Mobilisation activities would depend on the nature of the new insurer and its proposed business model, but the PRA would generally expect new insurers to be focused on the following activities:

- **Funding** – fully capitalising themselves for when they exit mobilisation.
- **Recruitment** – finalising and gaining regulatory approval for Senior Managers Regime (SMR) appointments, as well as the recruitment of other key personnel.
- **Operationalising their plan** – finalising their customer journey and preparing for business restrictions to be lifted at the end of the mobilisation period.
- **Risk and controls**
  - Completing the build out of key functions, including risk management and compliance.
  - Establishing an Audit Committee.

- **Building out their infrastructure**
    - Building-out, testing, and implementing systems and IT infrastructure to ensure they are suitable and operationally resilient for when the firm can exit mobilisation.
    - Finalising outsourcing arrangements.

8.33 To ensure transparency, the PRA proposes that it would discuss mobilisation activities with new applicants prior to entering mobilisation and clearly articulate the required list of activities in its authorisation letter. During mobilisation, the PRA would expect firms to work on completing all the activities set out in their mobilisation plan and promptly alert the PRA to any emerging risks or issues with timing.

Exiting mobilisation

8.34 Firms would need to apply for a Variation of Permission (VoP) to exit mobilisation. The PRA proposes that firms would need to have completed all their mobilisation activities, demonstrated that they will be fully operational upon exiting mobilisation, and addressed any additional actions the PRA has requested from the firm before they would be allowed to exit and start to trade fully without mobilisation restrictions. Firms would, therefore, need to be able to show they can meet regulatory requirements in full going forward, including applicable capital requirements.

8.35 If a firm were unable to complete the required activities by the end of their mobilisation stage, or to the required standard, the PRA would expect firms to apply to cancel their Part 4A authorisation and exit the market. The PRA and the FCA would reserve the right to use own-initiative variation or requirement powers where needed.[65] There should be minimal disruption in these cases, as firms would have written little or no business while in mobilisation and the written policies would only be providing short-term and short-tail insurance cover. Firms would also need to submit a plan before authorisation, showing how they can exit the market in an orderly way, without compromising policyholder protection.

8.36 The PRA proposes that mobilisation can last up to 12 months, though in some cases, it might be less. The PRA considered whether a longer timeframe would be appropriate for firms, but it expects that 12 months would give sufficient time for firms to transition to complete the final stages of their development while also encouraging them to work on their mobilisation plans without unnecessary delay. The PRA recognises there may be some

[65] **FSMA 55L and 55M** give the PRA and the FCA powers to impose requirements on authorised persons, or vary them, as they consider appropriate.

exceptional circumstances outside of a firm's control that could have a bearing on their ability to exit mobilisation within the 12-month period. It would, therefore, encourage firms in mobilisation to discuss with the PRA at the earliest opportunity if they do not believe they can meet the timelines.

Transfer and restatement of retained EU law in Rules

8.37 To ensure it would be able to modify rules to lower the MCR floor for firms choosing a mobilisation stage, the PRA proposes to transfer and restate Articles 248 to 253 of Commission Delegated Regulation (EU) 2015/35 into either the MCR Part or the Composites Part of the PRA Rulebook. The proposed changes are set out in Annex C and D in Appendix 2.

8.38 At the point of transfer, the PRA proposes to redenominate the MCR floor for all firms from EUR to GBP. These proposals are set out in full in Chapter 10 – Currency redenomination.

8.39 The PRA also proposes to remove the reference in MCR 3.1 to the MCR being calibrated at an 85% confidence level over a one-year period. The PRA considers that the reference would be redundant in the MCR Part following the proposed transfer and restatement of the MCR calculation. To ensure it would be clear there is no change in the intended calibration of the MCR, the PRA proposes to insert a reference to the 85% confidence level within the glossary definition of the MCR in the PRA Rulebook.

8.40 The PRA further proposes to amend the Composites Part to ensure the MCR floor is consistent for all permitted types of composite insurer. The proposed changes would clarify the MCR floor for firms with general insurance permissions and long-term reinsurance permissions, in line with how the floor is set out for all other types of composite firms. The changes would also ensure that all composites can fix their MCR floor at a lower amount of £3.5 million if their general insurance business is restricted to accident and sickness cover, and the gross written premiums from either their general or long-term insurance business is less than 10% of overall premiums.[66] As it stands, firms authorised as composites before 15 March 1979 are unable to benefit from this exception.

[66] Without this exemption, composite firms would have an MCR floor of £3.5 million for life insurance business and £2.4 million for general insurance business. The figures quoted here are redenominated from EUR to GBP, in line with Chapter 10 – Currency redenomination.

PRA objectives analysis

8.41 The PRA considers that the mobilisation proposals set out in this chapter would continue to advance the PRA's primary objectives on safety and soundness and policyholder protection, while also promoting its secondary objective on competition by facilitating entry into UK insurance markets.

8.42 The mobilisation proposals are intended to give new insurers the choice of using a set period of extra time to complete the final stages of their development. While firms in mobilisation would not have fully developed operational capabilities, which may increase their likelihood of failure, the PRA considers that its proposals would continue to promote safety and soundness and contribute to securing an appropriate degree of policyholder protection during mobilisation by:

- restricting a firm's business; limiting the mobilisation stage to 12 months
- requiring firms to produce credible mobilisation plans with a set of specified activities to be completed before exiting mobilisation
- ensuring that firms have a plan to protect policyholders in the event of failure

8.43 The PRA expects its mobilisation proposals could facilitate entry into insurance markets by giving start-up firms a limited period of up to 12 months to finish building out their businesses with the added confidence that comes with an authorisation. The PRA considers that the mobilisation proposals could; therefore, also facilitate entry into the insurance sector, which may encourage more firms to apply for authorisation and would facilitate more effective competition, in line with the PRA's secondary objective.

