

Bank of England PRA

Solvency II: Capital add-ons

Statement of policy

November 2024 (updating February 2024)



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1: Introduction

1.1 This statement of policy (SoP) sets out the approach that the Prudential Regulation Authority (PRA) expects to use in relation to capital add-ons (CAOs).

1.2 This SoP is relevant to all UK Solvency II firms, the Society of Lloyd's, its members and managing agents, herein referred to collectively as 'firms'. This SoP is also relevant to all UK holding companies.

1.3 The PRA recognises the importance of adopting a consistent and transparent approach to setting a CAO. The approach set out in this SoP is intended to make CAOs a more practical and effective supervisory tool.

1.4 This SoP sets out the circumstances in which the PRA expects to set CAOs (chapter 2), the methodologies for their calculation (chapter 3), information relevant to the use of CAOs at group level (chapter 4), the process for setting a CAO (chapter 5), and the ongoing monitoring, reporting, and removal of CAOs by the PRA (chapter 6).

1.5 This SoP should be read in conjunction with the SoP – Solvency II internal models: Permissions and ongoing monitoring, and the Solvency Capital Requirements and Group Supervision Parts of the PRA Rulebook.

2: Circumstances for setting capital add-ons

2.1 The PRA expects to consider setting a CAO under the circumstances specified in the definition of capital add-on in the PRA Rulebook:

- (a) where there is a significant deviation in the risk profile of a firm from the assumptions underlying the Solvency Capital Requirement (SCR), where the firm calculates its SCR using the standard formula (SF);
- (b) where 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 internal model (IM);
- (c) where there is a residual deviation in the risk profile of a firm from the assumptions underlying the SCR, where part or all of the firm's SCR is calculated, or the firm is applying for it to be calculated, using an IM;¹
- (d) where there is a significant system of governance deviation;
- (e) where there is a significant deviation from the assumptions underlying the matching adjustment, volatility adjustment, risk-free interest rate transitional measure (TMIR), or the transitional measure on technical provisions (TMTP); or
- (f) a specific risk existing at group level leading to a risk profile deviation at group level.

Assessment of a deviation as regards the SCR

2.2 This section is relevant to the assessment of SCR risk profile deviations ie circumstances (a) to (c) of paragraph 2.1. In determining the degree to which a firm's risk profile deviates from the assumptions underlying the SCR, the PRA will consider all relevant factors, including the following:

- (a) the nature, type, and size of the deviation;
- (b) the likelihood and severity of any adverse impact on policyholders;
- (c) the level of sensitivity of the assumptions to which the deviation relates;
- (d) the anticipated duration and volatility of the deviation over the duration of the deviation.

2.3 Where the PRA determines that there is a deviation as regards the SCR it will consider the appropriate supervisory response, which may include setting a CAO to ensure compliance with the calibration standards in Solvency Capital Requirement – General

¹ Defined as an 'IM residual deviation' within the PRA Rulebook.

Provisions 3.3 to 3.4. The PRA will assess the size of a risk profile deviation pursuant to paragraph 2.2(a) by considering the outcome of the calculation specified in paragraph 3.2, or in exceptional circumstances, paragraph 3.11 for an IM firm, expressed as a percentage of the firm's SCR, excluding any previous or simultaneous CAO. The PRA will apply the quantitative thresholds set out in table 1 to the outcome of the calculation as part of its determination as to whether a risk profile deviation as regards the SCR is significant.

Table 1: Criteria for assessing whether a risk profile deviation is significant

Result of the calculation specified in paragraph 2.3	Outcome as regards the assessment of the size of the risk profile deviation
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 2.2.
The PRA detects a risk profile deviation that is $\geq 10\%$ (and $< 15\%$) of the SCR.	The PRA expects to 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 2.2.
The PRA detects a risk profile deviation that is $\geq 15\%$ of the SCR.	The PRA expects to conclude that the risk profile of the firm deviates significantly from the assumptions underlying the SCR.

2.4 Where the PRA determines that a firm's risk profile deviates significantly from the assumptions underlying the SCR, as calculated using the SF in accordance with the Solvency Capital Requirement – Standard Formula Part of the PRA Rulebook, it will consider setting a CAO in accordance with the circumstances described in paragraph 2.1(a). This is particularly the case where the PRA considers that requiring the firm to develop an IM to calculate part or all of its SCR is inappropriate or has been ineffective as described in paragraph 2.5. In addition where the PRA does require a firm to develop a full or partial IM, in accordance with Chapter 4 of SoP – Solvency II internal models: Permissions and ongoing monitoring, it would consider setting such a CAO while the firm develops the required model.

