CP5/24 – Review of Solvency II: Restatement of assimilated law

Consultation paper 5/24

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Responses are requested by 22 July 2024.

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Responses can be sent by email to: CP5_24@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:
Insurance Policy Division
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Prudential Regulation Authority
20 Moorgate
London
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1: Overview

1.1 This consultation paper (CP) is the final PRA consultation needed to implement the conclusions of the **Solvency II Review** and to finalise PRA rules and other policy materials that will replace Solvency II assimilated law which is being revoked by the Government under its **Smart Regulatory Framework** (SRF) programme. It represents an important step in completing the adaptation of the UK's prudential regime for insurers inherited from the European Union (EU) into a framework consistent with the UK's approach to financial services regulation.

1.2 This CP proposes the restatement into PRA policy material of those parts of the Solvency II regime which have not already been subject to consultation as part of the Solvency II Review. It sets out how the PRA proposes to restate these Solvency II requirements from assimilated law[1] into the PRA Rulebook and other policy material such as Supervisory Statements (SSs) or Statements of Policy (SoPs) ('PRA policy material').[2]

1.3 The PRA considers the proposals in this CP would advance its primary and secondary statutory objectives by providing clarity and coherence to the prudential requirements for insurers which are currently split between secondary legislation and PRA policy material.

1.4 The PRA has already consulted on reforms to Solvency II and restatements of parts of assimilated law within those consultations. Accordingly, this CP should be read in conjunction with the following publications:

- **CP19/23 – Review of Solvency II: Reform of the Matching Adjustment** (published 28 September 2023) which sets out the proposed reforms that will enable broader and quicker investment by insurers in their matching adjustment (MA) portfolios. The policy statement for this CP is expected to be published in June 2024.
- **PS2/24 – Review of Solvency II: Adapting to the UK insurance market** (published 28 February 2024) which included the PRA's final policy (in the form of near-final rules and updated near-final policy materials) in respect of measures to simplify some Solvency II requirements, allow improved flexibility for others, and encourage entry into the UK insurance market. These proposals related to areas such as the transitional measure on technical provisions (TMTP), streamlining of rules for internal models (IMs) and third country branches.

[1] Retained EU law that continues to apply in the UK was renamed to 'assimilated law' by section 5 of the **Retained EU Law (Revocation and Reform) Act 2023**.
[2] Further details of the PRA's policymaking framework, including the purpose of rules, SSs, and SoPs, can be found on the Bank of England's **Policy** webpage.

- **PS3/24 – Review of Solvency II: Reporting and disclosure phase 2 near-final** (published 29 February 2024) which included the PRA's final reporting and disclosure policy (in the form of near-final rules and updated near-final policy materials). These included reforms to streamline Solvency II reporting and disclosure requirements and to improve the data collection in some areas for the UK insurance sector.

1.5 The material in this CP has been prepared in line with the Government's policy approach as set out in its response to the **Solvency II Review** consultation and the Government's anticipated revocation of assimilated law by year end 2024.The PRA will continue to work closely with the Government to implement the proposals laid out in this CP.

1.6 The proposed reforms, and the key benefits that the PRA considers will arise from them are set out below.

The PRA's proposals

1.7 The proposals included in this CP consist primarily of the restatement of assimilated law into PRA policy material, including removal of cross-references to the EU's prudential framework. In addition, there are a few instances where this CP proposes to reform certain areas as part of their restatement, as detailed below.

Restatement of elements of assimilated law

1.8 The PRA has considered all elements of the onshored **Commission Delegated Regulation (EU) 2015/35 (CDR)**, **the Solvency 2 Regulations 2015**, and related Technical Standards (TSs),[3] specifically those not covered in PS2/24, PS3/24 and CP19/23. The assimilated law covered in this CP is summarised in Appendix 2. The PRA has not put forward proposals to restate references to the credit quality step mapping tables in BTS 2016/1800 in this CP.[4] The PRA will propose restatement of that material with potential revisions in its policy framework in due course.

1.9 The PRA is proposing to restate this assimilated law into PRA policy material without material changes to the policy substance, unless explicitly mentioned.[5] The intention of these proposals is to maintain both the requirements on firms as well as the PRA's approach as they currently operate.

[3] Commission Implementing Regulation
[4] Binding technical standard (BTS) 2016/1800 with regard to the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps.
[5] When transferring assimilated law into the PRA Rulebook and other policy material, the PRA has made non-substantive changes to the text for consistency with UK English and PRA style, as well as minor administrative changes such as reordering.

1.10 Under the PRA's policy framework, requirements on firms are set out in PRA rules. Accordingly, where the assimilated law sets out provisions that firms are required to comply with, the PRA proposes to restate these requirements into the relevant part of the PRA Rulebook. Where regulations currently specify how the PRA exercises supervision of firms or groups, the PRA proposes to restate these provisions in an applicable SoP. Where regulations currently provide further expectations or clarifications for firms or groups, these have been restated in the relevant SSs.

1.11 The benefits of these proposals are discussed in the Cost and Benefits section below.

1.12 With the exception of a small number of proposals in this CP where policy changes are proposed, the PRA considers that it would be inappropriate to propose significant changes through this CP. This is because a number of priority areas of reform to Solvency II have already been identified and consulted on through the PRA's previous consultations, and to add further areas of substantive reform in this CP would complicate and delay the implementation of those reforms and the SRF. The PRA judges that to enable the completion of the Solvency II review in a timely manner, and to enable those other reforms to take effect, it is important to prioritise the restatement of the remaining requirements of Solvency II into the PRA Rulebook and policy materials. However, the PRA notes that in the future, it may consider further reforms to the policy material being restated under this CP.

1.13 The assimilated law restated in this CP is outlined in the mapping tables within Appendix 2.

Areas of Policy Reforms

1.14 While this CP has been focused on the restatement of assimilated law without changing the policy intention, the PRA has identified a small number of areas where policy changes are nevertheless warranted. In particular, there are two areas where this CP proposes changes to requirements on firms:

- The PRA proposes a new time-limited transitional rule in the Own Funds Part of the PRA Rulebook. This would permit firms to continue to treat legacy paid-in preference shares issued prior to 18 January 2015 as not relevant when assessing the compliance of their ordinary shares with certain unrestricted T1 own fund requirements, for a period of 25 years. See Chapter 7 – Own Funds for further details.

- This CP proposes that, when considering restating amounts denominated in EUR into the UK framework, those amounts will be restated into GBP using the same conversion rate used confirmed in PS2/24 for a similar purpose. See Chapter 8 – Solvency Capital Requirement – Standard Formula for further details.

1.15 In addition, in developing the policy materials to restate certain parts of assimilated law, the PRA has identified some areas of inconsistency in assimilated law (eg inconsistent or incorrect cross-references or missing definitions) which the PRA proposes to correct as part of this consultation. Those corrections have been clearly signposted and discussed in the relevant sections of the CP, together with an assessment of the costs and benefits relevant to the proposed corrections. Any such corrections not captured within this CP will be amended in the policy statement to this CP, without changing the policy substance.

Updating cross-references to the EU framework

1.16 One of the aims of this CP is to reflect the Government's overall plans to revoke Solvency II assimilated law and to update cross references to assimilated law or EU law (eg Solvency II Directive) which exist within PRA policy material. Accordingly, this CP proposes to update references to any EU Directives with references to the relevant parts of the UK's regulatory framework in accordance with the SRF (primarily being PRA rules, SoPs or SSs) that transposed or which now restate those same provisions. The changes being made include updating (or if appropriate deleting) existing cross references across the PRA Rulebook to reflect the expected revocation of Solvency II assimilated law. References to versions of EU law (in force or otherwise), have been maintained where they remain relevant. The draft rules included in this CP contains the majority of the amendments required to achieve this aim, however the PRA will continue to review the PRA Rulebook (including amendments made before the end of 2024) and will amend the draft rules included in this CP as required.

1.17 Where the draft rules and policy material included in this CP include references to assimilated law that are not addressed in this CP, such as BTS 2016/1800 mentioned above, the draft rules and policy materials cross refer to the assimilated law as it currently stands. When making any final rules and issuing final policy material in relating to this CP, those cross references will be updated to refer to those requirements as they have been restated into the PRA's rules or other parts of the overall framework where applicable.

1.18 References related to the UK's membership of the EU included in policy materials covered by this CP have been updated as part of these proposals to reflect the UK's withdrawal from the EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of assimilated law.[6]

1.19 The near-final reporting and disclosure templates, and instructions, published in PS3/24 contain cross references to the CDR and/or assimilated law, that is proposed to be restated in the PRA Rulebook in this CP. The PRA intends to include the updated cross references to

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

the templates and instructions with corresponding references to the PRA Rulebook, in the policy statement to this CP.

1.20 The new UK prudential regime for insurers will eventually be known as 'Solvency UK'. However, 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.

Approach to EIOPA Guidelines

1.21 In the EU's framework, requirements on insurance undertakings are supplemented by guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA). The PRA has set out its approach to EU guidelines in the **Statement of Policy on the Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU .**This sets out that generally the PRA expects firms to continue to consider those guidelines as relevant.

1.22 The EIOPA guidelines are generally not restated for this CP as they do not constitute requirements on firms. However, on an exceptional basis, certain chapters of the CP propose to incorporate some of these EIOPA Guidelines into PRA policy material at this stage, where the PRA considers that this will help ensure that the restated requirements are clear. Where those EIOPA Guidelines related to considerations for supervisory authorities when issuing approvals, this CP generally proposes to move those EIOPA Guidelines into the relevant SoPs, to clarify that the PRA's approach to issuing permissions will remain consistent with current practice.

1.23 The PRA will review the status of any remaining EIOPA guidelines at a later stage and may consult in future on any further changes.

Consequential changes

1.24 Following from CP19/23, the PRA also proposes to make minor clarification changes to the Capital Add-on SoP published in PS2/24. Furthermore, this CP proposes to delete **SS15/15 Solvency II: approvals** (including Matching Adjustment approvals) which is now superseded by the subject-specific SoPs set out in PS2/23 as well as those proposed in this CP and in CP19/23.

1.25 Under Third Country Branches 15.2 of the PRA Rulebook, third-country branch undertakings must currently ensure that any relevant provisions of the Solvency II Regulations are applied to the third-country branch in order to achieve the same effect as that provision would have (that is, complying with the requirements of the relevant provision) when applied to a UK Solvency II firm. Therefore, as a consequence of the proposal to

restate the remaining Solvency II requirements from assimilated law into the PRA Rulebook and other policy materials, the PRA further proposes to make consequential amendments to the Third Country Branches Part of the PRA Rulebook (see Appendix 3), to include third-country branches within the relevant provisions that are being restated. In doing so, the PRA has taken account of the reforms set out in PS2/24.

Scope

1.26 This CP is relevant to UK Solvency II firms, the Society of Lloyd's and its members and managing agents, insurance and reinsurance groups, insurance and reinsurance undertakings that have a UK branch (third-country branch undertakings), and UK holding companies. This CP will refer to these collectively as 'insurers' or 'firms' unless otherwise specified.

Legislative dependencies

1.27 The proposals in this CP are dependent on anticipated legislation in relation to commencement regulations to bring into force the provisions of the Financial Services and Markets Act 2023 (FSMA 2023) to revoke:

- Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/13/8/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance reinsurance (Solvency II).
- The Solvency 2 Regulations 2015, in particular the provisions of Part 4 that deal with measures that require PRA approval. The PRA intends to use section 138BA of FSMA (s138BA) permissions to give effect to the same measures.
- Solvency II Commission Implementing Regulations.

1.28 The proposals in this CP are also dependent on the following current and anticipated legislation relevant to Solvency II. These are:

- Regulation 3 of **The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023**, which sets out the PRA's duty to publish technical information, which is used by insurance firms to calculate their technical provisions and the solvency capital requirement (SCR) on the Standard Formula.
- **HMT's restatement of the Risk Margin (RM)**[7] The PRA anticipates that HMT will restate provisions on the Solvency II RM into UK legislation via a Statutory Instrument (SI). The

[7] **The Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023** is a temporary measure to reflect RM reform. The PRA anticipated that HMT will revoke the amended CDR at the same time as it restates the RM into UK legislation,

PRA's approach allows for this restatement is discussed in Chapter 5 – Technical Provisions: Risk Margin.

