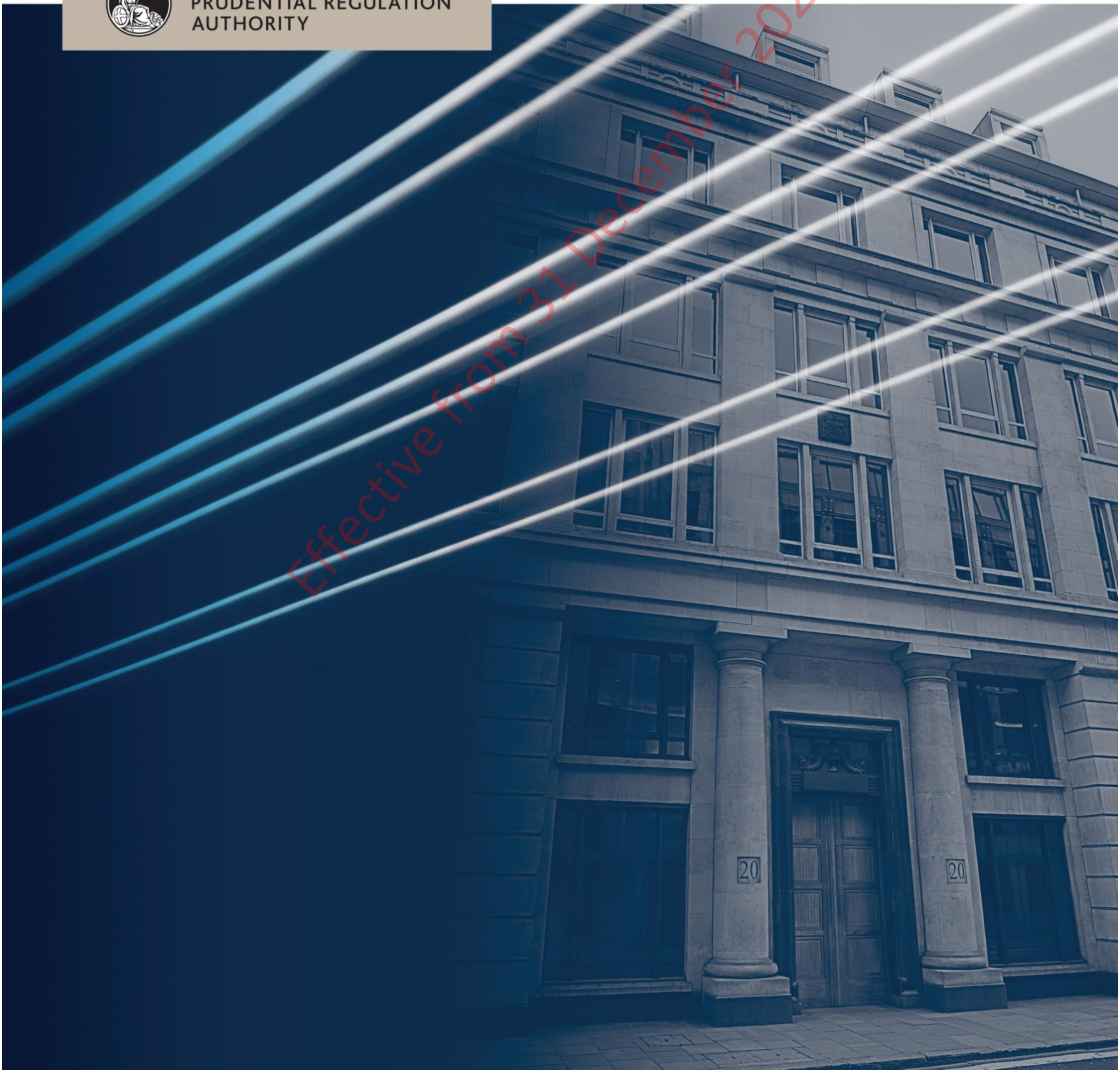
Supervisory Statement | SS15/15

Solvency II: approvals and permissions

February 2024

(Updating March 2015)

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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Contents

1 Introduction

1.1 This supervisory statement (SS) is of primary interest to all UK Solvency II firms and to the Society of Lloyd's, its members and managing agents. It sets out the Prudential Regulation Authority's (PRA's) expectations of firms regarding applications for the following Solvency II approvals and permissions:

- internal model;
- matching adjustment (MA), ancillary own funds (AOF) and undertaking specific parameters (USPs); and
- other Solvency II approvals including: exclusion of an entity from the scope of group supervision; single group own risk and solvency assessment (ORSA); solvency and financial condition report (SFCR) dispensation; and calculation method for the group solvency capital requirement

1.2 This statement expands on the PRA's general approach as set out in its insurance approach document[1].By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders. The PRA has considered matters to which it is required to have regard, and it considers that this statement is compatible with the Regulatory Principles and relevant provisions of the Legislative and Regulatory Reform Act 2006. This statement is not expected to have any direct or indirect discriminatory impact under existing UK law.

