

# Bank of England PRA

## Solvency II: Matching Adjustment Permissions

**Statement of policy**

September 2023

Draft for consultation



**Bank of England | Prudential Regulation Authority**

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# 1: Introduction

1.1 This statement of policy (SoP) sets out the PRA's approach to granting regulatory permissions in relation to the matching adjustment (MA), as well as variations to those permissions, and the circumstances in which the PRA may take the decision to revoke a firm's MA permission.

1.2 When granting these permissions, the PRA would exercise its powers under s138BA of the Financial Services and Markets Act 2000 (FSMA), which would have the effect of waiving or modifying the PRA's rules on the calculation of technical provisions to allow the firm to apply the MA in accordance with regulation [x] of [The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023] (referred to here as the 'MA regulations'). Using the same powers under FSMA, the PRA may also vary a firm's permission to use the MA, such as to allow assets with new features and/or risks into an MA portfolio. The PRA may also use these powers to revoke a firm's MA permission(s).

1.3 This statement is relevant to all UK Solvency II firms, and the Society of Lloyd's, and its members and managing agents, referred to collectively as 'firms'. It is particularly relevant to firms with permission to apply the MA, or those seeking permission to apply the MA.

1.4 This SoP should be read in conjunction with the MA regulations, the Matching Adjustment Part of the PRA Rulebook, the Investments Part of the PRA Rulebook, the relevant rules in the rest of the Solvency II Sector of the PRA Rulebook, the supervisory statement (SS) 7/18 – Solvency II: Matching Adjustment<sup>1</sup>, the supervisory statement (SS) 1/20 – Solvency II: Prudent Person Principle<sup>2</sup>, the supervisory statement (SS) 8/18 – Solvency II: Internal models – modelling of the matching adjustment<sup>3</sup>, the supervisory statement (SS) 3/17 – Solvency II: Illiquid unrated assets<sup>4</sup> and the PRA's insurance approach document<sup>5</sup>.

<sup>1</sup> [See the proposed update to SS7/18 that is currently undergoing simultaneous consultation. This footnote will be revised to provide a link to the updated SS when the final policy statement is published.]

<sup>2</sup> [SS1/20 – Solvency II: Prudent Person Principle, May 2020: [www.bankofengland.co.uk/prudential-regulation/publication/2020/solvency-ii-prudent-person-principle-ss](https://www.bankofengland.co.uk/prudential-regulation/publication/2020/solvency-ii-prudent-person-principle-ss). See also the proposed update to SS1/20 that is currently undergoing simultaneous consultation. This footnote will be updated to provide a link to the updated SS when the final policy statement is published.]

<sup>3</sup> [SS8/18 – Solvency II: Internal models – modelling of the matching adjustment, July 2018: [www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-2-internal-models-modelling-of-the-matching-adjustment-ss](https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-2-internal-models-modelling-of-the-matching-adjustment-ss). See also the proposed update to SS8/18 that is currently undergoing simultaneous consultation. This footnote will be updated to provide a link to the updated SS when the final policy statement is published.]

<sup>4</sup> [See the proposed update to SS3/17 that is currently undergoing simultaneous consultation. This footnote will be revised to provide a link to the updated SS when the final policy statement is published.]

<sup>5</sup> July 2023: [www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors](https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors).

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## 2: The procedure for considering MA permissions

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2.1 This chapter outlines the PRA's approach to considering, granting, and varying permission for a firm to apply the MA to the relevant risk-free rate term structure for calculating its best estimate liabilities. Chapter 3 goes on to discuss how this approach could be applied in a more flexible, streamlined manner in certain circumstances.

2.2 This chapter covers both initial MA applications by firms that do not already have permission to apply the MA; and applications to vary MA permissions, where firms are seeking to change the scope of an existing MA permission. It also covers possible revocation of MA permissions by the PRA.

### Interaction between the PRA and firms before an application

2.3 The PRA welcomes early engagement with firms that are considering submitting an application, via their usual supervisory contact. The nature of this engagement will depend on the complexity and scale of the proposed application, and the firm's readiness to submit a formal application.

2.4 For changes to MA portfolios, this engagement should cover whether a new MA application is required. For example, where a firm proposes to add new assets or liabilities to its MA portfolio, the engagement should cover the firm's considerations and conclusions as to whether the new assets or liabilities contain new features or risks.

### Initial application for permission to apply the MA

2.5 A firm should submit a written application to the PRA for initial permission to apply the MA. The application should be made in accordance with any relevant procedural requirements under section 138BA of FSMA and should incorporate all relevant documentary evidence.