- **The Financial Services and Markets Act 2000 (Disapplication or Modification of Financial Regulator Rules in Individual Cases) Regulations 2024** (which includes Regulations in exercise of the powers conferred by s138BA). This draft SI was laid in February 2024 and is expected to come into force on 30 June 2024. s138BA allows the PRA to grant firms permissions to not apply rules, or to apply them in a modified way ('rule permission'). The PRA's approach to s138BA permissions is explained in more detail below.

1.29 Further PRA policy amendments may be necessary to take into account any other secondary legislation made by HMT under FSMA 2023, for example in relation to equivalence, savings provisions, and amendments to FSMA 2000.

Section 138BA permissions

1.30 As noted above, the PRA intends to use s138BA permissions to replace the approvals currently in Part 4 of the Solvency 2 Regulations 2015. In practice, this generally means that a firm must apply to the PRA for permission where it previously applied for an approval in some areas. This CP generally uses the language of 'permissions' rather than 'approvals' when discussing proposed policy in these areas.

1.31 The PRA issued **CP3/24** on its proposed approach to the application of s138BA. In particular, CP3/24 proposes that subject-specific SoPs should contain the specific criteria which the PRA will consider in deciding whether to grant permissions. The proposals in this CP are consistent with that approach.

1.32 The PRA notes that the Government has been clear that firms' existing approvals to use measures covered by Part 4 of the 2015 Regulations will continue to be valid under the reformed regime. Consequently, the PRA has no plans to require firms to reapply for permission.

1.33 This CP proposes to use s138BA permissions in other contexts beyond giving effect to the current approvals under Part 4 of the Solvency 2 Regulations 2015. In particular, when restating assimilated law, some situations arise where Solvency II legislation currently sets a requirement on firms, but allows them to take an alternative approach where they are able to 'demonstrate to the satisfaction of the supervisory authority' that they comply with a set of criteria. Under these situations, there are generally two approaches that PRA could take when restating assimilated law:

- Retain the criteria in rules and simply remove reference to 'demonstrates to the satisfaction of the supervisory authority'. This approach would leave it to firms'

judgement whether they comply with the criteria and if so whether to adopt the alternative approach.

- Under the new s138BA framework, pursue a waiver or permission approach to allow the PRA to assess whether or not a firm should be able to adopt an alternative approach, and transfer relevant material (including criteria for granting the permission) to a PRA SoP.

1.34 The general approach adopted in the proposals in this CP has been to use the first approach where the PRA considers that the criteria can be assessed objectively by firms or third parties. In those cases, the PRA proposes requiring firms simply to notify the PRA that the alternative approach is being followed. However, where the PRA considers that compliance with the criteria is judgemental, and where the outcome is potentially material to its statutory objectives, the second approach is used, to retain scope for an assessment by the PRA that the criteria have been met to its satisfaction.

Accountability framework

1.35 The PRA has a statutory duty to consult when introducing new rules and changing existing rules (FSMA s138J), 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.

1.36 The Insurance Practitioner Panel was consulted about the proposals in this CP.

1.37 In carrying out its policymaking functions, the PRA is required to comply with several legal obligations. The analysis in this CP explains how the proposals have had regard to the most significant matters, including an explanation of the ways in which having regard to these matters has affected the proposals.

PRA Objectives Analysis

1.38 The paragraphs below analyse the impact of the PRA's proposals for restating assimilated law into its policy material. Where proposals involve policy changes, analysis against the PRA's objectives is contained in the relevant chapters.

Analysis against the PRA's primary objectives:

1.39 The PRA considers that the proposals would continue to advance its primary objectives of safety and soundness and policyholder protection. This is because the PRA considers that the proposed changes would enhance the clarity and coherence of the regulatory framework for firms due to the benefit of Solvency II rules and legislation being restated in the PRA Rulebook and other policy materials. The proposals in this CP would mean that all the requirements and expectations for firms would in future be contained within the PRA's

Rulebook and associated statements of policy and supervisory statements, making it easier for firms to understand the totality of the new Solvency UK regime which will apply.

1.40 The proposed restatement of remaining Solvency II requirements into PRA policy would also enable the PRA to consider more easily in future whether any further policy changes might be warranted, and if so it would enable the PRA to consult on any such changes through its usual policymaking processes. Moving obligations from legislation into the PRA Rulebook also allows the PRA to be more responsive and flexible to the need to evolve the PRA Rulebook to reflect UK firms and the UK market in the future. Currently, many obligations on firms are fixed in onshored regulations and cannot be easily amended to deal with changing circumstances – whether through rule making or through waivers. The proposals are also consistent with the government's aim within its Smarter Regulatory Framework to ensure that all the regulatory requirements for firms are contained in regulators' rulebooks and will enable the revocation of remaining Solvency II assimilated law.

1.41 The proposals in this CP are also intended to ensure that insurers continue to maintain sound systems of governance and risk management, and capital adequacy, by restating relevant provisions currently contained in assimilated law into PRA policy material. Good governance, risk management and capital adequacy are fundamental to the effective and sound management of insurers, as well as being key elements of the regulatory framework to promote the safety and soundness of insurers and the protection of their policyholders.

1.42 For permissions or waivers granted as part of section 138BA approvals, the PRA will also consider potential risks to its primary objectives through post permission monitoring of these measures as part of the proposed framework. This will also allow the PRA the opportunity to take timely supervisory action if necessary to ensure safeguards remain effective and appropriate in changing circumstances.

Analysis against the PRA's secondary objectives:

1.43 The PRA has assessed whether the proposals in this CP facilitate its secondary objectives relating to competition, and competitiveness and growth.

1.44 The proposals in the CP would continue to advance the PRA's secondary objective to facilitate effective competition in the markets for services provided by PRA authorised persons in carrying on regulated activities, by providing a clearer and more comprehensive PRA Rulebook and associated policy material for PRA-regulated insurers. This is expected to further contribute to rational and disciplined market behaviour which is a key driver of effective competition. Ensuring that the current Solvency II framework to promote sound governance, risk management and capital adequacy continues to have effect in PRA policy material should help support market confidence in insurers, thereby continually enabling insurers to develop and supply relevant products to support a growing economy.

1.45 The PRA also considers that the proposals in this CP continue to facilitate, subject to alignment with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term. A more accessible PRA Rulebook makes it more attractive for firms to operate in the UK because it enables firms to better understand what their obligations are. The proposals in this CP are also aligned with international standards.

1.46 In addition, the proposals would enable the UK to maintain its reputation as a sound place to conduct business and to facilitate the efficient allocation of capital and investment within the economy by insurers through ensuring that current provisions regarding the effective management of risk by those insurers are maintained unchanged in the PRA's policy material.

Cost benefit analysis

1.47 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 assimilated law, together with the anticipated legislation described above.

1.48 For areas where the PRA is proposing to restate assimilated law without changes to the policy substance or intention, the PRA considers that there would be limited additional cost though some benefits for the proposals compared to the baseline.

1.49 Where proposals introduce some changes to existing policy (in particular for Own Funds and Standard Formula), the PRA has considered the additional costs and benefits in the relevant chapters.

1.50 Overall, relative to the baseline, the PRA considers that the benefits of these proposals exceed the costs involved.

Costs

1.51 The proposed changes would not affect the PRA's approach to the regulation of Solvency II firms. The PRA is proposing that most provisions are restated unchanged in PRA policy material and so any administrative costs to Solvency II firms of updating their knowledge of these changes is expected to be minimal. The PRA considers that the costs of these proposals are proportionate to the benefits of the proposals, as outlined above in terms of advancing its primary and secondary objectives.

Benefits

1.52 Relative to the baseline, the proposals in this CP would lead to some improved efficiency and clarity for firms, through:

- Restating relevant parts of assimilated law in PRA rules and other policy materials, which will make it easier for firms to access and understand the rules that apply to them. This is relative to the current baseline in which requirements are split across legislation and the PRA Rulebook.
- Creating a more accessible PRA Rulebook makes it more attractive to operate in the UK because firms understand more clearly what their obligations are.
- As discussed in the analysis of PRA's primary objectives above, restating obligations into the PRA Rulebook will enable the PRA to be more responsive and flexible in future, by enabling the PRA to evolve the PRA Rulebook to reflect UK firms and the UK insurance market in the future.

1.53 The proposals are expected to continue facilitating effective competition, and international competitiveness and growth, through improved clarity for firms. This also contributes to a level playing field, thereby helping to facilitate the PRA's secondary competition objective.

'Have regards' analysis

1.54 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 following factors, to which the PRA is required to have regard, were significant in the PRA's analysis.

1. **The need to use the PRA's resources in the most efficient and economical way (FSMA principle):** The PRA considers that the proposals are in line with efficient use of PRA resources. The proposals in this CP have generally been limited to a restatement of assimilated law because the PRA has judged this to be the most efficient and economic approach to ensure that the Solvency II Review – including the reforms published in near-final form in PS2/24 and PS3/24 – can be implemented in full by the end of 2024. Once this material is incorporated into the PRA's rulebook and other policy materials, the PRA will be able to make any further policy changes at a later date. Similarly, the PRA has chosen not to undertake a full review of the EIOPA guidelines at this time, in order to prioritise the completion of the restatement of assimilated law by the end of 2024. Onshored EIOPA Guidelines can already be changed by the PRA at any time, and the PRA may consult in future on any further changes.

2. **The principle that the PRA should exercise its functions as transparently as possible (FSMA principle):** the restatement of assimilated law into the PRA rulebook and other policy materials is intended to give increased clarity to firms over the PRA's intended approach and its expectations of firms, and to ensure that all relevant policy requirements affecting firms are contained and are accessible within PRA policy material.
3. **Supporting the government's objective to promote i) the international competitiveness of the UK and ii) medium to long-term economic growth in the interests of consumers and businesses (Government's economic policy):**

- As discussed in the secondary objectives analysis above, the proposals support the government's SRF making it easier for firms to access and understand the rules that apply to them hence promoting competitiveness and growth.

1.55 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

1.56 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. This is because the fact that the restatement is carried in a consistent way across all assimilated law so will impact both mutuals and other firms in a similar manner.

Equality and diversity

1.57 In developing its proposals, the PRA has had due regard to the equality objectives under s.149 of the Equality Act 2010.

1.58 The PRA considers that the proposals in this CP do not give rise to equality and diversity implications. The PRA is aware of issues with the legibility of some of the formulas in the proposed draft rules. The PRA will work during this consultation period to ensure the final rules in the PRA Rulebook are clear and readable for all users. The PRA is also available to answer any questions about these formulas for impacted readers.