8.44 The PRA considers that the proposals relating to retained EU law in this chapter represent a proportionate approach to safety and soundness and policyholder protection, facilitate effective competition, and facilitate the international competitiveness of the UK economy because the regulations being transferred and restated advance the PRA's objectives as part of a coherent Solvency II regime that the PRA helped to develop.

8.45 The PRA considers that introducing an MCR floor for composite insurers with general insurance and life reinsurance permissions would advance the PRA's objectives by providing clarity around the absolute minimum level of capital required to preserve policyholder protection. The proposals would also ensure that composite firms are treated more consistently in the PRA Rulebook, which could facilitate effective competition.

8.46 In light of the FSM Bill which introduces a new secondary objective, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA considers that the mobilisation proposals would promote the international competitiveness and growth of the UK economy by helping to make the UK a more attractive place to establish a new insurance company. The PRA considers that there are currently no international standards relevant to this assessment.

Cost benefit analysis

8.47 The baseline for the CBA is the current Solvency II rules and legislation.

8.48 This CBA considers the impact of the proposals to introduce a mobilisation stage for new insurers, compared with a baseline of leaving the PRA's authorisation processes and the PRA Rulebook unchanged. The proposals are relevant for prospective new insurers, particularly start-up firms facing the circular problems relating to authorisation described in the 'Background' section.

8.49 Though it is not possible to determine how many firms would apply for mobilisation, the PRA would expect the proposed stage to attract interest from new applicants, based on industry engagement. In banking, the PRA authorised four new UK firms in the three years prior to the introduction of a mobilisation stage in March 2013. The rate of authorisations doubled in the following three years, with the PRA authorising nine new UK bank entities; eight of which used mobilisation.

Benefits

8.50 The PRA considers that mobilisation would directly benefit firms by easing their route to entry into UK insurance markets. To the extent they enable more firms to participate in insurance after mobilisation, these proposals would also encourage competition and innovation across the industry. This aligns with the PRA's secondary objectives on facilitating effective competition and promoting the international competitiveness of the UK economy.

Costs

8.51 The PRA would not expect firms to incur additional costs from its mobilisation proposals. The mobilisation stage would be optional, and eligible firms would be able to follow existing authorisation processes if they preferred. There may be higher costs for the PRA where implementing mobilisation requires more resources. These costs are difficult to quantify because they would depend on various factors, such as how many firms apply to enter mobilisation, whether a firm writes any business during mobilisation, and how many issues arise for firms during the mobilisation stage. The PRA expects to lower these potential costs through the proposals in this chapter by ensuring that firms have credible plans before entering mobilisation and by limiting the mobilisation stage to a maximum of 12 months.

8.52 As noted above, the mobilisation proposals would enable firms to be authorised based on lower entry standards for the limited purpose of mobilisation. In particular, entry standards would be lower because of the proposed reduction in the MCR floor to £1 million for firms in mobilisation. The PRA considers that a figure of £1 million strikes an appropriate balance between facilitating entry and ensuring adequate capitalisation for firms, in view of the proposed restrictions on business during mobilisation. An MCR floor of £1 million would ensure that capital is sufficient to meet claims as they fall due, in view of the proposed restrictions, while also ensuring the firm has a realistic prospect of meeting regulatory requirements for its business model before exiting mobilisation within 12 months. Where a firm writes no business in mobilisation, there would be no risks to policyholders from the proposed lower MCR floor.

8.53 Firms in mobilisation may be at a higher risk of failure, as they would likely have been authorised at an earlier stage in their development with lower entry standards, including lower capital requirements than firms pursuing existing routes to authorisation. The PRA would not expect failures to be costly for policyholders, present unacceptable exposure for FSCS, or cause disruption to the UK insurance market. This is because firms would have been limited through the proposals to writing only a small amount of short-term and short-tail business while in mobilisation, which would limit the duration of any possible run-off period and help to ensure that firms could continue to meet their obligations to policyholders. The PRA would also have required firms to submit plans showing how they would deal with insolvency or solvent run-off, which would help to ensure that any failures remain orderly, and any policyholders remain protected, including by FSCS for eligible claims.

8.54 The PRA considers that the proposal to transfer and restate retained EU law in the PRA Rulebook would generally have minimal cost and benefit implications, given they are already required to comply with these regulations.

8.55 The PRA would not expect an impact from its proposal to move the reference to the MCR being calibrated at an 85% confidence level from MCR 3.1 to the glossary of the PRA Rulebook, because this is intended to make the PRA Rulebook clearer and would not affect the way that firms apply the MCR calculation.

8.56 The PRA would not expect material costs from its proposal to clarify the MCR floor for composite insurers with permissions for general insurance and life reinsurance, because this business model is very rare. The MCR floor is also generally lower than a firm's linear MCR and its SCR, which would mostly be the binding capital constraint for composite firms. If the

MCR floor were to be the binding constraint, the proposal would benefit policyholders by ensuring that firms are held to a minimum capital standard.

'Have regards' analysis

8.57 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. **Competitiveness and better outcomes for consumers (HMT recommendation letter):** the PRA considers that its mobilisation proposals would ease the path to entry into insurance markets making the UK a more attractive place to start an insurance business.