2.5 Further to paragraph 2.4, the PRA recognises there may be circumstances where requiring a firm to develop an IM may be inappropriate eg where the estimated time, financial, and other resources required to develop an IM (or to extend the scope of an existing partial IM to cover additional risks) are disproportionate to the size of the firm's risk profile deviation from the assumptions underlying the SCR as calculated using the SF. Where the PRA has set a requirement for a firm to use an IM it considers that requirement to have been ineffective where the firm fails to develop an IM, or where the developed IM fails to

meet the overall standard and requirements for a firm to be granted a permission for a full or partial IM, as set out in SoP – Solvency II internal models: Permissions and ongoing monitoring.

2.6 Where the PRA determines that a firm's risk profile deviates significantly from the assumptions underlying the SCR, as calculated using a full or partial IM in accordance with the Solvency Capital Requirement – Internal Models Part of the PRA Rulebook, it will consider setting a CAO specified in paragraph 2.1(b). This may be the case if particular quantifiable risks are captured insufficiently within the firm's IM and where the adaptation of the model by the firm to better reflect its risk profile has failed within an appropriate timeframe as determined and communicated to the firm by the PRA.

2.7 Further to paragraph 2.6 in concluding that a firm's adaptation of its IM to better reflect its risk profile has failed or that the application of other measures is unlikely to improve deficiencies the PRA will consider all relevant factors in determining an appropriate timeframe, including the likelihood and severity of any adverse impact on policyholders. The PRA expects any such timeframe will not exceed six months.

2.8 Where the PRA determines that the deviation of a firm's risk profile from the assumptions underlying the SCR as calculated using a full or partial IM in accordance with the Solvency Capital Requirement – Internal Models Part of the PRA Rulebook does not constitute a significant risk profile deviation, but rather an IM residual deviation (as defined in the PRA Rulebook), it will consider setting a CAO specified in paragraph 2.1(c). In determining whether to set a 'residual model limitation (RML) CAO' in those circumstances,² either at the point of granting an initial model permission or varying an existing permission, the PRA will consider all relevant factors, including:

- (a) those specified in paragraph 2.2;
- (b) the likelihood that the firm is capable of remediating the underlying RML in a reasonable timeframe;
- (c) the factors set out in paragraphs 3.5 and 3.16, and in the case of groups, paragraph 3.18 in SoP – Solvency II internal models: Permissions and ongoing monitoring.

2.9 The PRA may consider setting one or more RML CAO in such circumstances, depending on the underlying IM residual deviation. The size of any such RML CAO will be proportionate and consistent with the fact that the size of the deviation does not warrant either rejection of

² Residual model limitations (RMLs) are defined in the PRA Rulebook and are described in more detail in chapter 3 of SoP – Solvency II internal models: Permissions and ongoing monitoring. An RML CAO is a model permission safeguard, designed to address an IM residual deviation stemming from an RML, to ensure compliance with Solvency Capital Requirement – General Provisions 3.3 to 3.4 and mitigate non-compliance with the internal IM requirements.

the model permission (or of the variation of an existing permission, where requested, in the case of a major model change application) or the setting of a CAO for IM significant risk profile deviation. The PRA expects the overall amount of RML CAOs in aggregate, at any given time, to be less than 10% of a firm's SCR, calculated in accordance with paragraphs 3.2 and 3.3.

Assessment of a significant deviation as regards the system of governance

2.10 In determining whether the system of governance of a firm deviates significantly from the requirements set out in Conditions Governing Business 2.2 to 7,³ the PRA expects to consider all relevant factors, including the following:

- (a) the effect of the deviation from the system of governance requirements set out in Conditions Governing Business 2.2 to 7 (including pursuant to Group Supervision 17.1(1)) on the sound and prudent management of the business and whether the deviation arises from an inadequate implementation of a requirement(s) relating to the system of governance or a failure to implement such a requirement(s);
- (b) the likelihood and severity of any adverse impact on policyholders;
- (c) the different ways of organising an effective system of governance which is proportionate to the nature, scale, and complexity of the risks inherent in the business of the firm;
- (d) the probable financial loss the firm could incur as a consequence of the deviation;
- (e) the anticipated duration of the deviation.