Structure of the CP

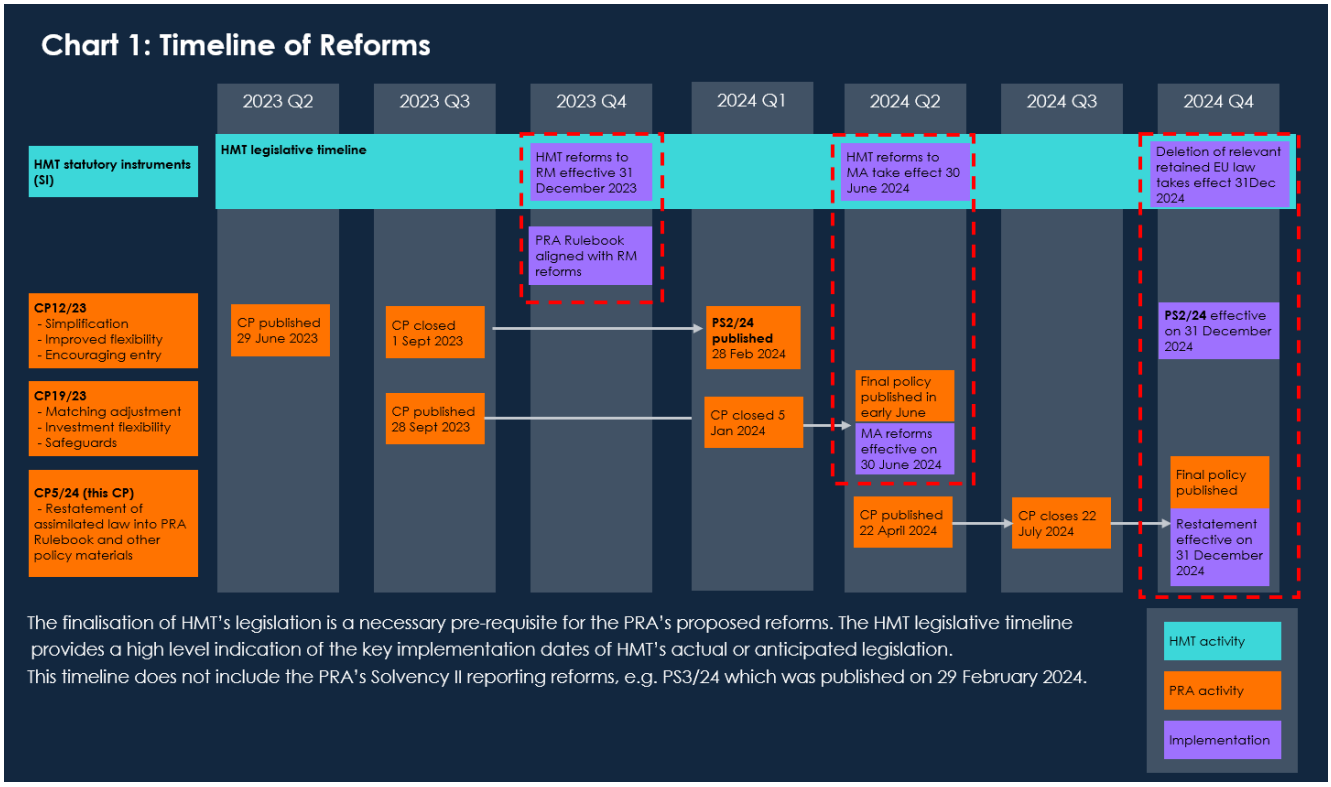
1.59 The proposals in this CP are structured into the following chapters. The draft rules and related policy materials are included in the relevant appendices.

- **Chapter 2: General Provisions**

- **Chapter 3: Valuation of assets and liabilities**
- **Chapter 4: Technical Provisions: Risk-free interest rate and Volatility Adjustment**
- **Chapter 5: Technical Provisions: Risk Margin**
- **Chapter 6: Technical Provisions: Further requirements**
- **Chapter 7: Own funds**
- **Chapter 8: Solvency Capital Requirement – Standard Formula**
- **Chapter 9: Investments in securitisation positions**
- **Chapter 10: Systems of governance**
- **Chapter 11: Extension of the recovery period**
- **Chapter 12: Public Disclosure**
- **Chapter 13: Insurance Special Purpose Vehicles**
- **Chapter 14: Insurance Groups**
- **Chapter 15: Consequential amendments**

Implementation

1.60 The PRA proposes that the implementation date for the changes resulting from this CP would be Tuesday 31 December 2024 as shown in Chart 1 below.



Responses and next steps

1.61 This consultation closes on Monday 22 July 2024. The PRA invites feedback on the proposals set out in this consultation.

1.62 Please address any comments or enquiries to **CP5_24@bankofengland.co.uk**.

1.63 When providing your response, please tell us whether or not you consent to the PRA publishing your name, and/or the name of your organisation, as a respondent to this CP.

1.64 Please also indicate in your response if you believe any of the proposals in this consultation paper 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.

1.65 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.

1.66 Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of assimilated law.

2: General Provisions

Introduction

2.1 This chapter sets out the PRA's proposals to restate in the PRA Rulebook, with no substantive changes, Articles 3(2) and 4-6 from CDR Chapter 1, Section 2. These provisions cover the use of external credit assessments in the calculation of the Solvency Capital Requirement (SCR) in accordance with the standard formula (SF), and, where applicable, in the calculation of the matching adjustment to the relevant risk-free interest rate structure for the calculation of the best estimate of a relevant portfolio of insurance obligations.

Areas covered

2.2 This chapter also sets out the PRA's proposals for the provision of certain technical information for firms as specified in Articles 3(1) and (3)-(5) of the CDR, relating to the calculation of the SCR in accordance with the SF, and to the assessment of the technical provisions for insurance liabilities.

2.3 These proposals would result in changes to the following Parts of the PRA Rulebook

- Solvency Capital Requirement – Standard Formula
- Matching Adjustment
- Conditions Governing Business Parts

Proposal 1: External credit assessments

2.4 The PRA proposes to restate Articles 4-6 of the CDR in the Solvency Capital Requirement – Standard Formula Part of the PRA Rulebook with no material changes.

2.5 The PRA proposes to amend the definition of a 'credit quality step' in the PRA Rulebook Glossary proposed in CP19/23 to reflect the substance of Article 3(2) of the CDR. This definition would then be relevant to all the Parts of the PRA Rulebook that apply to insurers.

2.6 Articles 3(1) and 3(3) of the CDR currently provide for the PRA to make technical standards on the allocation of credit assessments, consistent with their use in the calculation of the capital requirements for credit and financial institutions. The PRA intends to consult in Q3 2024 on its policy on the allocation of credit assessments to an objective scale of credit quality steps for banks and insurers within a consultation paper on proposed changes to the Capital Requirements Regulations for banks, building societies and investment firms.

2.7 Pending the outcome of this further consultation, the PRA proposes in this CP to refer in the PRA Rulebook to the mapping table for credit quality steps that is set out in external BTS 2016/1800 (as onshored in UK law at the end of the post-Brexit transition period).

2.8 The PRA proposes to include in the PRA Rulebook Glossary a definition of an 'external credit assessment institution' (ECAI) that would encompass the new definition of a 'credit rating agency' that was proposed in CP19/23, but which would still reflect the substance of the wording of the definition in Article 13(40) of the Solvency II Directive. This Glossary definition would also replace the current definition within the Conditions Governing Business Part of the PRA Rulebook.

2.9 The PRA proposes to retain for the time being the references in these proposed rules and Glossary definitions to Regulation (EC) No 1060/2009,[8] but notes that these references would need to be amended, as and when HMT commence the provision in FSMA to revoke this regulation, and in line with the UK legal framework for the recognition of ECAIs, including credit rating agencies.

2.10 The PRA proposes to make a consequential amendment to Matching Adjustment 7.4 (as proposed in CP19/23), so as to replace the reference to Articles 4-6 of the CDR with references to new Chapters 1A to 1C in the Solvency Capital Requirement – Standard Formula Part of the PRA Rulebook.

Proposal 2: Provision of technical information and making of technical standards

2.11 Paragraph 2.6 of this CP describes the PRA's proposals in relation to the making of technical standards, as specified in Articles 3(1) and 3(3) of the CDR, relating to the allocation of credit assessments to a scale of credit quality steps.

2.12 Article 3(4) of the CDR currently provides for the PRA to make technical standards on lists of regional governments and local authorities for which exposures are to be treated as exposures to the central government, the equity index upon which the symmetric adjustment to the standard equity capital charge is to be based, and adjustments to be made for currencies pegged to the euro in the currency sub-module. The PRA does not propose to restate Article 3(4) of the CDR in its Rulebook but proposes to include the relevant technical standards directly within the Solvency Capital Requirement – Standard Formula Part of the PRA Rulebook, Section 3D – Market Risk Module, 3D1, 3D13, 3D14, 3D33 and 3D34, and

[8] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (Text with EEA relevance):

Section 3E – Counterparty Default Risk Module, 3E1 (see Chapter 8 - Solvency Capital Requirement – Standard Formula).

2.13 Article 3(5) of the CDR currently requires the PRA to publish technical information on the symmetric adjustment to the standard equity capital charge. The PRA proposes to restate Article 3(5) of the CDR within amendments to the existing SoP – The PRA's approach to the publication of Solvency II technical information (Appendix 4) (see Chapter 4 – Technical Provisions - Risk free rates and Volatility Adjustment of this CP).

2.14 Article 149 of the CDR enables the separate calculation of a health underwriting risk component of the SCR for those health insurance obligations for which there is a health risk equalisation system (HRES) in place that meets certain specific criteria set out in Article 3(7) of the CDR. These criteria include a mechanism for the sharing of claim payments, and the existence of a guarantee by an EU Member State to meet in full the policyholder claims in respect of business that is subject to the HRES, in the event of default of an insurer participating in the HRES.

2.15 Articles 3(6) and 3(7) of the CDR, as onshored in the UK, then enable the PRA to make relevant technical standards for the operation of an HRES. The PRA understands that the only potentially eligible HRES currently in place that would meet the relevant EU criteria is that in the Netherlands, and the PRA has not issued any technical standards for this HRES.

2.16 The PRA proposes not to restate Articles 3(6), 3(7), and 149 of the CDR into its rules or policy materials, as the PRA considers these Articles would not be of any significant value for UK insurers. However, insurers would still be able to apply to the PRA for permission to apply some undertaking specific parameters (USP) for their health insurance business activities, see Chapter 8 – Solvency Capital Requirement – Standard Formula.

2.17 In addition, insurers may also be able to apply the UK's equivalence findings for the EU in relation to the group solvency calculation, so as to enable those insurance groups with operations or activities in the EEA to make use of the corresponding EU provisions for insurers writing health insurance business that comes within the scope of an eligible HRES.

PRA objectives analysis

2.18 These proposals are all, with the one exception set out in the following paragraph, a restatement of existing legislative requirements with no substantive changes. The PRA's assessment of the impact of the proposals on the PRA's primary and secondary objectives is therefore as described in Chapter 1 – Overview.

2.19 The proposal not to restate Articles 3(6), 3(7) and 149 of the CDR advances the PRA's objectives, as the provisions in these Articles have had very limited application for UK

insurers previously as explained above, and there are alternative means by which insurers with relevant health insurance activities may apply for USP permission or to make use of EU provisions for an HRES.

Cost benefit analysis

2.20 The costs and benefits of the proposals to restate existing regulatory provisions into its rules or policy materials with no substantive changes are as described in Chapter 1 – Overview.

2.21 The proposal not to restate Articles 3(6), 3(7) and 149 of the CRD would be proportionate and less costly for the PRA to implement and should not lead to any significant costs for firms as the provisions in these Articles have had very limited application (if any) for UK firms. Moreover, there are alternative means, as described above, by which insurers with relevant health insurance activities may apply for USP permission or to make use of EU provisions for an HRES in respect of the group solvency calculation where those options are suitable for the calculation of the health underwriting risk component of the SCR for such activities.

'Have regards' analysis

2.22 The Have Regards analysis is principally the same as the analysis described in Chapter 1 – Overview. In addition, the proposal not to restate Articles 3(6), 3(7) and 149 of the CDR is a proportionate approach which would enable a more efficient use of regulatory resource.

3: Valuation of assets and liabilities

Introduction

3.1 This chapter sets out the PRA's proposal to restate rules relating to the valuation of assets and liabilities, excluding technical provisions, in the Solvency II balance sheet from the CDR into the Glossary and Valuation Part of the PRA Rulebook. The PRA's proposals for rules relating to technical provisions are set out in Chapters 4 (Technical Provisions: Risk-free rates and Volatility Adjustment), 5 (Technical Provisions – Risk Margin) and 6 (Technical Provisions – Further Requirements) of this CP.

3.2 This chapter is structured as follows:

- Relevant material within assimilated law that is in scope for this chapter; and
- Proposal: Restatement of rules relating to the valuation of assets and liabilities

3.3 The proposal in this chapter would result in amendments to the:

- Valuation Part of the PRA Rulebook; and
- Glossary Part.