1.3 This statement has been subject to public consultation[2] and reflects the feedback that was received by the PRA.

1.4 Firms should also refer to:

- the Bank of England and PRA statement of policy (SoP) – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU;[3]
- SoP – Solvency II internal models: Permissions and ongoing monitoring;[4]
- SoP – Solvency II: Capital add-ons;[5]

1 The Prudential Regulation Authority's approach to insurance supervision, July 2023; https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/insurance-approach-2023.pdf
2 PRA Consultation Paper CP23/14, 'Solvency II approvals', October 2014; https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2014/cp2314
3 April 2019: https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.
4 https://www.bankofengland.co.uk/prudential-regulation/publication/2024/solvency-ii-internal-models-permissions-and-ongoing-monitoring-sop
5 https://www.bankofengland.co.uk/prudential-regulation/publication/2024/solvency-ii-capital-add-ons-sop

- SS1/19 – Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU;[6] and
- SS2/19 – PRA approach to interpreting reporting and disclosure requirements and regulatory transactions forms after EU withdrawal.[7]

1.5 Any reference to any provision of direct EU legislation is a reference to it as it forms part of retained EU law.

2 Applications for Solvency II approvals

2.1 Firms can formally submit applications to the PRA for Solvency II approvals or permissions. Prior to submitting an application the PRA encourages firms to discuss the approvals and permissions they intend to apply for with their usual supervisory contact.

2.2 For all Solvency II approvals or permissions, the PRA will consider applications against the criteria set out in the PRA Rulebook taking into account the approach in the relevant SoPs and inform the firm of its decision. As the PRA can reject an application for a Solvency II approval or permission, firms should have a contingency plan in place in case the application is rejected. This should include any wider impact on other aspects of Solvency II, for example, the internal model.

2.3 Where the PRA is the group supervisor, the PRA will consult the relevant members of the college of supervisors and take into account their views as part of reviewing group applications. The PRA also expects to have input into the group application processes where the PRA is part of a college of supervisors led by a group supervisor from a third country.

2.4 Once the PRA has received applications for approvals or permissions, further information regarding good practice, which may be considered useful or necessary for firms, will be communicated accordingly.

Dependencies between approvals

2.5 Firms submitting applications for multiple Solvency II approvals or permissions, including for the internal model, are expected to understand any dependencies between the approvals or permissions and how these may affect the order in which they submit their applications. In addition, as a result of the relationship which exists between certain approvals or permissions, firms are also expected to have a contingency plan in case they do not receive approval or permission for applications where dependencies exist, for example:

- firms applying to use the MA may consider another measure as an alternative;
- where firms apply for any of the transitional measures at the same time as applying for the MA and/or volatility adjustment (VA), the PRA expects firms to provide sensitivity tests showing the impact on the transitional measure(s) if their applications for the other adjustments are approved or rejected; and

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6 April 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pras-approachafter-the-uks-withdrawal-from-the-eu-ss.

7 April 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pra-approach-to-interpreting-reporting-and-disclosure-reqs-and-reg-trans-forms-ss.

- where a group submitting an internal model application is intending to use the deduction and aggregation method (method 2) for the group solvency calculation, or intending to apply to exclude an entity from the scope of group supervision, consideration should be given to the impact on the group internal model application if these applications are rejected.

Internal model permission and matching adjustment

2.6 Some firms applying for internal model permission may have a dependency on the approval to use the MA. Firms should consider the impact on the internal model if the MA application is rejected. This includes but not limited to, modelling of individual risk factors, proxy modelling techniques (including loss functions and identification of the biting scenario), and the solvency capital requirement.

Equivalence

2.7 Where approvals or permissions are related to an equivalence decision, if firms wish to submit an application before the equivalence decision is finalised, they may submit an application, stating the assumptions made with regard to equivalence. Where appropriate, the PRA may refrain from making a decision until the equivalence decision has been finalised.