2. **Encouraging economic growth, smart regulatory reform (HMT recommendation letter), and sustainable growth (FSMA regulatory principles):** the PRA considers that improving ease of entry and facilitating competition (see above) could have a positive impact towards sustainable economic growth in the UK by increasing the number of insurers operating in UK insurance markets.

3. **Innovation (HMT recommendation letter) and the desirability where appropriate of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (FSMA regulatory principles):** the PRA expects that its proposals for mobilisation would be adaptable to a range of business types. It considers that mobilisation would enable new insurers to gain authorisation at an earlier stage in their development, which may be particularly helpful for firms with new or innovative business models.

4. **Proportionality (FSMA regulatory principles)**: the mobilisation proposals recognise that some firms may find it difficult to attract investment before they have secured regulatory permissions. The PRA considers it appropriate to adjust some of the entry standards for these firms, so long as their activities are restricted, and they can meet full requirements after a set amount of time.

5. **Transparency (FSMA regulatory principles):** the PRA considers that its proposals to transfer and restate retained EU law in the PRA Rulebook would lead to a more proportionate and transparent application of the prudential framework by ensuring the MCR floor is applied more consistently for composite firms. The PRA also considers

that its consultation on development of a mobilisation stage is consistent with a transparent approach to policy development.

6. **The need to use the PRA's resources in the most efficient and economical way (FSMA regulatory principles):** the PRA expects that administering mobilisation would be a good use of PRA resource because the proposals would facilitate entry into UK insurance markets and advance the PRA's objectives. In developing its proposals, the PRA has also sought to limit any excessive burdens on PRA resource.
7. **Implementing the outcomes of the Future Regulatory Framework Review (HMT recommendation letter):** the proposals to transfer and restate retained EU law into the PRA Rulebook would enable the PRA to implement policies designed for UK insurance markets.

8.58 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for these proposals, it is because the PRA considers that 'have regard' to not be a significant factor for these proposals.

9. Thresholds

9.1 This chapter sets out the PRA's proposals to increase the size thresholds that determine whether a firm is regulated under Solvency II or the non-Directive firm (NDF) sector rules (the 'Solvency II thresholds'). The PRA also proposes to redenominate these thresholds from EUR to GBP.

9.2 The proposals in this chapter would result in changes to Chapter 2 of the Insurance General Application Part of the PRA Rulebook. The proposed rules are set out in Annex B in Appendix 2.

9.3 FSMA currently constrains the PRA's ability to amend the thresholds because some sections within Part 4A require the PRA to consider the thresholds as defined in EU law.[67] The Government stated in November 2022, in its **response** to its consultation on the Solvency II review, that it would work with the PRA to introduce legislative changes that would enable the PRA to increase the thresholds in line with the proposals in this chapter. This would include amending the relevant sections of FSMA under the FSM Bill.[68]

9.4 The PRA considers that NDFs generally benefit from simpler requirements, including simpler capital standards, reporting forms, and governance requirements. For instance, the NDF sector rules provide for non-risk-based capital requirements with less detailed specification in the PRA Rulebook than Solvency II capital requirements. The NDF sector rules were implemented on 1 January 2016 and were designed to provide an appropriate level of protection for policyholders of small firms, to be proportionate to the risks presented by those firms, and to be mostly consistent with the regulatory regime that applied to those firms before 2016.

9.5 Respondents to **HMT's Call for Evidence** on the Solvency II Review in 2020 presented a range of views about the thresholds. Some respondents suggested that the PRA should increase the Solvency II thresholds to provide more proportionality in the overall prudential regime, while others favoured maintaining the current thresholds to support strong risk management and supervision by ensuring that Solvency II continues to apply to all but the very smallest UK insurance firms. The PRA considers that its proposals to increase the

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[67] For instance, FSMA defines 'insurance undertakings' by reference to firms that would require authorisation in accordance with Article 14 of the Solvency 2 Directive if the UK were a member state.

[68] See Schedule 1, Part 4 of the FSM Bill.

thresholds strike the right balance by providing more proportionality for small firms while also maintaining an appropriately broad scope of application for Solvency II.

9.6 The proposals in this chapter would apply to all firms, for the purpose of determining whether they are subject to any of the provisions of the Solvency II Firms Sector of the PRA Rulebook.

Increasing the Solvency II thresholds

9.7 The PRA proposes to increase the Solvency II thresholds relating to:

- a firm's gross written premium income and redenominate it from EUR to GBP – the threshold would change in the PRA Rulebook from €5 million to £15 million.
- firm and group technical provisions and redenominate them from EUR to GBP –the thresholds would change in the PRA Rulebook from €25 million to £50 million.[69]

9.8 The PRA does not propose changes to the other thresholds for regulation under Solvency II described in Insurance General Application 2.3, except to redenominate the thresholds for reinsurance operations from EUR to GBP in line with the proposals set out in Chapter 10 – Currency redenomination.[70] Firms would be exempted from Solvency II provided they have not exceeded any of the Solvency II thresholds for three consecutive years and do not expect to exceed any of the Solvency II thresholds in the following five years, in accordance with Insurance General Application 2.6.[71]

9.9 Under this proposal, new and existing firms that do not exceed the proposed thresholds would continue to be able to apply for a voluntary requirement (VREQ) to operate within the Solvency II regime if they prefer. As noted by respondents to HMT's Call for Evidence, the option to remain in Solvency II is important because firms may not wish to invest in adapting to a different regulatory regime.

9.10 The PRA considers that the proposals in this chapter would result in a more proportionate approach to the regulation of small firms, supporting their ability to grow and compete in UK insurance markets.