Areas covered

3.4 The scope of this chapter is CDR Articles 7 to 16.

Proposal 1: Restatement of rules relating to the valuation of assets and liabilities

3.5 The PRA proposes to restate CDR Articles 7 – 16 to the Valuation Part of the PRA Rulebook. In addition, the Glossary Part will be updated to retain related definitions relevant to valuation.

3.6 The PRA proposes to include a new rule (rule 7.3) in Chapter 7 – Recognition of contingent Liabilities to clarify that the obligation in rule 7.1 to recognise material contingent liabilities as liabilities on the Solvency II balance sheet applies irrespective of whether a liability is required to be recognised in accordance with UK-adopted international accounting standards. The PRA considers that rule 7.3 clarifies the application of existing valuation provisions in the CDR and hence does not represent a change in requirements for firms.

PRA objectives analysis

3.7 The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

Cost benefit analysis

3.8 The costs and benefits of the proposals to restate existing CDR provisions into the PRA policy materials are as set out in Chapter 1. The PRA considers that the clarification provided by rule 7.3 is a restatement of existing provisions. Therefore, the costs and benefits arising from this approach are also as described in Chapter 1 – Overview.

'Have regards' analysis

3.9 The Have Regards analysis is the same as the analysis described in Chapter 1 – Overview.

4: Technical Provisions: Risk-free interest rate and Volatility adjustment

Introduction

4.1 This chapter sets out the PRA's proposals to restate certain regulations within the Solvency 2 Regulations 2015 and the CDR relating to risk-free interest rates, volatility adjustment ('VA'), and the Transitional Measure on the risk-free interest rate ('TMIR') within PRA rules and policy materials.

4.2 The proposals in this chapter would:

- amend the Glossary, Technical Provisions, and Transitional Measures Parts of the PRA Rulebook (Appendix 3);
- create a new PRA Rulebook Part: Technical Provisions – Further Requirements, which would also contain rules relating to proposals set out in Chapter 6 – Technical Provisions – Further requirements (Appendix 3);
- amend the PRA's existing statement of policy (SoP) – Permissions for transitional measures on technical provisions and risk-free interest rates (Appendix 6) ('the transitional measures SoP');
- amend the PRA's existing SoP – The PRA's approach to the publication of Solvency II technical information (Appendix 4) ('the TI SoP');
- create a new SoP – Volatility Adjustment Permissions (Appendix 5);
- delete the existing PRA SS23/15, with the content consolidated into the SoP listed in the previous bullet point; and
- consolidate a small amount of content from the existing PRA SS15/15 (to be deleted – see Chapter 15 – Consequential Amendments and Appendix 23) into the proposed new SoP on VA permissions (see Appendix 5).

Areas covered

4.3 The following material within assimilated law is covered in this chapter:

- Regulations 4B (paragraphs 3-7),[9] 43, and 53 of the Solvency 2 Regulations 2015; and

[9] Following the revocation of Regulation 4B of the Solvency 2 Regulations 2015, the content of paragraphs (1) and (2) of that regulation will be replaced by Regulation 3 of The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023. Those paragraphs are, therefore, not in scope for the restatement of assimilated law within the PRA's policy framework.

- CDR Articles 43 – 51.

Proposal 1: Transitional measure on risk-free interest rates

4.4 The material within assimilated law that is relevant to this proposal is regulation 53 of the Solvency 2 Regulations 2015, which sets out requirements on firms and the PRA relating to TMIR approvals.

4.5 As noted in Chapter 1 - Overview, the PRA intends to replace existing approvals covered under Part 4 of the Solvency 2 Regulations 2015 with permissions granted using s138BA of FSMA. This includes permissions relating to use of the TMIR by firms to calculate their technical provisions, which will replace TMIR approvals previously granted by the PRA under Regulation 53 of the Solvency 2 Regulations 2015. The PRA does not expect these changes to have any impact on firms with existing TMIR approvals.

4.6 The PRA proposes to restate Regulation 53 of the Solvency 2 Regulations 2015 in the Transitional Measures Part of the PRA Rulebook and the transitional measures SoP following the revocation of the Solvency 2 Regulations 2015 under FSMA 2023. The mapping table in Appendix 2 sets out the location for the restatement of each provision.

4.7 The PRA also proposes to consolidate the transitional measures specific content of paragraph 2.5 of its existing supervisory statement SS15/15 into the transitional measures SoP. See Chapter 15 – Consequential Amendments for the PRA's proposal to delete SS15/15.

4.8 Where firms are required to comply with the relevant regulations being restated, the PRA proposes to restate the requirements in those regulations in the Transitional Measures Part. Where regulations currently set out how the PRA must exercise its powers in relation to TMIR, the PRA proposes to restate that material within the transitional measures SoP. The PRA also proposes to make minor consequential amendments to the Transitional Measures Part to reflect the introduction of s138BA of FSMA.

Proposal 2: Restatement of material relating to RFR and VA technical information

4.9 The material within assimilated law that is relevant to this proposal is paragraphs (3) to (5) of Regulation 4B of the Solvency 2 Regulations 2015 and CDR Articles 43 to 51.

4.10 Regulation 4B of the Solvency 2 Regulations 2015 sets out requirements on the PRA relating to production and publication of technical information relevant to the valuation of insurance liabilities under Solvency II. Paragraphs (3) to (5) of Regulation 4B contain requirements for the PRA relating to production of currency-specific VA technical information

by the PRA, including reference portfolios (RPs) and risk-corrected spreads. The PRA understands that, following the revocation of the Solvency 2 Regulations 2015, it is not expected that the content of those paragraphs will be restated in legislation by HMT. The PRA, therefore, proposes to restate the content of those paragraphs in its existing TI SoP (Appendix 4). The PRA proposes to make minor amendments to that material when restating it in the SoP, in order to integrate it into the existing SoP content and update relevant cross-references.

4.11 The PRA's proposal for restating CDR Articles 43 to 51 within its policy framework is consistent with the approach set out in Chapter 1 - Overview: the PRA proposes to restate requirements on firms in the PRA Rulebook and requirements applying to the PRA in a SoP, as described in more detail below:

- CDR Articles 43 to 47 and 49 to 51 all currently apply to the PRA in its capacity as the producer of Solvency II technical information in the UK. These articles provide additional detail on the requirements relating to the production of technical information relevant to basic RFRs (Articles 43 to 47) and the VA (Articles 49 to 51). The PRA proposes to restate the content of those articles in its existing TI SoP.
    - The PRA proposes to make minor amendments to Articles 43 to 47 and 49 to 51 when restating them in its SoP, in order to integrate them into the existing SoP content and update relevant cross-references.
    - See Proposal 4 below for additional changes the PRA proposes to make when restating Articles 49 and 50 in its SoP.
- CDR Article 48 sets out requirements for when a firm may use the euro RFR curve to calculate the best estimate with respect to insurance or reinsurance obligations denominated in currencies pegged to the euro. The PRA proposes to restate the majority of the content of Article 48 in a new chapter 25 ('Risk-Free Rate Interest Term Structure of Currencies Pegged to the Euro') in a new Part of the PRA Rulebook: Technical Provisions – Further Requirements (Appendix 3).
    - The PRA proposes to not restate the final sentence of Article 48(2): 'The adjustment (for currency risk) shall be the same for all insurance and reinsurance undertakings'. The reason for not restating this part of Article 48(2) is because the only way to implement the provision would be for the PRA to publish basic RFRs for the euro, adjusted for currency risk, for currencies pegged to the euro, but such information is not included in the technical information published by the PRA pursuant to the relevant legislative requirements. The PRA considers that not restating that part of Article 48(2) would not have a material impact on UK Solvency II firms.

4.12 The PRA proposes to make the following minor consequential amendments to facilitate the proposal described in the preceding paragraphs:

- Amendments to the definition of the term ‘volatility adjustment’ and to replace the defined term ‘volatility adjustment approval’ with the term ‘volatility adjustment permission’ in the Glossary Part of the PRA Rulebook (Appendix 3).
- Amendments to existing rules 5.1, 5.2, 8.1, and 8.5 of the Technical Provisions Part of the PRA Rulebook (Appendix 3). These proposed amendments are to reflect changes in the underlying legislation by HMT, changes relating to reformulating existing Solvency II approval processes as permissions under s138BA of FSMA, and to refer to defined terms where relevant.
- Amendments to its existing TI SoP in order to accommodate the restatement of CDR Articles 43 to 47 and 49 to 51, including re-naming and broadening the scope of chapter 3 of the SoP, so that it covers PRA methodologies and judgements more generally, instead of focusing simply on variations by the PRA to EIOPA methodologies and judgements.

4.13 In updating its existing TI SoP as described above, the PRA also proposes to correct a minor error in paragraph 2.1 of that SoP. Instead of referring to ‘EU exposures’ the SoP should have referred to ‘EEA exposures’ when referencing exposures to which the PRA no longer applies a (preferential) 30% long-term average spread calculation. This amendment simply reflects the current situation and is expected to have no impact on firms.

4.14 The PRA considers that none of the elements of Proposal 2 amount to a change in the existing policy intent, and so the PRA does not expect Proposal 2 to have any impact on UK Solvency II firms.

Proposal 3: Restatement of material relating to VA permissions

4.15 The material within assimilated law that is relevant to this proposal is Regulation 43 of the Solvency 2 Regulations 2015, which sets out requirements on firms and the PRA relating to VA approvals.

4.16 As noted in Chapter 1 – Overview, the PRA intends to replace existing approvals covered under Part 4 of the Solvency 2 Regulations 2015 with permissions granted using s138BA of FSMA. This includes permissions relating to use of the VA by firms to calculate the best estimate of their technical provisions, which will replace VA approvals previously granted by the PRA under Regulation 43 of the Solvency 2 Regulations 2015. The PRA does not expect these changes to have any impact on firms with existing VA approvals.

4.17 The PRA proposes to restate the substantive requirements of regulation 43 that apply to the PRA, covering the content in paragraphs (2) to (4), in a new SoP – Volatility Adjustment

Permissions.[10] This includes the criteria which the PRA would consider when deciding whether to grant a firm permission to apply a VA, ie those corresponding to the conditions currently set out in Regulation 43(4).

4.18 The PRA notes that paragraph (5) of Regulation 43 explains what is meant by a 'relevant requirement' in Regulation 43(4)(b), which includes: '(a) a requirement imposed by or under FSMA in pursuance of the UK law which implemented the Solvency 2 Directive; or (b) a requirement of a directly applicable regulation made under the Solvency 2 Directive which forms part of retained EU law'. The PRA proposes to not restate the content of that paragraph within its policy framework. The rationale for this approach is as follows: point (a) is already covered under the PRA's powers within FSMA to impose requirements on firms relating to compliance with Solvency II rules set out in legislation or the PRA Rulebook; and point (b) is subsumed by the PRA's proposals set out in this consultation to restate assimilated law relating to Solvency II in its policy framework. The PRA further notes its proposal to consolidate material in SS23/15 into the proposed new SoP on VA permissions (see paragraph 4.20 below), including clarification for firms on what the PRA considers to be particularly relevant requirements relating to use of the VA.

4.19 The PRA's proposed restatement of the contents of Regulation 43(3) in its new SoP – Volatility Adjustment Permissions would provide context as regards the circumstances which may lead to variation or revocation of VA permissions, so that it is clear to firms when the PRA may consider it appropriate to take those actions.

4.20 In order to consolidate policy material relating to VA permissions, the PRA considers that the substantive content of its existing SS23/15 ('Solvency II: Supervisory approval for the volatility adjustment') can be included within the proposed new SoP – Volatility Adjustment Permissions. The PRA, therefore, proposes to delete SS23/15 and consolidate the majority of its content into the new SoP, except for section 1 and paragraphs 4.5 and 4.6,[11] which the PRA proposes to delete.

[10] Paragraph (1) of Regulation 43 permits a firm to apply to the PRA for approval to apply a VA to the RFR to calculate the best estimate of its technical provisions. The PRA proposes to not restate the content of that paragraph within its policy framework. The PRA considers that this approach would not change the rights of firms currently conferred by Regulation 43(1), as a firm's ability to apply for VA permission would be implicit within the PRA's policy framework. This is consistent with the PRA's approach to reformulating other existing Solvency II approvals as permissions under s138BA of FSMA.