3 Internal models

3.1 Firms intending to submit an application for internal model permission should refer to the Solvency Capital Requirement – Internal Models Part of the PRA Rulebook, and the SoP – Solvency II internal models: Permissions and ongoing monitoring regarding the internal model permission processes for information on how to submit a formal internal model application [Z.A.1]. The European Insurance and Occupational Pensions Authority (EIOPA) has published Common Application Package (CAP) template[A.1] for internal model applications which firms should use for their formal internal model applications. Firms in the pre-application process can continue to use the existing self-assessment template (SAT) which is part of the CAP.

3.2 All internal model firms are expected to produce a contingency plan in case the PRA rejects an internal model application. Firms are encouraged to discuss and agree this plan with their normal supervisory contact.

4 Matching adjustment, ancillary own funds and undertaking specific parameters

4.1 The Solvency II Regulations set out the legal requirements of the application process for the MA, AOF and USPs. This chapter sets out the PRA's expectations of firms and provides guidance on applications for these approvals.

4.2 The timescales for the PRA to decide whether a firm's application for one of these approvals is complete and then whether to approve or reject the application are detailed in the Solvency II Regulations and Financial Services and Markets (the Solvency 2 Regulations 2015) ('the Statutory Instrument').

Z.A.1 Application and supplementary information forms are available at: https://www.bankofengland.co.uk/prudential-regulation/authorisations/solvency-ii-approvals.

A.1 https://www.eiopa.europa.eu/publications/eiopa-common-application-package-internal-models_en.

4.3 When submitting an application for these approvals, firms are required to inform the PRA of any other approvals or permissions for which they have applied. The PRA encourages firms to also include details of other approvals or permissions for which they intend to apply during the next twelve months.

4.4 For the approvals discussed in this section, the PRA has produced supplementary information forms which firms should use when submitting their applications. These forms are not mandatory, but are designed to help firms submit the necessary information to allow the PRA to consider the application and avoid delays that may arise from incomplete applications. The application supplementary information forms are based on requirements set out in the PRA Rulebook and the Solvency II Regulations.

Matching adjustment

4.5 Under Article 77(b) of the Solvency II Directive[1a], firms may apply for approval to use a MA. The PRA's detailed expectations on the MA are set out in SS7/18 – 'Solvency II : Matching Adjustment', available on the Bank's website.[1b]

4.6 Those firms that participate in the MA pre-application process are also expected to provide the PRA with a detailed breakdown of any changes that have occurred since pre-application.

4.7 The MA calculation requires a fundamental spread to be assigned to each asset, based on the credit quality, duration and asset class. Where firms have unrated assets, and have rated these assets using an internal rating system, the PRA may consider undertaking a review of the process followed to produce the internal rating to determine its appropriateness.

4.8 If a firm uses internal ratings, suitable documentation should be provided with their MA application to allow the PRA to review the process followed in order to determine its appropriateness. The PRA expects that this should include details of the ratings methodologies; the calibration and back testing of the ratings; the governance around the ratings process; and the processes in place for the review of internally assigned ratings.

Ancillary Own Funds

4.9 Under Article 90 of the Solvency II Directive, firms may apply to the PRA for approval to recognise AOF when determining own funds.

4.10 The Solvency II requirements regarding AOF applications are designed to ensure that firms only receive approval when they can provide robust supporting evidence regarding the:

- loss absorbing capacity of the basic own fund item into which the AOF would convert upon call;
- ability and willingness of the counterparties to pay when called upon; and
- recoverability of funds (including the existence, or not, of any legal impediments to payment and whether collateral is held). Since the AOF must be callable on demand,

1a Please note this reference will be updated in due course.
1b https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-2-matching-adjustment-ss

firms will also need to demonstrate that there is no trigger event or restrictions affecting when the AOF item can be called.

4.11 The PRA does not expect firms to treat AOF items as emergency capital to be applied for when a firm is in danger of breaching its solvency capital requirement (SCR). In such a situation, raising basic own funds is likely to be a more appropriate action. AOF should be considered as part of a firm's medium term capital management planning. As such, the PRA will expect firms to submit their medium term capital management plan as part of any AOF application.

Undertaking Specific Parameters

4.12 Firms may apply to the PRA to use USPs when calculating their SCR using the standard formula. Firms are encouraged to submit the application supplementary information form as this will help to ensure firms meet the requirements of the PRA Rulebook.

4.13 The use of USPs is designed to ensure firms' SCR is being measured appropriately and firms should consider whether the use of an USP results in a more accurate reflection of their risk profile. As part of the decision-making process the PRA will consider the reasons why a firm has decided to apply to use USPs and whether they have been applied appropriately across a firm's business.