[69] In practice, the gross written premium threshold was €5.4 million at year-end 2022, and the technical provisions threshold was €26.6 million, because euro amounts in the PRA Rulebook have been updated for EU inflation. For more information, see Insurance General Application 4.2 and Official Journal C423/25.

[70] Firms are regulated under Solvency II if their business includes reinsurance operations exceeding €600,000 of gross written premium income, or €2.7 million of technical provisions.

[71] The proposed thresholds would apply retrospectively in view of Insurance General Application 2.6.

9.11 The PRA also proposes to delete Chapter 4 of the Insurance General Application Part of the PRA Rulebook (see Annex B in Appendix 2), which would be redundant following the changes proposed in this chapter and Chapter 10 — Currency redenomination.

PRA objectives analysis

9.12 The proposals in this chapter would enable more firms to be exempted from Solvency II for reasons of scale. These firms would operate under the NDF sector rules by default, where they would be subject to simpler requirements on capital, governance, and reporting, as noted above. The PRA considers that any firms excluded from Solvency II because of the proposals in this chapter would still be sufficiently small in scale that the NDF sector rules would provide an appropriate level of protection for policyholders. The PRA considers that raising the thresholds in line with the proposals in this chapter would therefore continue to advance the PRA's primary objectives of safety and soundness and policyholder protection.

9.13 Higher thresholds would enable new and existing firms to grow larger under relatively simpler prudential rules. Increasing the thresholds may; therefore, help smaller firms to compete more effectively with larger firms, supporting the PRA’s secondary objective on competition. The PRA considers that its proposals could also facilitate effective competition by removing barriers to entry for smaller firms seeking authorisation into a less burdensome prudential regime.

9.14 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. The PRA considers that smaller firms may operate more efficiently under the NDF sector rules compared to Solvency II, which would support their ability to grow, improve their capacity to offer products and services in UK insurance markets, and facilitate effective competition. The PRA; therefore, considers that its proposals would facilitate the provision of insurance services to the UK economy by a diverse range of UK insurers, supporting the growth of the UK economy in the medium to long term. The PRA considers that there are no international standards relevant to this assessment.

Cost benefit analysis

9.15 The baseline for the CBA is the current Solvency II rules and legislation.

9.16 In particular, this CBA considers the impact of the PRA’s proposals to raise the size thresholds for regulation under Solvency II, compared to leaving them unchanged. The proposals are relevant for all firms but would have more of an impact on firms that are close to the existing Solvency II thresholds, including those operating under the NDF sector rules.

9.17 The PRA expects that its proposals would likely affect nine existing Solvency II firms at present, accounting for about £77 million in annual gross written premiums at year end 2021, and effecting both life and non-life business. The nine firms would have the option of operating under the NDF sector rules if the PRA implemented its proposals to increase the size thresholds, while all NDFs including future new small insurers would benefit from having more room to grow before reaching the Solvency II thresholds. It would also benefit other small insurers in future if they approached the current thresholds.

9.18 The PRA considered alternative proposals for setting the size thresholds either above or below the levels proposed in this chapter. Raising the gross written premium threshold by a further £5 million to £20 million, and the technical provisions threshold by a further £25 million to £75 million, would almost double the number of Solvency II firms that would be affected by the proposals, allowing 17 firms with £168 million in annual gross written premiums at year end 2021 the option of operating under the NDF sector rules. In developing the proposals, the PRA has sought to strike a balance between reducing regulatory costs for small firms and advancing safety and soundness and policyholder protection. By allowing significantly larger firms in relative terms to move out of Solvency II, the PRA considers that the alternative proposals could increase the risks to its primary objectives and result in a disproportionate application of prudential rules intended only for the smallest UK firms. The PRA also expects that a disproportionate application of the NDF sector rules would undermine effective competition by disadvantaging firms that remain in scope of Solvency II.

Benefits

9.19 The benefits of the proposals include:

- **Enabling more proportionate regulation of small firms:** Existing firms that fall below the proposed thresholds could choose to operate under the NDF sector rules, which are tailored to small firms. The PRA considers that the NDF sector rules feature lower compliance costs than Solvency II, owing to simpler administrative requirements, reporting expectations and capital standards, as noted above.[72] The PRA's fee rates may also generally be lower for firms under the NDF sector rules.[73]

- **Simplifying the prudential framework:** The PRA proposes to specify the Solvency II thresholds in GBP, which is the operating currency for most PRA-regulated firms. The PRA considers that its proposals would therefore lead to a more transparent and consistent application of the PRA Rulebook, enabling firms to review their compliance with the thresholds without needing to convert the monetary amounts from euros.

- **Giving small firms more room to grow before being required to comply with Solvency II requirements:** The PRA considers that new and existing NDFs would benefit from the proposals by having more room to grow their businesses before reaching the thresholds for regulation under Solvency II, which may also help them to compete more effectively in UK insurance markets.

Costs

9.20 Firms could face one-off compliance costs in adapting to the NDF sector rules if they fall below the thresholds proposed in this chapter and decide not to apply to remain within Solvency II. The PRA does not expect there to be material costs from its proposals, particularly considering that firms could choose to remain in Solvency II if they consider that the benefits of doing so outweigh the costs.