[11] Paragraphs 4.5 and 4.6 of SS23/15 cover dependencies between a firm's Solvency II approval applications, eg for approval of the VA as a contingency option in the event a firm's MA application is rejected. The PRA proposes to delete those paragraphs, in particular noting the changes to the MA applications process proposed in CP19/23. The PRA considers that this issue is sufficiently addressed by the general comments on the interaction between VA applications and those for other Solvency II permission processes included in the proposed new SoP on VA permissions.

4.21 The PRA also proposes to consolidate the VA-specific content of paragraph 2.5 of its existing SS15/15 into its proposed new SoP on VA permissions. See Chapter 15 – Consequential Amendments for the PRA's proposal to delete SS15/15.

4.22 The PRA considers that none of the elements of Proposal 3 amount to a change in the existing policy intent, and so the PRA does not expect Proposal 3 to have any impact on UK Solvency II firms with existing VA approvals, firms considering applying for VA approvals before year end 2024, or firms considering applying for VA permission after year end 2024.

Proposal 4: Removal of country-specific VA requirements

4.23 The material within assimilated law that is relevant to this proposal is paragraphs (6) and (7) of Regulation 4B of the Solvency 2 Regulations 2015 and references to country-specific VA in CDR Articles 49 and 50.

4.24 The existing Solvency II (SII) framework for the VA allows for the application of a 'country adjustment' in specific circumstances, where one currency is used across multiple countries. The derivation of a country adjustment is based on country-specific RPs, as described in CDR Article 49 (ie using asset data from insurers in the relevant country).

4.25 In the case of the GBP VA, a country adjustment is not relevant, as it applies to a currency used in a single country. This position is reflected in the current wording of paragraph 3.11 of the PRA's existing TI SoP.[12] For currencies that are used across multiple countries (eg euro), the PRA does not produce a country adjustment as it does not receive the necessary data from insurers in those countries.

4.26 In order to clarify the PRA's processes relating to publication of SII technical information, the PRA proposes to delete and/or not restate all references relating to production of country adjustments for the VA. This proposal includes the following:

- To not restate paragraphs (6) and (7) of Regulation 4B of the Solvency 2 Regulations 2015 in the PRA's policy framework, which relate to information relevant to country-specific VAs.
- To not restate references to country-specific RPs and spreads when restating CDR Articles 49 and 50 in the PRA's existing TI SoP, as described in Proposal 2. For the avoidance of doubt, the PRA proposes to only include the content of CDR Articles 49 and 50 relating to currency-specific RPs and spreads as it pertains to the calculation of VA technical information the PRA publishes in respect of relevant currencies.

[12] SoP paragraph 3.11: The PRA published country VA RP for GBP is the same as the currency VA RP.

4.27 In addition, the PRA proposes the following consequential amendments to facilitate the proposals described in the preceding paragraph:

- Delete existing rule 8.4 from the Technical Provisions Part of the PRA Rulebook, to remove the requirements on firms relating to country-specific VA.
- Amend the wording of paragraph 3.11 of its existing TI SoP to further clarify that the PRA does not publish information on separate country VA RPs for any 'PRA relevant currencies' (as defined in paragraph 1.3 of the PRA's TI SoP).

4.28 Given the PRA does not currently produce any country-specific VA technical information, it does not expect Proposal 4 to have any impact on UK Solvency II firms.

PRA objectives analysis

4.29 The assessment of the impact of Proposals 1, 2, and 3 on the PRA's primary and secondary objectives is covered by the analysis set out in Chapter 1 – Overview.

4.30 For Proposal 4, the PRA considers that the proposed removal of requirements relating to country-specific VA, would have no quantitative impact on firms as regards their calculation of Solvency II own funds or SCR. It further considers that the removal of the requirements would improve the clarity of the PRA Rulebook and policy framework for firms, thereby advancing its primary objectives of policyholder protection, and safety and soundness.

4.31 The proposed removal of the requirements relating to country-specific VA would, in the PRA's view, advance both its secondary competition and secondary competitiveness and growth objective, owing to the improved clarity provided to both existing firms and potential new entrants.

4.32 The proposed removal of the requirements relating to country-specific VA would provide a marginal benefit to firms by providing additional clarity as regards the PRA's policy in this area, and by streamlining the PRA's Rulebook and other policy materials.

Cost benefit analysis

4.33 The costs and benefits of Proposals 1, 2, and 3 are as set out in Chapter 1 – Overview.

4.34 The baseline for the assessment of costs and benefits associated with Proposal 4 comprises the restatement proposals set out in this CP, without the proposed removal of requirements relating to the country-specific VA (which, in terms of policy intent, is the same as the status quo of the current Solvency II framework).

4.35 Compared to the baseline, the PRA considers that there are no additional costs for firms resulting from the proposed removal of requirements relating to country-specific VA, given that the PRA does not currently publish such information.

'Have regards' analysis

4.36 The 'have regards' analysis of Proposals 1, 2, and 3 is as set out in Chapter 1 – Overview.

4.37 The analysis of 'have regards' relevant to Proposal 4, the proposed removal of requirements relating to country-specific VA, is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview. In addition, the PRA considers the following factor, to which the PRA is required to have regard, to be significant in shaping this proposal:

- **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposal would aid transparency by clarifying within the PRA Rulebook and other PRA policy materials that it does not publish information relating to country-specific VA.

5: Technical Provisions: Risk Margin

Introduction

5.1 This chapter sets out the PRA's proposals to restate certain regulations relating to the risk margin from the CDR, EIOPA Guidelines and anticipated HM Treasury legislation into PRA rules and policy materials and should be read in conjunction with Chapter 6 which sets out proposals relating to the technical provisions.

5.2 The proposals in this chapter would result in:

- Amendments to the Technical Provisions Part of the PRA Rulebook (Appendix 3); and
- Amendments to the Glossary Part of the PRA Rulebook.

5.3 The risk margin is part of the technical provisions. It is an amount added to the best estimate liabilities (BEL) so that the technical provisions represent a transfer value – the amount for which insurance liabilities could be transferred to a willing third party. It is calculated as the cost of the regulatory capital that would be needed to support the liabilities over their lifetime.

Interaction of the PRA's proposals with legislation on the risk margin

5.4 In the Government's **response** to its Solvency II Review consultation in November 2022, it announced that it will legislate to reduce the risk margin by 65% for long-term life insurance business, including Period Payment Orders, and by 30% for general insurance business, by introducing a modified cost of capital approach to its calculation.

5.5 The first step of the Government's reforms to the risk margin has been carried out, and the PRA understands that the second step completing the reforms will require further legislation. These two steps are described below.

- First, to facilitate reforms to the risk margin at 31 December 2023, the Government laid legislation[13] that made amendments to the risk margin formulae and parameters contained in Article 37 (Calculation of the risk margin) and Article 39 (Cost-of-Capital rate) of the SII CDR. Specifically, this modified the risk margin formula to include a risk tapering factor with a parameter of 0.9 for life insurance and reinsurance obligations (and where the risk tapering is subject to a floor of 0.25), and reduced the Cost-of-Capital parameter from 6% to 4%.

[13] **Insurance and the Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023**

- Second, the PRA anticipates further legislation will be laid to restate the same amended risk margin formulae and parameters (as described above) within the statute book, which will commence from 31 December 2024. This will replace the legislation described in the first step above, once the assimilated law is repealed. This second step arises from the Government's overall plans under the Smarter Regulatory Framework to revoke the whole of the SII CDR (including the risk margin parts) under FSMA 2023, as set out in the Government's **explanatory memorandum** accompanying the 31 December 2023 legislation.

5.6 The proposals in this chapter have been prepared, and are dependent, upon the assumption that the Government lays legislation in line with the second of the steps described above.[14] The PRA also anticipates that the Government's legislation will acknowledge the PRA's power to make rules permitting a firm to use simplified methods to calculate the risk margin.

5.7 It is the PRA's intention that the proposals in this chapter will come into force on 31 December 2024, the same time as the Government's anticipated final legislation.

Areas covered

5.8 The scope of this chapter is:

- CDR Articles 37 (paragraphs 2 and 3) and 38;
- The contents of the Government's anticipated legislation; and
- Guideline 2 of the EIOPA Guidelines on the implementation of the long-term guarantee measures.

Proposal 1: Restating the risk margin specification

5.9 The PRA proposes to restate into new chapters in the Technical Provisions Part of the PRA Rulebook:

- The risk margin formula and parameters in line with that set out in the **Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023** (the 'Risk Margin Regulations 2023').
- Paragraphs 2 and 3 of Article 37 (Calculation of the risk margin) of the SII CDR.
- Article 38 (Reference undertaking) of the SII CDR.

[14] See initial draft legislation set out in Regulation 4 of the **Insurance and Reinsurance Undertakings (Prudential Requirements) (No. 2) Regulations 2023**.

5.10 The PRA's proposals are consistent with the SII CDR as amended by the Risk Margin Regulations 2023 to introduce a modified cost of capital calculation approach and reduce the size of the risk margin. The PRA's proposals are intended to reflect and align with the Government's anticipated legislation on the risk margin. In this case the PRA's policymaking and rules are set within the context of the Government's policy intent for the risk margin to achieve certain reductions in the size of the risk margin for insurers, and to introduce a modified cost of capital calculation approach. Therefore, the PRA's baseline for this consultation is the risk margin framework and calculation in the anticipated legislation as set out above in paragraph 5.6.

5.11 The PRA considers it necessary to restate paragraphs 2 and 3 of Article 37 into the PRA Rulebook in order to make it clear how firms with internal models should calculate the risk margin and how the risk margin should be allocated to different lines of business.

5.12 The PRA considers it necessary to restate Article 38 of the SII CDR into the PRA Rulebook, in order to clarify the assumptions that firms should make when calculating SCR(t) of the reference undertaking referred to in the Government's risk margin formula. Furthermore, the PRA considers that restating Article 38 of the SII CDR unchanged is consistent with the Government's policy intent for the risk margin. Specifically, the application of the risk margin formula and parameters in anticipated legislation, together with the reference taking assumptions from Article 38 of the SII CDR, is expected to lead to an overall calibration of the risk margin that is consistent with the Government's **response** to its Solvency II Review consultation in November 2022.

5.13 The PRA will also include rules reflecting the risk margin calculation anticipated in the Government's upcoming legislation, which as noted above is expected to align with the Risk Margin Regulations 2023.

PRA objectives analysis

5.14 The assessment of the aspects of this proposal which relate to restating elements of assimilated law in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

5.15 In addition, the PRA considers that the proposals in this chapter would give firms certainty as to the interaction between the Government's anticipated legislation and PRA rules, maintaining the clarity and coherence of the PRA Rulebook.

5.16 The PRA therefore considers that the proposals would advance the PRA's primary objectives of promoting firms' safety and soundness and policyholder protection, and its secondary objective of facilitating effective competition and supporting international competitiveness, within the constraints of the Government's anticipated legislation.

Cost benefit analysis

5.17 This proposal is to restate existing requirements in the PRA Rulebook. The costs and benefits of this proposal are described in Chapter 1 – Overview.

5.18 The PRA further believes that the proposals in this chapter will assist in implementing the Government's anticipated legislation on the restatement of the risk margin. Furthermore, the PRA considers that the proposed changes would enhance the clarity and coherence of the PRA Rulebook for firms, which is a benefit.

5.19 The proposed changes would not affect the PRA's approach to the regulation of Solvency II firms. Furthermore, the PRA does not believe this will increase costs for firms given that the proposed changes do not lead to any changes compared to the baseline situation where firms will have to meet the risk margin requirements in the Government's anticipated legislation, and the restatement of the Article 38 reference undertaking requirements are unchanged from the SII CDR (notwithstanding Proposal 2 described below). Overall, the PRA considers that the benefits of the proposals are proportionate to the costs.