4.14 Groups may can also apply to the PRA to use group specific parameters (GSP) when calculating the group SCR with the standard formula. Groups seeking to use GSPs should use the same application process as described for USPs, including the submission of the application supplementary information form.

5 Other Solvency II approvals

5.1 This section sets out the PRA's expectations of firms and provides guidance on applications for the following:

- exclusion of entity from scope of group supervision;
- single group Own Risk and Solvency Assessment (ORSA);
- SFCR dispensation; and
- calculation method for group SCR.

5.2 For the approvals discussed in this section, the PRA, intends to make every effort to communicate, in writing the decision to approve or reject the application, within six months of receiving a completed application.

5.3 It should be noted that while the PRA will make every effort to act within this timeframe and in many cases will be able to communicate a decision in shorter timeframes for straightforward or standalone approvals, it reserves the right to exceed these deadlines when necessary.

5.4 If during the review it is established further information is required from the firm, the PRA will request this information in writing. This may delay the decision on the approval application.

5.5 For the approvals discussed in this section, the PRA has produced application and supplementary information forms which firms should use when submitting their applications. These forms are not mandatory but are designed to help firms submit the necessary information to allow the PRA to consider the application and avoid delays that may arise from incomplete applications. The application and supplementary information forms are based on requirements set out in the PRA Rulebook, and the Solvency II Regulations.

5.6 All approvals discussed in this section may be effected by use of the statutory waiver powers. Firms should refer to the Bank of England website for further information on the relevant waiver process.

Exclusion of entity from scope of group supervision

5.7 A group may apply to exclude an entity from the scope of group supervision. This Article is the mechanism to exclude any entity from the scope of group supervision, regardless of its type. The PRA expects such applications to articulate the way in which the group believes that the conditions set out in Group Supervision 2.3 are met.

5.8 [Deleted]

Single group ORSA

5.9 A group may apply to produce a single ORSA report which covers the group and the firm-level ORSA for all the firms in the group as described in Group Supervision 17.2(3).

5.10 Groups that wish to apply for the single ORSA report are encouraged to complete the application supplementary information form which details:

- the group's motivation for producing a single ORSA report;
- how the group Board has sought to ensure that all solo risks are individually identifiable in the single ORSA; and
- how the single group ORSA submission presents a true picture of solo entity solvency.

5.11 [Deleted]

5.12 Groups intending to seek approval for a single ORSA report covering the group and the firm-level ORSA findings, should provide a draft single ORSA report as part of their application process.

5.13 A firm can apply to the PRA for a disclosure exemption, allowing them to exclude certain information from their Solvency and Financial Condition Report (SFCR). Rule 4.1 of the Reporting Part of the PRA Rulebook sets out disclosure requirements applicable to firms that have been granted a permitted non-disclosure waiver.

5.14 Groups that wish to apply for a non-disclosure waiver are also encouraged to submit the application supplementary information form.

Calculation method for group solvency capital requirement

5.15 [Deleted]

5.16 Where groups do not think that the exclusive use the default accounting- consolidation method ('method 1') is appropriate,-they may apply to use the deduction and aggregation method ('method 2'), or a combination of method 1 and method 2. The PRA expects groups to indicate this by submitting the PRA's application supplementary information form. This form includes the necessary information the PRA needs to make its decision on the choice of calculation method and includes the financial and solvency position of subsidiaries, availability of data, and rationale for using an alternative to method 1.

5.17 [Deleted]

Appendix – SS15/15 updates

February 2024

This SS was amended as a part of PS2/24[2]. The SS was amended by updating the name of the SS and by inserting new paragraphs 1.4, 1.5, 5.1 as a result of the proposals in CP12/23. Similarly, paragraphs 5.8, 5.11 and 5.17 have been deleted as a part of CP12/23. References to the Solvency II Directive in articles 104 (7), 230, 214(2), 246, 53(1) and 220 have been updated to reference the relevant areas in the PRA's policy materials. Paragraph 2.2 has been updated as the PRA has identified a typo in Appendix 8 of CP12/23.

March 2015

SS15/15 was originally published in March 2015.

This appendix details the changes that were made to this supervisory statement (SS) following its initial publication.

2 February 2024: www.bankofengland.co.uk/prudential-regulation/publication/2024/february/review-of-solvency-ii-adapting-to-the-uk-insurance-market-policy-statement.