2.10A Where a firm fails to comply with any requirement set out in Article 5(4) of Regulation (EU) 2017/2402, by reason of its negligence or omission, the PRA will assess whether that failure should be considered a significant deviation from the system of governance requirements set out in Conditions Governing Business 2.2 to 7.

2.11 The PRA may consider setting a CAO specified in paragraph 2.1(d) where it determines that:

- a firm's system of governance deviates significantly from the system of governance requirements set out in Conditions Governing Business 2.2 to 7 (including pursuant to Group Supervision 17.1(1) where appropriate), and the deviation prevents it from

³ Including pursuant to Group Supervision 17.1(1).

being able to properly identify, measure, monitor, manage, and report the risks that it is or could be exposed to; and

- the application of other measures is in itself unlikely to sufficiently improve the deficiencies within an appropriate timeframe.

Assessment of a significant deviation as regards adjustments to the relevant risk-free rate and transitional measures

2.12 In determining whether the risk profile of a firm deviates significantly from the assumptions underlying the matching adjustment, the volatility adjustment, the TMIR, or the TMTP, the PRA expects to consider all relevant factors, including the following:

- (a) those specified in paragraph 2.2;
- (b) the impact of the deviation on the SCR and own funds of the firm; and
- (c) for the matching adjustment, the conceptual and technical assumptions set out in Chapter 1A of SS7/18 – Solvency II: Matching Adjustment.

2.13 Where the PRA determines that a firm's risk profile deviates significantly from the assumptions underlying the adjustments to the relevant risk-free rate (ie the matching adjustment or volatility adjustment) or transitional measures (ie the TMIR or TMTP), it will consider setting a CAO specified in paragraph 2.1(e). The PRA expects to set a CAO only in circumstances where the deviation from the assumptions underlying those adjustments or transitional measures is of a temporary nature and does not justify revoking the permission for the use of those adjustments or transitional measures granted by the PRA.

3: Methodology for calculating a capital add-on

Calculation of capital add-ons in relation to deviations as regards the SCR

3.1 The PRA may decide to express the CAO either as a fixed amount, or with reference to certain outputs calculated by the firm to enable the CAO to respond dynamically to changes over time in the business and economic environment. These outputs may be derived from the firm's IM, SF, or balance sheet calculations. For example, the PRA may express the CAO as a proportion of the pre (or post) diversified SCR prior to application of the CAO. In cases where the CAO is specified dynamically, the PRA expects the firm to then calculate the amount of additional capital that it is required to hold in accordance with the dynamic formula set by the PRA. The PRA expects to include the frequency and timings for when this amount should be recalculated in the firm's written notice setting the CAO. The PRA expects to review these recalculations regularly. The SCR prior to the imposition of the capital add-on, together with the amount of the CAO following its most recent recalculation, will constitute the firm's SCR.

3.2 For the purposes of setting a CAO in relation to a deviation in a firm's risk profile from the assumptions underlying the SCR,⁴ the PRA expects to calculate the CAO as the difference, at a given point in time, between the following:

- (a) the SCR of the firm, excluding any previous or simultaneous CAO, that would be calculated if the SF or IM, as appropriate, were modified to reflect the actual risk profile of the firm,⁵ to ensure compliance with SCR – General Provisions 3.3 to 3.4;
- (b) the SCR of the firm, excluding any previous or simultaneous CAO.

3.3 For the avoidance of doubt, the PRA will use the same approach for calculating a CAO for IM significant risk profile deviation and an RML CAO. The basis for both types of CAO is the same, and the main distinction between them is the magnitude of the deviation, ie whether the risk profile deviation as regards the SCR is significant (as described in paragraph 2.3 and Table 1). Furthermore, the PRA will not consider setting a CAO for IM significant risk profile deviation at the point of granting an initial IM permission, or varying an existing

⁴ This includes CAO for SF or IM significant risk profile deviation, and RML CAO for internal model residual deviation.

⁵ To the extent that an RML CAO is imposed at the point of granting a firm an IM permission, the calculation will be between the SCR that would be calculated by the proposed IM modified in accordance with 3.1(a) and the SCR calculated by the proposed IM without any such modifications.

permission to enable a firm to make a major model change; it will only consider setting an RML CAO at that point. The PRA's approach to setting CAOs for IM risk profile deviations is described in more detail in paragraphs 3.15 and 3.17 in SoP – Solvency II internal models: Permissions and ongoing monitoring.