9.21 The proposals in this chapter would permit more firms to operate under the NDF sector rules rather than under Solvency II, which could increase risks for policyholders due to lighter prudential regulation and generally lower capital standards under the NDF sector rules when compared with those under Solvency II. However, the PRA does not consider these risks to be material, because firms falling under the proposed thresholds would still be small enough for the NDF sector rules to provide an appropriate level of policyholder protection. There

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[72] **FSA (2011) Transposition of Solvency II** includes estimates of the costs of complying with Solvency II. Survey data provided to the FSA for its estimates suggests the costs of implementing Solvency II for small firms was, on average, approximately £800,000, expressed in current prices. This is in line with an estimate from one of its members submitted to the review of Solvency II by the Association of Financial Mutuals (AFM (2021) AFM Response to Review of Solvency II: call for evidence). Similarly, estimates in 2014 before the implementation of Solvency II expected Solvency ratios to decrease for small non-life firms from 190% under the pre-Solvency II regime to 154% under Solvency II. Solvency coverage for small life firms was estimated to be broadly unchanged at approximately 190%. HMT (2014) Transposition of Solvency II Directive (2009/138/EC) and Omnibus II, Impact Assessment

[73] CP7/23 – **Regulated fees and levies: Rates proposals 2023/24** includes a description of the fees applied to NDF firms at paragraph 5.9.

would also be no change to the current levels of protection provided for policyholders by FSCS.

'Have regards' analysis

9.22 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. Proportionality (FSMA regulatory principles): The PRA considers that increasing the Solvency II thresholds could lead to the application of a less burdensome and more proportionate regime for smaller firms, without unduly affecting their safety and soundness, or the protection of policyholders.

2. Transparency, and the efficient and economical use of the PRA's resources (FSMA regulatory principles): The proposals may also enable more efficient and economical use of PRA resources, because setting the thresholds in GBP would lead to a simpler, more transparent, and more consistent application of the PRA Rulebook.

3. Competitiveness, growth in the interests of consumers and businesses, smart regulatory reform (HMT recommendation letter), and sustainable growth (FSMA regulatory principle): Higher thresholds would allow smaller firms to grow more under the NDF sector rules, ensuring they only need to comply with Solvency II at an appropriate stage in their development. The PRA considers that this would enable them to compete more effectively with larger peers, which would work in the best interests of consumers. The PRA considers its proposals would support competitiveness and growth of the UK economy by helping smaller firms to meet the needs of the economy, as noted in this chapter.

9.23 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for these proposals, it is because the PRA considers that 'have regard' to not be a significant factor for these proposals.

Impact on mutuals

9.24 The PRA considers that mutuals are more likely than non-mutuals to fall below the proposed Solvency II thresholds and therefore benefit from greater flexibility in future about whether to adopt the NDF regime, given that more than half of small firms operating near the thresholds are mutuals.

10. Currency redenomination

10.1 This chapter sets out the PRA's proposals to redenominate monetary values within the Solvency II firms Sector of the PRA Rulebook from EUR to GBP.[74] The PRA considers this to be appropriate following UK's withdrawal from the EU and given that GBP is the domestic currency of the UK and the main reporting currency of most PRA-regulated firms. The proposed methodology for redenomination uses the average daily GBP/EUR spot exchange rate covering the 12-month period prior to 31 December 2020, rounded to two decimal places, with the resulting GBP values rounded to two significant figures.

10.2 The policy proposals included in this chapter would result in:

- the redenomination from EUR to GBP of the absolute floor of the Minimum Capital Requirement (MCR) within the MCR Part of the PRA Rulebook;
- the redenomination from EUR to GBP of the threshold for a 'material transaction' in the 'Insurance – Supervised Run Off' and 'Run-Off Operations' Parts of the PRA Rulebook;
- the redenomination from EUR to GBP of the quantitative thresholds for regulation under Solvency II relating to reinsurance operations in the Insurance General Application Part of the PRA Rulebook;[75] and
- the specification of the amount that a third-country branch undertaking must hold on deposit as security in the UK in the Third Country Branches Part of the PRA Rulebook, and redenominating these values to GBP.

10.3 The proposals in this chapter would result in changes to:

- the Minimum Capital Requirement Part (Annex C of Appendix 2);
- the Third Country Branches Part (Annex K of Appendix 2);
- the Insurance – Supervised Run Off Part (Annex L of Appendix 2);

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[74] Monetary values and fees in the FCA Handbook may be denominated in a different currency.

[75] Insurance General Application Rules 2.3(5)(a)(i) and 2.3(5)(a)(ii).

- the Run-Off Operations Part (Annex M of Appendix 2); and
- the Insurance General Application (Annex B of Appendix 2).

10.4 The PRA considers the proposals would lead to more consistency for firms, and hence advance the PRA's primary objectives of firm safety and soundness and policyholder protection, as the regulatory values specified in the PRA Rulebook would no longer vary each year due to exchange rate fluctuations. The PRA further considers that the proposed methodology would appropriately maintain the size and effect of these regulatory values after redenomination. The PRA considers that these proposals would also help to advance its secondary objective given that it would make it easier for firms to comply with PRA rules.

10.5 The proposals in this chapter are relevant to all UK Solvency II firms, the Society of Lloyds, its members and managing agents, and insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings).

10.6 The proposals relating to the Solvency II reinsurance operations thresholds in the Insurance General Application Part would apply to all firms, for the purpose of determining whether they are subject to any of the provisions of the Solvency II firms Sector of the PRA Rulebook.

Redenomination of MCR floor, threshold for a material transaction, and quantitative thresholds for regulation under Solvency II relating to reinsurance operations

10.7 The PRA proposes to redenominate the values for the MCR floor, the threshold for a 'material transaction', and the quantitative thresholds for regulation under Solvency II relating to reinsurance operations from EUR to GBP.