'Have regards' analysis

5.20 The 'have regards' analysis for this proposal is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview.

5.21 Furthermore, the following analysis is also relevant to these proposals:

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 the Government's anticipated legislation and PRA rules in the implementation of the Smarter Regulatory Framework (SRF).
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 the Government's anticipated legislation.
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 the Government's anticipated legislation aids in reflecting the requirements imposed by the government.

Proposal 2: Restatement of EIOPA Guideline on the interaction of the long-term guarantee measures with the risk margin calculation

5.22 The PRA proposes to restate as a rule the contents of Guideline 2 of the EIOPA Guidelines on the implementation of the long-term guarantee measures to rule 4B.1(13) of the Technical Provisions Part of the PRA Rulebook. This guideline clarifies that, when calculating the risk margin, firms should assume that the reference undertaking does not apply the matching adjustment (MA), volatility adjustment (VA), transitional measure on risk-free interest rates (TMIR), or the transitional measure on technical provisions (TMTP).

5.23 The PRA considers that this particular Guideline sets out an important assumption in the calculation of the risk margin, which should be included in the Rulebook alongside the Article 38 CDR reference undertaking assumptions under Proposal 1 above.

5.24 The PRA considers that restating Guideline 2 in PRA rules is consistent with current practice and the general expectation that firms will continue to comply with the Solvency II EIOPA Guidelines where these are relevant as explained in Chapter 1 – Overview.

5.25 The PRA also considers that this proposal is consistent with implementing the Government's policy intent for the risk margin, as it is delivering its reforms by amending specific parts of the risk margin formulae and parameters through legislation and otherwise not changing any other key underlying assumptions.

PRA objectives analysis

5.26 The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview. In addition, given the importance of this guideline to the calculation of the risk margin, the PRA considers that restating it in the PRA Rulebook will make it clearer for firms what the key assumptions are regarding the reference undertaking, and therefore support its primary objectives of safety and soundness of firms and ensuring an appropriate degree of policyholder protection.

5.27 The PRA considers that having a clear set of requirements on firms will also promote the PRA's secondary objectives for competition as well as for competitiveness and growth, for the reasons set out in Chapter 1 – Overview.

Cost benefit analysis

5.28 As set out in Chapter 1 – Overview, the PRA has set out an expectation that firms should continue to comply with the Solvency II EIOPA guidelines where these are relevant.

This specific guideline has been a known feature of the application of the RM since the introduction of Solvency II and was the subject of some debate in the context of potential reforms to the risk margin.[15] It was also highlighted in the context of the EU's own reforms to Solvency II.[16]

5.29 Accordingly, the PRA considers that the guideline being restated should already be followed by all firms that apply the MA, VA, TMTP or TMIR, and therefore that this proposal will not involve any changes in firms' calculations or results in practice. Therefore, this proposal is not considered to result in any additional costs or benefits other than those described in Chapter 1 – Overview.

'Have regards' analysis

5.30 The 'have regards' analysis for this proposal is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview.

5.31 Furthermore, the following analysis is also relevant to these proposals

- **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposals aid transparency by clarifying the requirements underlying the calibration of the risk margin calculation.

[15] See for example section 6.3 of the 2019 report of the Risk Margin Working Party of the Institute and Faculty of Actuaries: **www.actuaries.org.uk/documents/review-risk-margin-solvency-ii-and-beyond**.
[16] See the analysis in paragraph 3.163 of EIOPA's consultation: **www.eiopa.europa.eu/consultations/consultation-paper-opinion-2020-review-solvency-ii_en**.

6: Technical Provisions: Further requirements

Introduction

6.1 This chapter sets out the PRA's proposals on the provisions in CDR relating to technical provisions except those related to discount rates and risk margin. The PRA's proposals relating to the components of technical provisions which are excluded in this chapter are set out in chapters 4 and 5 of this CP. Proposals relating to the MA were covered in CP19/23.

6.2 This chapter is structured as follows:

- Relevant material within assimilated law that is in scope for this chapter;
- Proposal 1: Restatement of relevant requirements for the calculation of Technical Provisions into the PRA Rulebook; and
- Proposal 2: Restatement of relevant guidance for the calculation of Technical Provisions into a new supervisory statement

6.3 The proposals in this chapter would result in:

- the creation of a new chapter in the PRA Rulebook: Technical Provisions – Further Requirements;
- the creation of a new SS – Solvency II: Calculation of Technical Provisions; and
- amendments to the PRA Rulebook Glossary.

Areas covered

6.4 This chapter covers the restatement of CDR Articles 17 – 36, 40 – 42, Article 55 together with Annex I, and Article 56 in the PRA Rulebook. It also covers the restatement of CDR Articles 57 – 61 into a new SS.

Proposal 1: Restatement of relevant requirements for the calculation of Technical Provisions into the PRA Rulebook

6.5 The PRA proposes to restate CDR Articles 17 – 36, 40 – 42, 55, and 56 in a new Part in the PRA Rulebook: Technical Provisions – Further requirements.[17] The PRA also proposes to restate CDR Annex I (Lines in Business) to Annex 1 of that chapter. In addition, the

[17] CDR Articles 37 – 39 are covered in Chapter 5 – Technical provisions – Risk margin. CDR Articles 43 – 51 are covered in Chapter 4. CDR Articles 52 – 54 were covered in CP19/23.

Glossary Part of the PRA Rulebook will be updated to retain related definitions relevant to the calculation of Technical Provisions.

6.6 The PRA considers that the cash-flow projections used in the calculation of best estimates are already subject to the proportionality rule in CDR Article 56, which the PRA proposes to restate in the PRA Rulebook. In restating CDR Article 35 (Homogeneous risk groups of life insurance obligations), the PRA proposes to delete mention of 'undue burden' as it considers it to be redundant given the now explicit link to the proportionality rule.

Proposal 2: Restatement of relevant guidance for the calculation of Technical Provisions into a new Supervisory Statement

6.7 The PRA further proposes to restate CDR Articles 57 – 61 into a new SS – Solvency II: Calculation of Technical Provisions (see Appendix 7). Those CDR Articles do not contain requirements for firms, rather they provide guidance to firms on aspects of the calculation of Technical Provisions. As a consequence, the PRA considers that the most appropriate way to restate them in PRA policy materials is in a SS which clarifies specific simplifications that the PRA considers would be possible when firms calculate Technical Provisions.

PRA objectives analysis

6.8 The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

Cost benefit analysis

6.9 This proposal is to restate articles in the CDR either to a new part of the PRA Rulebook, or to a new SS. The proposed destinations are consistent with the nature of the articles and are not changes to the policy intention. The costs and benefits of this proposal are described in Chapter 1 – Overview.

'Have regards' analysis

6.10 The Have Regards analysis is the same as the analysis described in Chapter 1 – Overview.

7: Own funds

Introduction

7.1 This chapter sets out the PRA's proposals to restate requirements relating to own funds from the CDR to the PRA Rulebook. It also sets out the PRA's proposals to restate certain parts of the CDR, Solvency 2 Regulations 2015, relevant EU guidelines, and relevant EU Technical Standards relating to own funds into a new PRA SoP.

Areas covered

7.2 The PRA proposes to:

- restate the majority of own funds requirements from the CDR[18] to the **Own Funds** Part of the PRA Rulebook;
- set out its approach to granting own funds permissions, unchanged from its current approach. The PRA proposes to do this by restating relevant material from several sources, including assimilated law and EIOPA guidelines, and consolidating them in a new SoP;
- amend a number of CDR provisions when restating them into the PRA Rulebook to remove any uncertainty and ensure they align with current practice; and
- introduce a new own funds transitional rule.

7.3 The proposals in this chapter would:

- amend the PRA Rulebook Glossary (Appendix 3);
- amend the Own Funds Part of the PRA Rulebook (Appendix 3); and
- introduce a new draft SoP – The PRA's approach to insurance own funds permissions (Appendix 8);

7.4 The PRA also proposes to restate parts of paragraphs 4.10 and 4.11 of SS15/15 – **Solvency II: Approvals** to SS2/15, as a consequence of the PRA's proposed deletion of SS15/15, as set out in Chapter 15 – Consequential Amendments. The resulting additions to SS2/15 are set out in Appendix 9.

[18] CDR requirements for own funds are currently set out in Articles 62 to 82.

7.5 See Appendix 2 for the mapping tables, which set out how the PRA proposes to restate assimilated law into PRA Rules and accompanying policy materials ('the PRA policy framework').[19]

Proposal 1: Restatement of own funds requirements

7.6 The PRA proposes to restate own funds requirements from the CDR in the Own Funds Part of the PRA Rulebook or in relevant policy materials.

7.7 As part of the restatement of the CDR, the PRA proposes to make minor amendments to some provisions with the aim of contextualising them appropriately in the PRA Rulebook without changing their substance. These amendments include minor changes and additions to definitions in the Own Funds Part and the PRA Rulebook Glossary, which enable the PRA to simplify and abridge some of the CDR provisions within the draft rules. For example:

- The PRA proposes to replace the cross-references to Articles 69(a)(iii), (v), and (b) (proposed to be Own Funds 3A.1(c), 3A.1(e), and 3A.2) throughout the draft rule instrument, which refer to restricted Tier 1 items on the Tier 1 items list, with a defined term 'restricted Tier 1 own funds', to allow for easier navigation and understanding of the relevant rules.
- The definition of 'policyholders' in the PRA Rulebook Glossary already includes the concept of 'beneficiaries'. Hence, the proposed new rules remove the reference to 'beneficiaries' when describing the creditor hierarchy in Own Funds 3B.1(1)(b), 3E.1(1) and 3G.1(1) (currently CDR Articles 71(1)(a)(ii), 73(1)(a), 77(1)(a)) to avoid the redundant reference.
- The PRA proposes to create a definition for 'restricted own funds' within the Own Funds Part of the PRA Rulebook. This would replace the definition provided in Article 80 (proposed to be Own Funds 3L). This approach would be more consistent with the PRA Rulebook structure which sets out definitions in the first chapter to each Part rather than within the main text.
- In restating Article 82 (proposed to be Own Funds 4A), the PRA proposes changes to improve clarity and to ensure alignment with the definition of 'Eligible Own Funds' within the PRA Rulebook Glossary. The PRA also proposes to amend the definition of 'Eligible Own Funds' to reflect the restatement of Article 82 within the Own Funds Part of the PRA Rulebook.
- To ensure the Rulebook is consistent with the PRA's near-final policy as set out in Chapter 6 – Third-country branches of PS2/24, the PRA also proposes to amend the following own funds related definitions in the Glossary Part of the Rulebook as follows:

[19] Though the PRA is proposing to change the numbering of the CDR Articles to match the format of the PRA Rulebook (as set out in Appendix 2 – Mapping tables), it has left notes in the draft Own Funds rule instrument to assist with clarity.

- delete (3) in the definition of 'ancillary own funds';
- delete (3) in the definition of 'basic own funds';
- delete (5) and (6) in the definition of 'eligible own funds'; and
- delete (3) in the definition of 'own funds'.

7.8 The PRA considers that the proposed minor amendments would not change the substance of the equivalent provisions as stated in the CDR.

Proposal 2: Approach to own funds permissions

7.9 There are specific circumstances, as set out in assimilated law, in which firms must apply to the PRA for 'supervisory approval' or 'exceptional waiver' before undertaking certain actions in relation to own fund items. For example, firms must have supervisory approval to recognise ancillary own funds (AOF), and items not included on the lists of own fund items (INOLs), as regulatory capital.[20] In other instances, firms may require supervisory approvals or exceptional waivers in relation to specific features that the CDR either requires or permits to be included in the terms and conditions, or equivalent, of Tier 1, 2 or 3 own fund items.