2.6 The application should include confirmation that it contains all information that the firm considers necessary for the PRA to reach a decision. The application must be signed-off by the board or by the relevant persons responsible for the submission of MA applications (in line with the expectations set out in paragraph 9.6A of SS7/18).<sup>6</sup>

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<sup>6</sup> [Paragraph 9.6A of the proposed update to SS7/18 currently undergoing consultation; this footnote will be updated when the final policy statement is published.]

2.7 In order for a firm to apply a Matching Adjustment under the MA regulations, the PRA must be satisfied that the firm meets the matching adjustment eligibility conditions as set out in regulation [x] of the MA regulations and Chapter 2 of the Matching Adjustment Part. As required by Matching Adjustment 3.1, a firm's initial MA application must contain written confirmation of its compliance with the MA eligibility conditions as well as adequate documentary evidence to support this, including:

- i. evidence that the relevant portfolio of assets meets the applicable requirements set out in regulation [x] of the MA regulations and Matching Adjustment 2.2(6);
- ii. evidence that, in relation to any asset with cashflows that are not fixed, the asset cashflows are highly predictable (regulation [x] of the MA regulations and Matching Adjustment 5) and the risks to the quality of matching are not material;
- iii. evidence that the relevant portfolio of insurance or reinsurance obligations meets the applicable requirements set out in Matching Adjustment 2.2(1) to (4), 2.3, and 2.4;
- iv. evidence that the criteria of regulations [x] of the MA regulations are met, including a quantitative and qualitative assessment of whether any mismatch gives rise to risks which are material in relation to the risks inherent in the insurance business to which the MA is intended to be applied; and
- v. evidence that adequate processes will be in place to properly identify, organise, and manage the relevant portfolio of insurance or reinsurance obligations and relevant portfolio of assets separately from other activities of the firm (as per regulation [x] of the MA regulations), and to ensure that the assigned assets will not be used to cover losses arising from other activities of the firm (as per Matching Adjustment 2.2(5)).

2.8 Assets with highly predictable (HP)<sup>7</sup> cashflows pose additional risks to the quality of matching. Where a firm is seeking an MA permission to include assets with HP cashflows in its MA portfolio, the firm should set out in its MA application how it proposes to mitigate these risks. As well as the required addition to the fundamental spread (FS) (FS addition)<sup>8</sup> for these assets, firms may choose to apply other mitigants/safeguards for example, exposure limits, or close monitoring of matching. Like the FS addition, these other mitigants would then form part of a firm's MA permission if the application is approved. Therefore, in addition to 2.7(ii) above, the application should contain information covering:

- i. the proposed methodology for determining the best estimate cashflows;<sup>9</sup>

<sup>7</sup> Matching Adjustment 5.3.

<sup>8</sup> Matching Adjustment 8.2.

<sup>9</sup> Matching Adjustment 5.4.

- ii. the proposed methodology for calculating any FS additions or confirmation that a standard approach will be used (as set out in either paragraph 5.23 or 5.24 of SS7/18,<sup>10</sup> as applicable); and
- iii. any other proposed mitigants/safeguards that the firm considers should form part of its MA permission.

2.9 The PRA will also consider the extent to which the firm meets the relevant expectations set out in SS7/18<sup>11</sup> and SS1/20.<sup>12</sup> The firm should therefore provide its assessment against these expectations, together with adequate supporting documentary evidence, within its application.

2.10 In addition to the above, a firm should ensure (in line with paragraph 2.6) that the application includes any other information (not explicitly mentioned in paragraphs 2.7 to 2.9 above) that it considers may be necessary for the assessment and decision by the PRA. Where a firm is seeking to include any guaranteed elements of With-Profits annuities in its MA portfolio(s) the PRA would expect the application to include confirmation that the firm has satisfied itself that any implications for its With-Profits business (including points around fairness, investment strategy and wider management) have been considered and, if necessary, discussed with the FCA.

2.11 As part of its assessment, the PRA may also request additional evidence relevant to the operation of the MA portfolio. A firm should be able to provide, on request:

- i. confirmation that the firm will meet the requirements of Matching Adjustment 13.3 if permission to apply an MA is granted;
- ii. a copy of the liquidity plan referred to in Conditions Governing Business 3.1(3) ;
- iii. an explanation of the calculation process (that will be) used to determine the MA in accordance with the requirements of Chapter 4 of the Matching Adjustment Part;
- iv. an assessment of the impact of a reduction in the MA to zero (Conditions Governing Business 3.2(2)(c)); and
- v. details of any limits eg investment limits (not already covered in the firm's application) that the firm intends to apply to specific assets or asset types in line with the

<sup>10</sup> [Please see the update to SS7/18 that is currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

<sup>11</sup> [Please see the update to SS7/18 that is currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

<sup>12</sup> [This includes the update to SS1/20 currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

expectations around the Prudent Person Principle (PPP) as set out in chapter 3 of SS1/20.<sup>13</sup>

2.12 Where an application is submitted in respect of more than one portfolio of insurance or reinsurance obligations, the application shall set out the evidence required separately for each portfolio that is covered by the application.