10.8 In accordance with Insurance General Application 4.2, the PRA updated its **Euro-Sterling value for insurance regulatory purposes document** in December 2022, to reflect that the euro amounts set out in Minimum Capital Requirement 3.2 have been succeeded by the amounts published in the **Official Journal C423/12** on 19 October 2021. As such, the values used in the calculation to redenominate the MCR floor are those set out in the PRA's 'Euro-Sterling value for insurance regulatory purposes' document.

10.9 The values used in the calculation to redenominate the quantitative thresholds for regulation under Solvency II relating to reinsurance operations also align with the amounts published in the Official Journal C423/12, in accordance with the Insurance General Application 4.2.

10.10 The values used in the calculation to redenominate the threshold for a material transaction are those set out in the 'Insurance – Supervised Run Off' and 'Run-Off Operations' Parts of the PRA Rulebook.

10.11 The PRA proposes to redenominate the values for the MCR floor, the threshold for a material transaction, and the quantitative thresholds for regulation under Solvency II relating to reinsurance operations using the average daily GBP/EUR spot exchange rate covering the 12-month period prior to 31 December 2020, rounded to two decimal places: £1 = €1.13. The PRA considers this date to be appropriate for the following reasons:

- 31 December 2020 is the day on which EU law ceased to apply in the UK – hence it is a reasonable reference point for translating the Solvency II EUR amounts to GBP; and
- the increase in the MCR floors referenced in paragraph 2.2 reflects inflation (as measured by the EU's Harmonised Indices of Consumer Prices) recorded until 31 December 2020.

10.12 To ensure these resulting GBP figures remain clear and simple for firms, the PRA proposes to round them to two significant figures.

10.13 The proposed methodology to use the average daily exchange rate over a reasonable 12-month time period rounded to two decimal places, and rounding the subsequent GBP amounts to two significant figures, is similar to the approach that the PRA has taken in the past when redenominating EUR amounts in the CRR Sector of the Rulebook.[76]

10.14 The table below lists the PRA rules for which the PRA proposes to set thresholds and monetary values in GBP, together with the proposed GBP value using an exchange rate of £1 = €1.13, rounded to two significant figures:

[76] See CP 5/21 – **Implementation of Basel Standards**, February 2021 and CP 14/21 – **Consultations by the FPC and PRA on changes to the UK leverage ratio framework**, June 2021.

Table 5: Proposed GBP thresholds and monetary values

Relevant PRA rule	Summary	Permission type	EUR (€)	Proposed GBP (£)
Minimum Capital Requirement 3.2	Absolute floor for the MCR for firms with various permissions	General insurers (excluding business classes 10-15)	2,700,000[(a)]	2,400,000
		General insurers (including classes 10-15)	4,000,000[(a)]	3,500,000
		Life insurers	4,000,000[(a)]	3,500,000
		Pure reinsurers	3,900,000[(a)]	3,500,000
		Pure captive reinsurers	1,300,000[(a)]	1,200,000
Insurance – Supervised Run Off 1.2	Threshold for a material transaction	All	20,000	18,000
Run-Off Operations 1.2	Threshold for a material transaction	All	20,000	18,000
Insurance General Application 2.3(5)(a)(i) and 2.3(5)(a)(ii)	Solvency II threshold: amount of reinsurance operations in relation to gross written premium income	All	600,000[(b)]	530,000
	Solvency II threshold: amount of reinsurance operations in relation to technical provisions	All	2,700,000[(b)]	2,400,000

(a) The EUR amounts used are those set out in: **Euro-Sterling value for insurance regulatory purposes**, December 2022.

(b) The EUR amounts used are those set out in: Official Journal of the European Union C423/12, **Notice regarding the adaptation in line with inflation of the amounts laid down in the Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) 2021/C 423/12**, October 2021.

Redenomination of third-country branch security deposit

10.15 The amount a third-country branch must hold on deposit as security in the UK is currently determined by calculating one quarter of the MCR floor.[77] However, given the proposal to remove the requirement to calculate a branch MCR (as set out in Chapter 6 – Third-country branches), the PRA proposes to determine the value of the branch security deposit by taking one quarter of the redenominated values of the MCR floor that have been rounded to two significant figures (as set out in Table 5), and specifying these values in the Third Country Branches Part. Table 6 sets out the PRA rules which the PRA proposes to amend, together with the proposed GBP values.

Table 6: Proposed GBP monetary values for third-country branch security deposit

Relevant PRA rule	Summary	Permission type	Proposed GBP (£)
Third Country Branches 3.3	The amount that a third-country branch undertaking must hold on deposit as security in the UK with a CRD credit institution.	General insurers (excluding business classes 10-15)	600,000[(a)]
		General insurers (including classes 10-15)	875,000[(a)]
		Life insurers	875,000[(a)]

(a) These amounts are calculated by taking one quarter of the redenominated MCR floors, as set out Table 5.

[77] Third Country Branches 3.3 Part of the PRA Rulebook

10.16 The PRA also proposes to delete Chapter 4 (Euro Interpretation) of the Insurance General Application Part, which would be redundant following the changes proposed in this chapter and the Chapter 9 – Thresholds.[78] See Appendix 2 for the proposed rule changes.

PRA objectives analysis

10.17 The PRA considers that the proposals to redenominate the regulatory amounts in the PRA Rulebook from EUR into GBP would provide greater certainty to firms by reducing the potential effects of exchange rate fluctuations, thus helping to advance the PRA's primary objectives of firm safety and soundness and policyholder protection. For example, the proposals would ensure that exchange rate fluctuations would not affect the value of the security deposit held by third-country branches.