7.10 Following the restatement of assimilated law in the PRA Rulebook, the PRA proposes that it would grant all approvals relating to own fund items using new permission powers under s138BA of FSMA. Therefore, the PRA proposes to make changes in the PRA Rulebook to ensure that:

- 'supervisory approvals' for AOF to be included in own funds are captured by a new definition for 'ancillary own funds permission';
- 'supervisory approvals' for INOLs to be included in Tier 1, 2 or 3 own fund items are captured by a new definition for 'classification of own funds permissions';
- 'supervisory approvals' or 'exceptional waivers' that relate to the permitted or required terms and conditions of own fund instruments are stated as requiring 'prior permission' from the PRA; and in addition,
- new operative provisions have been inserted, to provide the basis for the granting of permissions under s138BA of FSMA for the operation of terms and conditions included within firms' own fund instruments.

7.11 The PRA considers that its proposed approach to granting own funds permissions under s138BA of FSMA would be clear, consistent, and transparent for firms. The PRA also considers that there would be no material increase in the legal or administrative burden

[20] INOLs are items that are not specified in CDR Articles 69, 72, 74, 76, and 78 (proposed to be Own Funds 3A, 3D, 3H, 3F and 3J).

associated with applying for own funds permissions as a result of the PRA's proposal to use the new permission powers under s138BA of FSMA.

7.12 There are currently various sources of assimilated law and guidance that set out how firms and the PRA should approach applications for the supervisory approvals. These are set out in the following existing materials:

- '**Guidelines on classification of own funds**', originally issued by EIOPA and referred to hereafter as the 'own funds guidelines';
- Articles 70(10)(c), 71(11), 73(5) and 77(5) of the CDR;
- specifically for AOF approvals:
    - Articles 62-67 of the CDR;
    - '**Guidelines on ancillary own funds**', originally issued by EIOPA and referred to hereafter as the 'ancillary own funds guidelines';[21]
    - the assimilated Commission Implementing Regulation (EU) 2015/499, as amended by the **Technical Standards (Solvency II Directive & Institutions for Occupational Retirement Provision Directive) (EU Exit) Instrument 2019** – referred to hereafter as the 'ancillary own funds ITS'; and
    - **Regulation 44** of the Solvency 2 Regulations 2015 on the supervisory approval of ancillary own funds;
- specifically for INOL approvals:
    - Article 79(2) of the CDR;
    - Own funds guidelines; and
    - **Regulation 46** of the Solvency 2 Regulations 2015 on the classification of funds.

7.13 To ensure there is consistency and transparency in the process for obtaining permissions relating to own fund items, the PRA proposes to restate relevant aspects from the materials listed above to a new SoP – The PRA's approach to insurance own funds permissions (Appendix 8). The new SoP would describe the PRA's approach to granting own funds permissions in a single location, replicating its current approach to considering applications for supervisory approval. The PRA considers that the new SoP would therefore make the process of applying for own funds permissions simpler and more accessible.

7.14 Further to the above, the PRA considers that the new SoP would be consistent with the proposal in CP3/24 that the PRA would generally use 'subject specific SoPs' to communicate the criteria or factors that it would take into account when assessing specific rule permissions

[21] The PRA has onshored EIOPA's **Guidelines on the classification of own funds** and EIOPA's **Guidelines on ancillary own funds** in line with the approach described in the **Statement of Policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU**.

under s138BA of FSMA. The PRA has only proposed to restate provisions and guidelines to the SoP if it considers this is necessary to ensure the coherence of own funds permissions under s138BA of FSMA. In line with the general approach set out in this CP, the PRA has not proposed to restate any other materials to new PRA policy documents.

7.15 Table 7A summarises the PRA's proposals for restating the relevant existing materials that currently describe the PRA's approach to granting own funds permissions to a new SoP:

Table 7A: The PRA's approach to own funds permissions

Source	Provisions and guidelines that would be restated to the new SoP
CDR:	**The following articles would be restated to the new SoP:** • **Articles 62 to 67,** which set out the factors that the PRA would need to consider when assessing applications to determine items as ancillary own funds; • **Article 71(10),** which sets out the factors that the PRA would need to consider when assessing applications from firms to avoid triggering principal loss absorbency mechanisms in own fund items despite significant non-compliance with the SCR;[22] • **Article 71(11), 73(5) and 77(5),** which set out the factors the PRA would consider when assessing applications for the redemption of Tier 1, 2 and 3 own fund items prior to five years from the point of issuance;[23] and • **Article 79(2),** which sets out the factors the PRA would need to consider when assessing applications for INOL approvals (proposed to be referred to in the PRA Rulebook as 'classification of own funds permissions').

[22] The PRA proposes that Articles 71(10), 71(11), 73(5) and 77(5) are restated in the Own Funds Part of the PRA Rulebook because these provisions set out the requirements for the own fund instrument itself. The PRA also proposes to transfer these articles to the new SoP, to the extent they set out factors the PRA would consider before granting permissions under the new operative permissions provisions in relation to the required or permitted features of own fund instruments. The operative provisions that provide the basis for the granting of permissions under s138BA of FSMA are included at Own Funds 3B.14, 15 and 16; 3E.6 and 7; and 3G.6 and 7.
[23] The PRA proposes that Articles 71(10), 71(11), 73(5) and 77(5) are restated in the Own Funds Part of the PRA Rulebook because these provisions set out the requirements for the own fund instrument itself. The PRA also proposes to transfer these articles to the new SoP, to the extent they set out factors the PRA would consider before granting permissions under the new operative permissions provisions in relation to the required or permitted features of own fund instruments. The operative provisions that provide the basis for the granting of permissions under s138BA of FSMA are included at Own Funds 3B.14, 15 and 16; 3E.6 and 7; and 3G.6 and 7.

Source	Provisions and guidelines that would be restated to the new SoP
Solvency 2 Regulations 2015:	**The following regulations would be restated in the new SoP:** • Relevant aspects of Regulation 44 (ancillary own funds application process) and Regulation 46 (application process for INOLs).

Own funds guidelines:	**The following guidelines would be restated in the new SoP:**
	• **Guidelines 8**, **15, 16, and 18,** which set out factors and procedures the PRA would consider when assessing applications for own funds permissions in respect of the:
	  ○ repayment or redemption of own fund items;
	  ○ repayment or redemption of 'restricted Tier 1 own fund' items between five- and 10-years post issuance, or for Tier 1, Tier 2 and Tier 3 own fund items less than five years from the date of issuance - and, in either case, whether a margin over the SCR is appropriate;
	  ○ waiver of a suspension of repayments or redemptions upon breach of the SCR;
	  ○ waiver of a cancellation or deferral of distributions upon breach of the SCR;
	Guideline 12, which provides a definition for repayments and redemptions as mentioned in certain CDR articles, as well as in guidelines 8, 15 and 18;
	• **Guidelines 21-23,** which set out how the PRA expects firms to apply for a classification of own funds permission; and
	• **Guidelines 25-26,** which set out how the PRA assesses applications for a classification of own funds permission.

Ancillary own funds guidelines:	**The following guidelines would be restated in the new SoP:** • **Guidelines 5 and 6**, which set out how the PRA would engage with firms if they have reason to believe a material change in the loss absorbency of an ancillary own funds item is imminent or likely, and what information the PRA would assess when considering whether ancillary own funds items continue to meet the relevant criteria for loss absorbency.

Source	Provisions and guidelines that would be restated to the new SoP
Implementing Technical Standards (ITS):	**The following ITS would be restated in the new SoP:** • **The ancillary own funds ITS articles 1-7**, which provide details about the process for granting permission for the use of ancillary own funds items.

Source: PRA

7.16 As noted above, the new SoP is not expected to change the PRA's approach to granting own funds permissions materially because it comprises provisions that describe the PRA's existing approach.

7.17 Any EIOPA Guidelines relating to own funds that the PRA has not proposed to restate in the new SoP would continue to apply to firms, as explained in paragraph 1.21 of Chapter 1 – Overview.

7.18 The PRA notes that where firms have issued own fund items that contain references to 'supervisory approval' or 'exceptional waivers', it would assess applications for these in accordance with the relevant chapter of the new SoP.

Proposal 3: Amendments to CDR Articles to remove uncertainty and align with current practice

7.19 The PRA proposes to make further changes to some CDR Articles as part of the restatement of own funds requirements into the PRA Rulebook, with the aim of clarifying the requirements to align with current practice. The PRA does not consider these changes to affect the current policy position under the existing Solvency II (SII) regime, or to impact how firms and industry apply the rules in practice, as explained further below.

7.20 The PRA proposes to make the following changes:

Table 7B: changes to CDR provisions

CDR provision	Description	PRA Rulebook mapping
Articles 82(3), 68(5)(b), and 73(1)(j)	Amend sub-sections to ensure consistent treatment of restricted Tier 1 own fund items.	Own Funds 4A, 3K, and 3E
Article 81(1)	Amend sub-section to ensure clear calculations.	Own Funds 3M
Article 70(2)	Exclude from restatement as already covered by the definition in 70(1), which would be restated to Own Funds 3C.	n/a
Recital 35	Restate part of this recital into the PRA Rulebook to clarify that the reconciliation reserve may be positive or negative.	Own Funds 3C

CDR Articles 82(3), 68(5)(b), and 73(1)(j): references to restricted Tier 1 items

7.21 Own fund items can be classified into three tiers under the current SII regime, which reflect the quality of capital: Tier 1 (the highest quality capital), Tier 2, and Tier 3.

7.22 The relevant CDR articles set out separate lists of own fund items that can be classified into each tier, provided that they also display the specific features required. Alternatively, where the own fund item is not on the relevant list, but still displays the specific features required for the relevant tier, firms may currently apply for supervisory approval of the own fund item's classification into that tier (under Regulation 46 of the Solvency 2 2015 Regulations, and in accordance with Article 79 of the CDR and Own Funds 3.4(2)). A firm may not consider the item as classified into a tier unless they have such approval. As part of the proposed approach to owns funds permissions, firms would be able to seek a 'classification of own funds permission' under the process explained above in Proposal 2 of this chapter, as the equivalent to the current approvals process.

7.23 The PRA considers that own fund items that are classified into a tier through an approvals or permissions process should be treated in the same manner as those items that are included on the own fund item lists for each tier in the CDR. The PRA considers this to be

consistent with the policy intent for Own Funds requirements in the CDR, given these items represent the same quality of capital and demonstrate the same features that determine classification.

7.24 Items classified as Tier 1 own fund items are divided into those that are 'unrestricted' and 'restricted', depending on the capital instrument in question and the features of that instrument. 'Restricted Tier 1' (rT1) items are lower quality capital compared to unrestricted Tier 1 items.

7.25 The following CDR Articles set out a number of provisions that apply to rT1 items:

- Article 82(3) provides that rT1 items may only represent up to 20% of the total amount of the firm's Tier 1 own fund items.
- Article 68(5)(b) requires a deduction from rT1 items, under certain limited scenarios relating to participations in financial and credit institutions.
- Article 73(1)(j) provides that firms can classify rT1 capital that exceeds the 20% limit set out in Article 82(3) as Tier 2 own funds.[24]

7.26 The above articles refer to rT1 items in different ways. Articles 82(3) and 68(5)(b) of the CDR currently cross-refer to three specific items from the Tier 1 own fund items list in Article 69: 69(a)(iii), (v), and (b), which represent rT1 items. The PRA proposes to replace this cross-reference throughout the Own Funds Part of the PRA Rulebook with a new definition 'restricted Tier 1 own funds' to make navigating the rules easier, as explained above – but this would not change the substance of these cross-references (ie they would refer to the same three items on the Tier 1 list).

7.27 By referring to specific items on the relevant list, these articles do not explicitly make reference to items that are 'not on the list' (INOLs) but display the same features as rT1 items and are instead classified through the supervisory approvals process (the proposed future 'classification of own funds permission' process). The PRA notes this could give rise to ambiguity as to the applicability of these provisions.

7.28 Similarly, Article 73(1)(j) makes reference to the features of the items, but again does not make clear that the provision includes rT1 items that are classified through an approvals or permissions process, which the PRA considers may also leave room for uncertainty.

7.29 The PRA considers the CDR articles listed above should apply to all capital instruments that display the features of rT1 items and represent the same quality of capital, regardless of how such items were classified as rT1 capital, which is consistent with the policy intent of these articles.