Scope and approach of modifications as regards a deviation from SCR assumptions

3.4 In calculating the amount referred to in paragraph 3.2(a), the PRA expects to consider the aspects of the SF or the full or partial IM that gave rise to the deviation of the risk profile assumed under the SF or the IM, respectively, from the actual risk profile of the firm. This will include, where relevant, quantifiable risks not taken into account by the SF or the IM, the structure of the SF or the IM, aggregation methods, parameters, and assumptions.

3.5 For the purposes of paragraph 3.4, the PRA expects to modify the assumptions and parameters underlying the SCR as calculated using the SF or IM,⁶ in order for those assumptions or parameters to properly reflect the actual risk profile of the firm and to ensure compliance with Solvency Capital Requirement – General Provisions 3.3 and 3.4.

3.6 Where the modifications referred to in paragraph 3.5 are insufficient or inappropriate to calculate the amount referred to in paragraph 3.2(a), the PRA expects to consider alternative methodologies which go beyond modifying assumptions or parameters to calculate the amount referred to in paragraph 3.2(a).

3.7 The PRA expects that any modifications referred to in paragraph 3.5 or alternative methodology referred to in paragraph 3.6 will use adequate, applicable, and relevant actuarial and statistical techniques, and that they will be based on accurate, complete, and appropriate data of the firm to the extent available. Where such data are not available, the PRA expects firms to use data which is relevant for their operations.

3.8 Where alternative methodologies referred to in paragraph 3.6 are insufficient or inappropriate, the PRA may calculate the SCR for the purposes of paragraph 3.2(a) by comparing the SCR of firms with similar risk profiles.

3.9 For the purposes of paragraphs 3.7 and 3.8, where the PRA uses information relating to other firms with similar risk profiles, it will clearly state the reasons for its decision to set a CAO in a letter to the firm. The PRA will ensure that the statement of reasons complies with the professional secrecy requirements in section 348 of the Financial Services and Markets Act 2000 (FSMA).

⁶ For this purpose, modifications include those to a model for which a firm has submitted an IM permission application.

3.10 The PRA generally expects to not set off aspects of a risk profile deviation that indicate that a lower SCR would better reflect the firm's actual risk profile, against the other aspects that indicate that a higher SCR is appropriate. The PRA will consider whether such set off is appropriate, and only where the firm satisfies all of the following conditions:

- (a) a modification or a methodology exists which complies with the approach set out in paragraph 3.7 to quantify the impact on the amount referred to in paragraph 3.2(a) of the aspects which indicate a lower SCR;
- (b) it would be inappropriate to address the aspects that indicate a lower SCR by replacing standard parameters with parameters specific to the firm in accordance with SS4/15 – Solvency II: the solvency and capital requirements, or by using an IM in accordance with Solvency Capital Requirement – Internal Models Part of the PRA Rulebook;
- (c) the overall SCR that would result after setting off the risk profile deviations against each other complies with Solvency Capital Requirement – General Provisions 3.3 to 3.4.

3.11 Alternatively, the PRA would consider the following approach for calculating a CAO for IM significant risk profile deviation as regards the SCR in exceptional circumstances. 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, the PRA would consider setting a CAO calculated as:

- (a) a proportion of the difference between the SCR calculated using the firm's IM and the SCR that would be calculated if the firm's model permission was varied so that model components with significant limitations reverted to calculating the SCR using the SF; or
- (b) a proportion of the difference between the SCR calculated using the firm's IM and the SCR that would be calculated if the firm's model permission was revoked so that it was required to calculate its entire SCR using SF.

The proportion chosen would reflect the strength of concerns around the extent to which the firm's IM reflects its risk profile as well as the extent to which the firm's risk profile was significantly different to that underlying the SF calibration.

3.12 The PRA expects this approach to be a proportionate supervisory action to consider in particular scenarios such as those described in paragraph 3.36 of SoP – Solvency II internal models: Permissions and ongoing monitoring. It may be used in advance of the PRA considering to exercise its power to vary or revoke IM permission. The PRA expects that any calculations in accordance with the approaches described in paragraph 3.11 will use adequate, applicable, and relevant actuarial and statistical techniques, and will be based on accurate, complete, and appropriate data of the firm to the extent available. Where such data are not available, the PRA expects firms to use data that is relevant for their operations. The

PRA considers that the conditions relevant to set off described in paragraph 3.10 are not applicable when applying the approach for calculating a CAO described in paragraph 3.11 (ie the PRA does not consider set off to be appropriate in those circumstances).