10.18 The PRA further considers that the proposals would advance its secondary competition objective, given that the redenomination from EUR to GBP would make it easier for firms to comply with PRA rules, thus removing a compliance burden that smaller firms might find more onerous than larger firms.

10.19 In light of the upcoming FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA considers that the proposals would facilitate competitiveness given that it would reduce uncertainty from fluctuating exchange rates. This would benefit all UK firms that would not face uncertainty regarding the value of these amounts in GBP and would also make the UK a more attractive jurisdiction for third-country insurers wishing to establish a UK subsidiary or branch. The PRA considers that there are no international standards relevant to this assessment.

Cost benefit analysis

10.20 The baseline for the CBA is the current Solvency II rules and legislation, with a year-end 2022 exchange rate of £1 = €1.16, in line with the PRA's latest annual guidance on interpreting the euro-Sterling value for insurance regulatory purposes.

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[78] The PRA proposes to raise the overall level of the other quantitative thresholds for regulation under Solvency II, while also redenominating them in GBP rather than EUR. The proposals are therefore presented separately from this chapter (see Chapter 9 – Thresholds), where the PRA is only proposing to redenominate euro monetary values without any further changes.

10.21 The proposals in the chapter affect all Solvency II firms, with approximately 30 insurers affected by the proposed change to the MCR; firms in run-off affected by the proposed change to the threshold for a material transaction; firms operating close to the Solvency II thresholds affected by the proposed change to the thresholds relating to reinsurance operations; and approximately 130 third-country branches affected by the redenomination of security deposit proposal.

Benefits

10.22 The PRA considers that the proposal to denominate the amount a third-country branch undertaking must hold as security deposit in GBP in the Third Country Branches Part of the Rulebook would result in more efficient engagement with PRA supervisors and reduce the PRA's resource burden, given that existing and potential third-country branch undertakings will have greater clarity on the amount of security deposit that must be held in the UK.

10.23 Given that GBP is the domestic currency of the UK and the reporting currency for most firms that are supervised by the PRA, the PRA expects that the proposals set out in this chapter would lead to more certainty for firms going forward. This is because the MCR floor, the security deposit that third-country branches are required to hold in the UK, and the quantitative thresholds for regulation under Solvency II relating to reinsurance operations would no longer vary each year with exchange rate fluctuations. Furthermore, firms would no longer have to consider exchange rate fluctuations when determining whether a transaction is 'material'.

10.24 The PRA also considers that the proposed exchange rate (£1 = €1.13) provides clarity to firms given that it is related to the date that the EU law ceased to apply in the UK, and hence is a reasonable period to use, as compared to the year-end 2022 exchange rate set out in the PRA's Euro-Sterling value for insurance regulatory purposes (£1 = €1.16 rounded to two decimal places).

Costs

10.25 The PRA considers that the general approach of redenominating the amounts set out in Table 5 from EUR into GBP would not result in material costs for firms, given that it would reduce uncertainty from fluctuating exchange rates.

10.26 However, the PRA has also considered the costs associated with using the proposed exchange rate (£1 = €1.13) as compared to a counterfactual exchange rate of £1 = €1.16. This is the year-end 2022 exchange rate that is set out in the PRA's Euro-Sterling value for insurance regulatory purposes.[79] It has been rounded to two decimal places. The PRA considers that this is an appropriate counterfactual, given that it is the exchange rate firms are currently using when converting EUR amounts to GBP.[80]

10.27 Compared to the counterfactual set out in the previous paragraph, the proposal to redenominate the MCR floors would increase the floors by approximately £50,000 to £140,000 depending on permission type. This proposal applies to all firms that must comply with the Minimum Capital Requirement Part of the PRA Rulebook. Based on data for year-end 2021, the PRA estimates approximately 30 firms would be affected by the redenomination of the MCR floor. However, a number of these firms have a significant buffer of eligible own funds over their MCR, and the PRA considers that the proposal to redenominate the absolute MCR floors would not materially change this. The PRA estimates approximately 10 of the firms that have a lower buffer over the MCR floor may decide to increase their capital levels.

10.28 The proposal to redenominate the amount of security deposit that must be held in the UK by a third-country branch would increase the amount required to be held by approximately £13,000 to £18,000 per firm, depending on permission type.

10.29 The proposal to redenominate the definition of material transaction would increase the definition of a material transaction by approximately £800, which would be a minor reduction in the number of transactions deemed material. The PRA considers that this would not lead to a cost impact for firms, given that the definition of material transaction is relevant to the content of a firm's scheme of operations, and as such, the redenomination would not affect the firm's ability to enter into a material transaction.

10.30 The proposal to redenominate the thresholds for regulation under Solvency II relating to reinsurance operations would also lead to an increase of approximately £13,000 for the threshold relating to gross written premiums from reinsurance operations and £70,000 for the threshold relating to technical provisions for reinsurance operations. The PRA considers that the increases would not have a material impact on firms based on data for year-end 2021. This is because no firms are close to being excluded from regulation under Solvency II based on the reinsurance operations thresholds.

[79] This document uses the exchange rates set out in the EU's Official Journal C420/03, **Euro exchange rates 31 October 2022**, November 2022.

[80] The PRA further considers that £1 = €1.16 is an appropriate counterfactual given that the average daily GBP/EUR spot exchange rate covering a more recent 12-month period prior to 28 February 2023 is also £1 = €1.16 (rounded to two decimal places).