2.13 The application should include a list of any other applications, submitted by the firm or currently anticipated, that may be relevant to the regulatory balance sheet or capital requirements of the firm or group.

## Change of scope MA application

2.14 The PRA recognises that a firm may wish to alter the scope of an existing MA permission via a variation of its existing MA permission. A firm should submit a written application to the PRA to vary its MA permission. The application should be made in accordance with any relevant procedural requirements under section 138BA of FSMA and should incorporate all relevant documentary evidence.

2.15 The application should include confirmation that it contains all information that the firm considers necessary for the PRA to reach a decision and the application must be signed-off by the board or by the relevant persons responsible for the submission of MA applications (in line with the expectations set out in paragraph 9.6A of SS7/18).<sup>14</sup>

2.16 A firm's application must as a minimum contain:

- i. a description of the proposed change(s) in scope;
- ii. written confirmation of its compliance with the MA eligibility conditions, including adequate documentary evidence to support this (as per 2.7 above); and
- iii. to the extent relevant, the information described in 2.8, 2.9, 2.10, 2.12, and 2.13 above.

2.17 The PRA may also request the additional items set out in 2.11 above as part of its assessment. It may also ask the firm to explain the likely impact on the MA of the proposed change(s).

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<sup>13</sup> [This includes the update to SS1/20 currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

<sup>14</sup> [Paragraph 9.6A of the proposed update to SS7/18 currently undergoing consultation. This footnote will be updated when the final policy statement is published.]



2.18 To ease the administrative and operational burden on both firms and the PRA, the PRA expects a firm to update the suite of documentary evidence covering its initial MA permission, for each subsequent variation of that permission. Applications for a variation of MA permission should therefore cover a short description of the proposed changes together with an updated suite of documentary evidence, where the changes to this evidence from that submitted to the PRA to support the existing permission are clearly signposted, for example using 'track changes'. A 'clean' version of the full application should also be provided by the firm.

2.19 The PRA considers that effective use of its resources to grant future variations of the MA permission would be contingent on the firm developing a consolidated package of documentation based on its current MA permission and submitting it for PRA review before making its next application to vary its MA permission.

2.20 The PRA expects firms to avoid making speculative applications to vary an MA permission in order to cover a range of potential future eventualities. The PRA will consider MA applications to add new asset types, features, or risks to a MA permission where the firm has yet to invest in those new assets. However, the PRA expects the firm to provide credible details of plans to invest in these new asset types or assets with new features or risks within 12-months of the PRA reaching a decision on the MA application. After MA permission has been given, the PRA expects a firm's MA portfolio to evolve over time to reflect its MA permission or for the firm to seek a variation of its MA permission if this is not the case (eg if a firm has been unable to invest in assets with certain features and a material amount of time has passed since it received the necessary MA permission).

2.21 As set out in Matching Adjustment 3.2, once a firm applies the MA to a relevant portfolio of insurance or reinsurance obligations it may not revert to an approach which does not include the MA. The PRA therefore expects a firm to obtain approval for a variation of its MA permission from the PRA before reducing the scope of the relevant portfolio of insurance or reinsurance obligations to which the MA applies.

## Assessment of an initial or change in scope application

2.22 The PRA will confirm receipt of the application to the firm.

2.23 The PRA's approach to assessing the application will be proportionate and appropriate to the circumstances. In particular, for applications to vary MA permissions, the PRA does not expect to routinely seek additional information in respect of areas outside the proposed variation.

2.24 Where the PRA considers the application does not include sufficient information to allow it to make a decision, the PRA will request the additional information necessary for carrying

out its assessment. This information would then be treated as being part of the documentary evidence supporting the application.