Calculation of capital add-ons in relation to adjustments to the relevant risk-free rate or transitional measures

3.13 For the purposes of setting a CAO in relation to a significant deviation from the assumptions underlying the matching adjustment, volatility adjustment, TMIR, or the TMTP, the PRA expects to calculate the CAO as the sum, at a given point in time, of the following amounts:

- (a) the negative of the amount of eligible own funds that would be calculated if the adjustment or transitional measure were modified in a manner such that the assumptions underlying the adjustment or transitional measure would reflect the actual assets, liabilities, and risk profile of the firm;
- (b) the amount of the SCR, excluding any previous or simultaneous CAO, that would be calculated if the adjustment or transitional measure were modified in a manner such that the assumptions underlying the adjustment or transitional measure would reflect the actual assets, liabilities, and risk profile of the firm, and ensure compliance with Solvency Capital Requirement – General Provisions 3.3 to 3.4;
- (c) the amount of eligible own funds; and
- (d) the negative of the amount of the SCR, excluding any previous or simultaneous CAO, of the firm.

3.14 The PRA may decide to express the CAO either as a fixed amount, or with reference to outputs from the firm's balance sheet calculations enabling the CAO to respond dynamically to changes over time in the business and economic environment. For example, the PRA may express the CAO as a proportion of the amount of matching adjustment, volatility adjustment, TMIR or TMTP, as appropriate, prior to application of the CAO. In cases where the CAO is specified dynamically, the firm must then calculate the amount of additional capital that it is required to hold in accordance with the dynamic formula set by the PRA. The PRA expects to include in the firm's written notice setting the CAO, the frequency and timings for when this amount should be recalculated. The PRA expects to review these recalculations regularly. The SCR prior to the imposition of the capital add-on, together with the amount of the CAO following its most recent recalculation, will constitute the firm's SCR.

Scope and approach of modifications as regards adjustments to the relevant risk-free rate and transitional measures

3.15 In calculating the amounts referred to in paragraphs 3.13(a) and 3.13(b), the PRA will consider the features of the firm's assets, liabilities, or risk profile which gave rise to the deviation from the assumptions underlying the adjustment or transitional measure.

3.16 For the purposes of paragraph 3.15, the PRA expects to modify the adjustment or transitional measure and the calculation of the SCR in a manner such that the assumptions underlying the adjustment or transitional measure would reflect the actual assets, liabilities, and risk profile of the firm, and ensure compliance with SCR – General Provisions 3.3 to 3.4.

3.17 The PRA expects that any modification referred to in paragraph 3.16 will use adequate, applicable, and relevant actuarial and statistical techniques and will be based on accurate, complete, and appropriate data of the firm, or where these are not available, data that is relevant for the operations of the firm.

Calculation of capital add-ons in relation to deviations from system of governance requirements

3.18 For the purposes of calculating a CAO (either fixed or dynamic) in relation to deviations from the system of governance requirements set out in Conditions Governing Business 2.2 to 7,⁷ the PRA will consider all relevant factors, including the following:

- (a) where appropriate, the factors referred to in paragraph 2.10;
- (b) where appropriate, CAOs set previously for comparable deviations of other firms with similar risk profiles. Where it does so, the PRA will clearly state the reasons for its decision to set a CAO in a letter to the firm, and will ensure that the statement of reasons complies with the professional secrecy requirements set out in section 348 of FSMA.

Apportionment of capital add-ons for firms that simultaneously pursue life and non-life insurance activities

3.19 When calculating a CAO in relation to a firm that simultaneously pursues life and non-life insurance activities, the PRA expects to calculate a notional life CAO and a notional non-life CAO.

⁷ Including pursuant to Group Supervision 17.1(1).

3.20 Where the causes of the relevant deviations can be objectively apportioned between the life insurance activity and the non-life insurance activity, the PRA expects to calculate the notional life CAO and the notional non-life CAO according to the same apportionment.

3.21 Where an apportionment in accordance with paragraph 3.20 is not possible, the PRA expects to calculate the notional life CAO and notional non-life CAO consistently with the apportionment between the notional life Minimum Capital Requirement ('MCR') and the notional non-life MCR, as set out in Composites 4.2.