10.31 Overall, the PRA considers that the costs would be outweighed by the benefits discussed above.

'Have regards' analysis

10.32 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force, it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals outlined in this chapter:

1. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The PRA considers that the proposals would lead to a more proportionate and transparent application of the prudential framework, by reducing the extent of change in the requirements applicable to firms that result from variations in the GBP/EUR exchange rate.

2. **Competitiveness and UK attractiveness for international financial services (HMT recommendation letter):** The PRA has had regard to these principles by acknowledging that these proposals would make it easier for firms to comply with PRA rules, thus removing any potential uncertainties arising from fluctuating exchange rates. The PRA considers this would facilitate effective competition and competitiveness of the UK with regard to third-country insurers wishing to establish a subsidiary or branch in the UK.

10.33 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this set of proposals, it is because the PRA considers that 'have regard' to not be a significant factor for the proposals.

11. Administrative amendments to PRA rules

11.1 This chapter sets out the PRA's proposals to make minor consequential changes to the PRA Rulebook to update definitions that encompass, or refer directly to the SII CDR. These proposed changes are consequential to the Government's **proposed** reforms to the Solvency II risk margin (RM). The changes will ensure PRA rules refer to the SII CDR as amended by **HMT's SIs**.

11.2 The proposals in this chapter would result in changes to:

- the Glossary of the PRA Rulebook;
- the External Audit Part of the PRA Rulebook;
- the Financial Conglomerates Part of the PRA Rulebook;
- the Group Supervision Part of the PRA Rulebook; and
- the Own Funds Part of the PRA Rulebook.

The proposed changes are set out in the draft rule instrument in Appendix 30.

11.3 HMT published its draft SIs on 22 June 2023. These draft SIs make provision for the Solvency II RM to be reformed via transitional amendments to the onshored SII CDR.

11.4 The PRA has considered if the Government's proposed reforms to the Solvency II RM as effected by HMT's amendments to the SII CDR will require any consequential changes to PRA rules. The PRA has identified that amendments to the following definitions within PRA rules are necessary in order to ensure consistency with the onshored SII CDR as at the date at which the RM reforms will take effect:

- the definition of 'Solvency II Regulations' within the Glossary; and
- the Part-specific definitions of 'delegated act/s' within other Parts of the PRA Rulebook.

11.5 These proposed minor consequential amendments will maintain the clarity and coherence of the PRA Rulebook in view of the Government bringing forward its RM reforms in advance of year-end 2024. The amendments will deliver consistency between the requirements for the RM calculation imposed by the Technical Provisions Part of the PRA Rulebook, and those imposed by the SIs. In addition, the amendments will deliver consistency between other Parts of the PRA Rulebook and the SII CDR as amended by HMT.

11.6 For the proposals in this chapter, the PRA is setting a one-month consultation period. This reflects the nature of these proposals as minor amendments that arise as a consequence of HMT's amendments to the SII CDR to reform the Solvency II RM. Subject to responses received, the PRA would expect to be able to issue its final policy in relation to the proposals in this chapter in advance of the Government's reforms taking effect.

11.7 The consultation on the proposals in this chapter closes on Monday 31 July 2023. Please address any comments or enquiries to **CP12_23@bankofengland.co.uk.**

11.8 The proposals in this chapter are relevant to all UK Solvency II firms, the Society of Lloyds and its members and managing agents, and insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings).

PRA objectives analysis

11.9 The PRA considers that the proposals in this chapter would maintain the clarity and coherence of the PRA Rulebook and would advance the PRA's primary objectives of firms' safety and soundness and policyholder protection.

11.10 The PRA considers that given their nature as clarifying amendments to the PRA Rulebook, these proposals would give firms legal certainty as to the interaction between HMT's SIs and PRA rules. This advances the PRA's secondary objective of facilitating effective competition.

11.11 In light of the FSM Bill, the PRA has assessed whether the proposals in this chapter facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. Having done so, the PRA considers that in providing firms with legal certainty as to the interaction between HMT's SIs and PRA rules, the proposals support this objective.

Cost benefit analysis

11.12 The baseline for the CBA is the current Solvency II rules and legislation.

11.13 The PRA considers that the proposed changes would enhance the clarity and coherence of the PRA Rulebook for firms, which is a benefit.

11.14 The proposed changes would not affect the PRA's approach to the regulation of Solvency II firms. Any administrative costs to Solvency II firms of updating their knowledge of these changes is expected to be minimal. The PRA considers that the benefits of the proposals are proportionate to the costs.

'Have regards' analysis

11.15 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. The FSM Bill includes a measure to amend the FSMA regulatory principles. If this measure comes into force it would add a regulatory principle relating to the UK's net zero emissions target. The PRA has had regard to this matter. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposal:

1. **Implementing the outcomes of the Future Regulatory Framework Review (HMT recommendation letter):** The PRA considers that the proposals provide clarity as to the interaction of HMT's SIs and PRA rules preceding the implementation of the Future Regulatory Framework (FRF) Review.

2. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposals aid transparency by clarifying the PRA's rules as they relate to HMT's SIs.

3. **The need to use the resources of the PRA in the most efficient and economical way:** The PRA considers that the proposal to provide consistency between the Technical Provisions Part of the PRA Rulebook and HMT's SIs is minor, however the PRA considered it necessary to reflect the requirements imposed by HMT's SIs.

11.16 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this set of proposals, it is because the PRA considers that 'have regard' to not be a significant factor for the proposals in this chapter.