2.25 The PRA may also consider other factors and evidence that are relevant when reaching a decision as to whether the MA eligibility conditions have been met. Given that the granting of an MA permission impacts both technical provisions and the Solvency Capital Requirement (SCR), the PRA notes that the credit rating, valuation methodology, and modelling in stress are key determinants of the financial impact of the MA. Other evidence that the PRA requests may therefore include a firm's approach to obtaining a credit rating for a given asset or assets and how the MA portfolio (or changes to the MA portfolio) will be reflected in the SCR calculation. Firms may find it helpful to refer to the PRA's expectations regarding these areas as set out in SS3/17<sup>15</sup> and SS8/18.<sup>16</sup>

2.26 The PRA will co-ordinate with the FCA if a firm proposes to include any guaranteed elements of With-Profits annuities in the MA portfolio, in line with the agreed processes under the PRA-FCA Memoranda of Understanding (MoUs) (both the main MoU<sup>17</sup> and the With-Profits MoU).<sup>18</sup>

2.27 Firms that intend to submit a further MA application before a determination of a previous MA application should engage with the PRA as early as possible, particularly to clarify any potential interaction between the applications and to set out how the firm will ensure the documents supporting the MA permission at any time are up-to-date. Should the PRA consider that the content of a further MA application interconnects with an already submitted application, the PRA will advise the firm of any impact on the application already submitted or the likely review timescales.

2.28 The assessment of the application will involve ongoing communication with the firm and may include discussions regarding adjustments to the content and/or changes to the scope of the application.

2.29 Assuming that the firm has provided a sufficient amount and quality of evidence to allow the PRA to make a decision, and that the need for additional information and/or clarification has been limited, the PRA expects to determine the outcome of an application no later than six months from the date of receipt. Where insufficient evidence is provided and/or there is

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<sup>15</sup> [Please see the update to SS3/17 that is currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

<sup>16</sup> [This includes the update to SS8/18 currently undergoing simultaneous consultation. This footnote will be deleted when the final policy statement is published.]

<sup>17</sup> [www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/fca-and-bank-prudential-july-2019.pdf](https://www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/fca-and-bank-prudential-july-2019.pdf).

<sup>18</sup> [www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/fca-and-pra-supervision-of-with-profits-policies.pdf](https://www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/fca-and-pra-supervision-of-with-profits-policies.pdf).

need for material iterative dialogue between the PRA and the firm then this is likely to extend the time needed for the PRA to reach a decision.

## Right to withdraw the application by the firm

2.30 A firm that has applied for permission to apply the MA, or to vary an existing permission, may withdraw that application by notifying the PRA in writing at any time before the PRA reaches a decision on the application.

## Decision on the application

2.31 When the PRA has reached a decision on an application, it will notify the firm in writing with its decision. Where the PRA grants permission, the written notice will specify the scope of the permission and the starting date from which the permission can be used.

2.32 Where a single application covers multiple portfolios, the PRA may grant the MA permission for some portfolios but not for others.

2.33 A decision by the PRA to permit a firm to apply the MA is on a going concern basis, such that the scope of that permission shall be considered to cover future insurance and reinsurance obligations and assets that are added to the MA portfolio, provided that the obligations and assets have the same features and risks for which the MA permission was granted; and the MA portfolio continues to meet the relevant MA eligibility conditions.

## The PRA's powers to vary or revoke permission to apply the MA

2.34 The PRA's power to grant permission to apply the MA under section 138BA of FSMA, exercised in accordance with regulation [x] of the MA regulations also permits the PRA to vary and/or revoke an MA permission.

2.35 As set out in Matching Adjustment 13.5, where a firm is unable to restore compliance with MA eligibility conditions within two months of the date of non-compliance, firms will be required to reduce the MA proportionately by 10%, for each further month or part-month of non-compliance. It is also possible that in some circumstances the MA could be reduced by more than the set out in Matching Adjustment 13.5 or that a firm's permission to apply the MA could be revoked by the PRA.<sup>19</sup>

2.36 Where a firm has been required to reduce the MA, due to non-compliance for a period of greater than two months, the PRA will monitor the firm's efforts to return to compliance with

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<sup>19</sup> [Paragraphs 8.1B and 8.1C of the proposed update to SS7/18 currently undergoing consultation; this footnote will be updated when the final policy statement is published.]

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MA eligibility conditions and inform the firm of any further actions that may need to be taken (eg obtaining approval to vary its MA permission) before a firm may apply the full MA.

2.37 The PRA will exercise its power to revoke MA permissions in a proportionate manner. The PRA expects that it might use this power in cases where a firm has significantly breached the MA eligibility conditions, where the firm has been (or will be) unable to restore compliance in a reasonable period of time after the initial two-month window, where the firm's MA is zero, or when a firm has repeatedly breached the MA eligibility conditions. The PRA does not expect to make use of this power routinely.

2.38 Once permission to apply the MA is revoked, a firm will need permission from the PRA to apply the MA again. Under these circumstances, a firm would need to submit an MA application to the PRA for decision. This MA application would be treated as an initial MA application.