4: Group capital add-ons

4.1 Where the PRA is the group supervisor, it will follow the approach as set out in this SoP when considering whether the consolidated group SCR appropriately reflects the risk profile of the group. The PRA expects to consider setting a CAO that applies to a group if the specified circumstances defined in the PRA Rulebook and set out in paragraph 2.1 arise at the group level.

A capital add-on applied to a related undertaking using method 1

4.2 The PRA expects to consider setting a CAO to increase the group SCR where a CAO is set on any related undertaking within an insurance group due to any of the circumstances set out in paragraph 2.1(a) to 2.1(e), and that related undertaking is consolidated into the group according to method 1.⁸ In making such a determination, the PRA expects to consider all relevant factors, including those specific to each type of CAO listed in Chapter 2 of this SoP, but applied within the context of the group. In the case of an RML CAO, ie the circumstance in paragraph 2.1(c), the PRA will also consider the factors set out in paragraph 3.5 of SoP – Solvency II internal models: Permissions and ongoing monitoring.

A capital add-on applied to a related firm using method 1

4.3 Where the PRA has set a CAO that is applied to a related firm due to any circumstances set out in paragraphs 2.1(a) to 2.1(e), and that related firm is consolidated into the group according to method 1, the PRA expects to assess at group level the significance of the deviation, and will consider the need for setting a CAO at the level of the group.

A capital add-on applied to a related undertaking using method 2

4.4 Where all or part of a group's SCR is calculated using method 2,⁹ and a CAO for SCR risk profile deviation is set on a related undertaking by that undertaking's solo supervisor for any of the circumstances set out in paragraphs 2.1(a) to 2.1(c), and where the related undertaking is consolidated into the group using method 2, the CAO will be added to the group SCR according to the proportional share for that related undertaking as referred to in

⁸ The method for calculating group solvency described in Group Supervision 11.1.

⁹ The method for calculating group solvency described in Group Supervision 12.1.

Group Supervision 8.1 to 8.3. The PRA will seek to avoid any double counting of CAOs to address the same deviation at individual entity and group levels.

Assessment of deviation at the level of a firm where there is a group capital add-on

4.5 Where a CAO has been set which applies to a group, the PRA expects to assess whether it stems from a deviation for any of the circumstances set out in paragraphs 2.1(a) to 2.1(e), at the level of a firm within the group. If so, the PRA expects to assess the following factors and consider the need for setting a CAO at the level of the firm:

- (a) the significance of the deviation of the firm's risk profile from the assumptions underlying the SCR, as calculated using the SF or a full or partial IM, as described in paragraph 2.3 and Table 1; in the case of an IM residual deviation, the PRA will assess the size of the deviation stemming from an RML at the level of the firm, and also consider the factors set out in paragraph 2.8 above;
- (b) the significance of the deviation from the system of governance requirements set out in paragraph 2.10; and
- (c) the significance of the deviation from the assumptions underlying the matching adjustment, the volatility adjustment, TMIR, or TMTP.

Group-specific risks

4.6 In determining whether the circumstances referenced in paragraph 2.1(f) apply to a group, the PRA expects to consider the group-specific risks of the firm, in addition to the relevant factors specified in Chapter 2 of this SoP, which may include but are not limited to risks:

- (a) which are also present at individual entity level, but where the impact of those risks is significantly different (or which behave in a different way) at group level; or
- (b) only present at group level.

5: Process for setting a capital add-on

5.1. The PRA intends to set CAOs using its powers under s55M/s192C of FSMA.¹⁰ This chapter does not reproduce relevant statutory requirements that will apply to any exercise of those powers. It rather explains aspects of the process the PRA ordinarily expects to follow in exercising those powers for the purpose of setting a CAO.

5.2 The PRA will notify the entity or entities concerned of its intention to set a CAO and the reasons for setting the CAO.¹¹

5.3 The PRA expects to set a deadline by which the entity or entities should respond to the notification referred to in paragraph 5.2. The PRA will consider any information provided by the entity or entities before taking its decision on whether to set a CAO.

5.4 The PRA may request the entity or entities to perform the calculation of the CAO in accordance with specifications set by the PRA.

5.5 If the information (referenced in paragraph 5.3) received is insufficient, the PRA may request the entity or entities to provide further information necessary for taking a decision on setting a CAO by a deadline set by the PRA.

5.6 When determining the deadline referred to in paragraph 5.5, the PRA would pay particular attention to the likelihood and severity of any adverse impact on policyholders.

5.7 The entity or entities should immediately notify the PRA if it / they cannot meet the deadline referred to in paragraph 5.5.

5.8 The PRA will notify the entity or entities in writing of its decision to set a CAO. The decision of the PRA will be sufficiently detailed to enable the entity or entities to understand what measures are needed to take or what deficiencies need to be remedied in order to have the CAO removed.

5.9 In providing its decision referred to in paragraph 5.8, the PRA will inform the entity or entities of the following:

- (a) the reasons for setting the CAO;
- (b) the methodology for calculating the CAO and the amount of the CAO;

¹⁰ S.192C is the power to direct qualifying parent undertaking.

¹¹ 'Entity or entities' in the context of solo CAOs would refer to a firm, but in the context of group CAOs would refer to the group undertaking that is responsible for calculating the group SCR.

- (c) the date from which the CAO is applicable;
- (d) where relevant, the deadline by which the entity or entities are expected to remedy the deficiencies that led to setting of the CAO;
- (e) where relevant, the content and frequency of any progress report to be provided in accordance with paragraph 6.2.

6: Ongoing monitoring, reporting, and removal of a capital add-on

6.1 This chapter explains aspects of the process the PRA ordinarily expects to follow in exercising the powers referenced in paragraph 5.1 for the purpose of ongoing monitoring, reporting, and removal of a CAO, subject to following any relevant statutory requirements. As above, this chapter does not reproduce relevant statutory requirements that will apply to any exercise of those powers.

6.2 In the cases set out in paragraphs 2.1(a) to (d) and (f), the PRA may request that the entity or entities provide an update on the progress made towards remedying the deficiencies that led to the setting of the CAO and the relevant measures taken.¹²

6.3 Where the PRA sets a CAO, it will review the CAO on a regular basis. The frequency of this review will be determined on a case-by-case basis. In addition, the PRA expects to review a CAO if it determines that there is a material change in the circumstances that led to the setting of the CAO. Following a review of a CAO, the PRA will maintain, change, or remove the CAO.

6.4 When considering whether to maintain, change, or remove a CAO, the PRA will consider the following:

- (a) information submitted by the entity or entities during the process of setting and calculating the CAO;
- (b) in the case of CAOs referred to in paragraphs 2.1(b), 2.1(c), and 2.1(f) (where appropriate), information submitted by the firm as part of the internal model ongoing review (IMOR) framework;¹³
- (c) information provided in the progress report referred to in paragraph 6.2;
- (d) any other information obtained by the PRA through the course of its supervision of the firm or group; and
- (e) any other relevant information indicating a material change in the circumstances that led to the setting of the CAO. Examples of material changes include increased investment in a particular asset class or transfers of business.

¹² As required by Solvency Capital Requirement – General Provisions 5.1A, Solvency Capital Requirement – Internal Models 5B.2, or Group Supervision 13.1B.

¹³ The IMOR framework is described in more detail in Chapter 5 of SoP – Solvency II internal models: Permissions and ongoing monitoring.

6.5 The PRA will notify the entity or entities in writing of its decision to change or remove a CAO and the effective date of that decision.

6.6 Where the PRA decides to change a CAO, it will take a new decision in accordance with the relevant statutory requirements, and in a manner consistent with the approach set out in this SoP.

6.7 The PRA expects to publish on a regular basis a report summarising at an aggregate level its application of significant deviation CAOs. For the avoidance of doubt, this report will not cover safeguards including RML CAOs.

Annex – Statement of Policy Updates

This annex details the changes that have been made to this SoP following its initial publication in February 2024.

2024

November 2024

Following publication of policy statement (PS) 15/24 – Review of Solvency II: Restatement of assimilated law,¹⁴ minor amendments have been made to this SoP to reflect the PRA's final policy on the restatement of assimilated law. In particular these updates reflect the use of the MA conceptual and technical assumptions in the context of capital add-ons for the MA, when determining if the risk profile of a firm deviates significantly from the assumptions underlying the MA, as set out in PRA SS 7/18 (version effective from 30 June 2024).

Paragraph 2.10A is new relative to the February 2024 version of this SoP and has been deliberately labelled with a combination of a letter and numbers.

This policy is effective from 31 December 2024.

¹⁴ November 2024: www.bankofengland.co.uk/prudential-regulation/publication/2024/november/review-of-solvency-ii-restatement-of-assimilated-law-policy-statement.