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## 3: Flexible approach to MA permissions

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3.1 This chapter outlines specific areas where the PRA considers its approach to assessing MA applications can be more flexible/streamlined. It covers what is meant by a streamlined approach and also explains how such an approach would work in practice.

### A streamlined approach to assessing MA applications

3.2 The PRA is committed to assessing and providing decisions on all MA applications as quickly as possible, and it expects to give its decision no later than six months from the PRA's receipt of a firm's application (subject to the points made in paragraph 2.29 above). If a streamlined approach is considered suitable, then the PRA would expect to reach a decision more quickly.

3.3 When a firm engages with the PRA regarding a proposed MA application, the PRA will indicate whether such an application is likely to be suitable for a streamlined approach.

3.4 As explained in paragraph 2.25 above, the granting of an MA permission impacts both technical provisions and the SCR. For assets held in MA portfolios, the credit rating, valuation methodology, and modelling in stress are therefore key in determining the overall financial impact of applying the MA.

3.5 Under a streamlined approach, the PRA would limit its review to a consideration of whether the proposed assets and/or liabilities meet the MA eligibility conditions and would not review other related supervisory issues that are not directly covered by the MA eligibility conditions but which are related to the firm's ongoing application of the MA (eg the firm's approach to calculating the MA) as part of its review of the MA application. The PRA may decide to review items not covered by the streamlined MA application review later, as part of its ongoing supervisory activity, as appropriate.

3.6 The PRA notes that the requirement for the credit quality of the assets in firms' MA portfolios to be capable of being assessed through a credit rating or the firm's internal credit assessment of a comparable standard is one of the MA eligibility conditions.<sup>20</sup> Under a streamlined approach, firms should still evidence how this eligibility condition is met as part of their application, but (as in paragraph 3.5) the PRA may decide to defer any review of the appropriateness of the credit assessment until a later stage.

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<sup>20</sup> Regulation [x] of the MA regulations.

## A streamlined approach in practice

3.7 The PRA will still require firms to submit a written application including the relevant documentary evidence set out in paragraph 2.16 above but is unlikely to ask for additional information unless the information provided by the firm is insufficient for the PRA to reach a decision.

3.8 The PRA will endeavour to undertake a streamlined review of the application where applications are clearly in line with the MA eligibility conditions, propose straightforward changes, or where firms propose appropriate safeguards.

3.9 The PRA notes that its ability to undertake a streamlined review will critically depend on whether all relevant information is included in the application, the quality of the information provided by the firm, and how straightforward it is for a firm to demonstrate compliance with the relevant requirements. Requests for clarification or additional information from firms are likely to increase the review time needed.

3.10 A firm may propose safeguards, such as exposure limits, to enable a streamlined review of its application. The PRA expects to discuss this with firms as part of a streamlined approach to the review.

3.11 Where a firm is only seeking to make changes to the assets included in its MA portfolio, a streamlined approach is most likely suitable for:

- an asset type that a firm already has permission to include in its MA portfolio but where new features are present;
- an asset type that a firm already has permission to include in its MA portfolio but where new risks are present; and
- where an asset includes a new combination of features and/or risks but the firm already has MA permission for other assets containing subsets or different combinations of these features and risks.

3.12 A streamlined approach may also be suitable for certain more novel assets, including assets that are more complex in nature or assets with HP cash flows. However, as a streamlined approach increases the risks to the PRA's statutory objectives, including where risks to the quality of matching may be material, the PRA expects firms to consider proposing or discussing with the PRA safeguards or mitigants to limit the materiality of these risks. Nevertheless, even allowing for safeguards, the risks and complexities associated with some assets (eg internal securitisations) may mean it is not possible to apply a streamlined approach for those assets, particularly where assurance around areas such as capital

modelling, valuation and ratings is required to confirm eligibility (eg whether the cash-flows are fixed).

3.13 Where a firm is seeking to make changes only to the liabilities included in its MA portfolio, a streamlined approach is most likely suitable for:

- a type of liability that a firm already has permission to include in its MA portfolio but where new features are present;
- a type of liability that a firm already has permission to include in its MA portfolio but where new risks are present; and
- where a liability includes a new combination of features and/or risks but the firm already has MA permission for other liabilities containing subsets or different combinations of these features and risks.

3.14 For other changes to MA portfolios, the ability for the PRA to apply a streamlined approach will depend on the extent, nature, and complexity of the change(s) proposed. Due to the number of areas covered, initial MA permissions, and variations of permission that include many proposed changes to the scope of the MA permission are less likely to be able to benefit from a streamlined approach. The same applies to applications that include a number of changes in one area (eg a number of proposed changes to the relevant portfolio of assets).