[24] See also EIOPA Guidelines on classification of own funds, Guideline 20 – which would continue to apply.

7.30 Therefore, to promote clarity and consistency of the PRA rules and remove any risk of misinterpretation or uncertainty, the PRA proposes to amend the wording from CDR articles 82(3), 73(1)(j), and 68(5)(b) when restating these provisions into the PRA Rulebook, to ensure the inclusion of items that are classified as rT1 capital via the proposed classification of own funds permission. The relevant provisions in the draft rule instrument are Own Funds 4A.3, 3E.1(11), and 3K.5(2) as set out in the draft rule instrument (**Appendix 3**).

7.31 The PRA does not consider these proposed amendments to be a change to the policy intent behind these provisions – and considers this would align with and confirm industry's current understanding of how these rules apply in practice. For example, reporting information shows that firms correctly apply the 20% limit set out in Article 82(3) (proposed to be Own Funds 4A.3) to all rT1 own funds in practice.[25]

7.32 The PRA considers the proposed amendments to the wording from these CDR articles would ensure the consistent treatment of rT1 items, which is an important part of the SII framework for Own Funds. This is particularly important for the 20% limit in Article 82(3) (proposed to be Own Funds 4A.3), to restrict the amount of rT1 capital that can be used to comply with the SCR and MCR, given it is lower quality capital compared to unrestricted Tier 1. The consistent treatment of these items is also important to ensure rT1 own funds in excess of the 20% limit are appropriately classified as Tier 2 funds under Article 73(1)(j) (proposed to be Own Funds 3E.1(11)), and to ensure correct calculations under Article 68(5)(b) (proposed to be Own Funds 3K.5(2)).

CDR Article 81(1): Adjustment for ring-fenced funds and matching adjustment portfolios

7.33 Under the current wording of Article 81(1) (proposed to be Own Funds 3M.1), firms are directed to do the following when calculating the reconciliation reserve:

'For the purposes of calculating the reconciliation reserve, insurance and reinsurance undertakings shall reduce the excess of assets over liabilities referred to in Article 70 **by comparing the following amounts: (a) the restricted own-fund items within the ring-fenced fund or matching adjustment portfolio; (b) the notional Solvency Capital Requirement for the ring-fenced fund or matching adjustment portfolio.**

Where the insurance or reinsurance undertaking calculates the Solvency Capital Requirement using the standard formula, the notional Solvency Capital Requirement shall be calculated in accordance with Article 217.

[25] This analysis is based on year end data for financial periods ending in 2022.

Where the undertaking calculates the Solvency Capital Requirement using an internal model, the notional Solvency Capital Requirement shall be calculated using that internal model, as if the undertaking pursued only the business included in the ring-fenced fund or matching adjustment portfolio.' (emphasis added)

7.34 In practice, this means the excess of assets over liabilities must be reduced by the amount of restricted own fund items within a ring-fenced fund or MA portfolio that is in excess of the notional SCR of the ring-fenced funds or MA portfolio.

7.35 The PRA considers this calculation could be made clearer within the rules by explicitly setting out what is meant by 'comparing the following amounts'. To ensure clarity and reduce any need for supervisory queries or intervention, the PRA therefore proposes to amend the wording from this article when restating the provision across to the PRA Rulebook, by introducing revised text in Own Funds 3M.1 as set out in the draft rule instrument (**Appendix 3**).

7.36 For the avoidance of doubt, the PRA does not consider the amendments to this provision to change the underlying policy, or that these would change what firms are already doing in practice. The PRA is also proposing to update the definition of ring-fenced fund, as set out in Chapter 8 – Solvency Capital Requirement – Standard Formula, again without any expected change to the underlying policy or outcomes.

CDR Article 70(2) and recital 35

7.37 The PRA does not propose to restate Article 70(2) of the CDR to PRA rules, meaning that upon its revocation it would no longer apply as part of the new Solvency UK regime. Article 70(2) states that the reconciliation reserve includes the amount that corresponds to the expected profit included in future premiums (EPIFP) as defined in CDR Article 260. The PRA considers that this does not represent a change in policy because this statement is not an operating provision, as it is clear from the definition in Article 70(1) of the CDR (proposed to be Own Funds 3C) that EPIFP would be included in the reconciliation reserve, and reiterating this would be redundant.

7.38 The proposal not to restate Article 70(2) of the CDR is consistent with PS3/24 **– Review of Solvency II: Reporting and disclosure phase 2 near-final**, which removes the requirement for firms to report or disclose specific information on EPIFP. It is also consistent with the proposal in this CP not to restate Article 260(2)-(4) of the CDR regarding the definition of EPIFP, and the proposal in this CP not to restate Article 295(5) of the CDR regarding the disclosure of total EPIPF in the SFCR. These proposals are set out in Chapter 10 – Systems of governance and Chapter 12 – Public disclosure.

7.39 In addition to the above, the PRA proposes to clarify in Own Funds 3C that the reconciliation reserve may be positive or negative, in line with the context provided by CDR Recital 35. This does not represent a change in policy.

Proposal 4: New own funds transitional rule

7.40 The PRA is aware of a small number of UK insurance firms that have outstanding preference shares with dividend stopper features, which were issued prior to the development and introduction of SII requirements on own funds. Those instruments are included in Tier 1 own funds by virtue of the own funds transitional measures[26], which will expire on 1 January 2026. Dividend stoppers in those instruments, as well as dividend stopper language in those firms' Articles of Association (AoAs), typically place restrictions on distributions that can be made on a firm's ordinary shares, which undermines the compliance of the ordinary shares with the SII Tier 1 (T1) own funds features determining classification set out in Table 7C.

Table 7C: SII Tier 1 own funds features determining classification compromised by dividend stopper features in transitioned preference share instruments.

CDR reference	Mapping to proposed location in the PRA Rulebook
Art 71(1)(n) and 71(3)(c) requiring full flexibility over distributions.	Own Funds 3B.1(14) and 3B.3(3), respectively.
Art 71(1)(d) requiring no features that could hinder recapitalisation.	Own Funds 3B.1(4).

7.41 The PRA considers that transitioned instruments are not relevant when assessing the extent to which non-transitioned own fund items possess the features listed in CDR Article 71 during the own funds transitional period.[27,28] This permits firms to treat transitioned preference share instruments with dividend stoppers (hereafter referred to as 'legacy paid-in preference shares') as not relevant when assessing compliance of their ordinary shares with the criteria set out in Table 7C during the own funds transitional period. However, when the SII own funds transitional period ends on 1 January 2026, legacy paid-in preference shares would disqualify the affected firms' ordinary shares from unrestricted T1 own funds.[29,30]

[26] Own Fund transitional measures are set out in 4.1 of the Transitional Measures Part of the PRA Rulebook.
[27] This point was previously clarified by EIOPA: **333 - European Union (europa.eu)**
[28] 'Non-transitioned own fund items' are those that meet the SII own funds requirements and are not dependent on transitional measures for inclusion within SII own funds.
[29] At that point, the ordinary shares could qualify as a lower tier of capital, provided they meet the relevant features determining classification and subject to the SII tiering limits.
[30] When the own funds transitional period ends, the legacy paid-in preference shares would cease to qualify as regulatory capital because they contain features which do not comply with SII own funds requirements.

Furthermore, the PRA is aware that, for some firms, specific terms in their legacy paid-in preference shares present challenges for remediation within the remaining availability of the current transitional period.

7.42 To address this issue, the PRA proposes to insert a new, time-limited transitional rule into the Own Funds Part of the PRA Rulebook. The rule would permit firms to continue to treat legacy paid-in preference shares issued prior to 18 January 2015 as not relevant when assessing the compliance of their ordinary shares with the unrestricted T1 own funds requirements in Table 7C, for a period of 25 years.[31] The proposed rule would also require a firm to disregard any dividend stopper terms in its AoA where the firm has legacy paid-in preference shares in issue. The proposed new rule Own Funds 3B.17 and PRA Rulebook definition of 'legacy paid-in preference shares' are set out in Appendix 3.

7.43 The PRA considers the quality of capital to be an important aspect of the SII framework and recognises the need for consistency across firms in meeting SII own funds requirements. Those points notwithstanding, the PRA considers that disqualification of the ordinary shares of affected firms from SII unrestricted T1 own funds due to the presence of dividend stoppers in legacy paid-in preference shares and AoAs after expiry of the current own funds transitional period would be disproportionate. Furthermore, given the small number of affected firms and the small amount of legacy paid-in preference shares in issue, the PRA considers that it would continue to advance the PRA's objectives to provide those firms with more time to ensure an orderly alignment of all capital instruments with the SII own funds requirements.

7.44 The PRA notes that legacy paid-in preference shares have been in issue since before the start of the current own funds transitional period. During the transitional period, such instruments have been deemed to be fully included in restricted T1 own funds under rule 4.1 in the Transitional Measures Part of the PRA Rulebook and the eligibility requirements in CDR Article 82(3), and this is one reason why the PRA considers the proposed approach proportionate in all circumstances.[32]

7.45 The PRA considers that the scope of the proposed new rule is tightly defined so as to only apply to the specific circumstances described in paragraphs 7.40 and 7.41. The rule would take effect from the end of the date on which the current own funds transitional period ends (ie from 2 January 2026). The rule would not extend the current own funds transitional period, nor would it would apply to firms with AoAs that contain dividend stopper language but with no legacy paid-in preference shares in issue.[33] The PRA reminds all firms of its existing expectation for them to comply with EIOPA guidelines on the classification of own

[31] The existing basic own funds transitional measures apply only to items of basic own funds issued prior to 18 January 2015, as set out in Transitional Measures 4.1(1) and 4.2(1).
[32] Note the PRA is also proposing to restate CDR Article 82(3) as new rule 4A.3(2) in the Own Funds Part of the PRA Rulebook as part of this consultation. If that proposal is adopted, then the content of Article 82(3) would apply for the remainder of the current own funds transitional period, as a PRA rule from 1 January 2025.
[33] The PRA considers that no rule is needed for firms in such a situation because there can be no impact on full flexibility and hindrance to recapitalisation where there are no legacy paid-in preference shares in issue.

funds.[34] Paragraphs 1.13 and 1.32 of those guidelines set an expectation that firms should not issue own fund items with dividend stopper features where those stoppers affect T1 own funds. For clarity, any preference shares with dividend stoppers issued in future would not be covered under the proposed new transitional rule.

7.46 For the avoidance of doubt, the proposed new transitional rule would not extend recognition of legacy paid-in preference shares as own fund items beyond the expiry date of the existing own funds transitional period. That is, the legacy paid-in preference shares will cease to qualify as regulatory capital after 1 January 2026. The proposed new transitional rule relates to how those legacy instruments are taken into account when a firm assesses the compliance of its ordinary shares with the unrestricted T1 own funds requirements in Table A.

7.47 The PRA considers that a period of 25 years for the new transitional rule is an appropriate timeframe for affected firms to ensure their capital instruments comply with SII own funds requirements. The time-limited nature of the proposed rule reflects the importance of capital quality to the PRA. The PRA anticipates this period should provide sufficient time for affected firms to remediate while avoiding any potential market disruption.

Alternative options considered

7.48 The PRA also considered the following approaches to address the issue described in paragraph 7.41:

- Granting rule waivers to affected firms. This approach would have had a similar effect as the proposed new rule, in that it could have prevented disqualification of the firms' ordinary shares by dividend stoppers in legacy paid-in preference shares and AoAs after the current own funds transitional period expires on 1 January 2026. The PRA discounted this option as less appropriate than the proposed approach, for many of the reasons set out in the next paragraph.
- By extending the existing own funds transitional period. This action would have removed the risk of disqualification of ordinary shares, but it would have also extended the recognition of all transitioned instruments as SII regulatory capital.

7.49 The PRA opted to consult on a time-limited, transitional rule change for the following reasons:

- Specificity – a transitional rule narrowly focused to address the specific issue described in paragraph 7.41 that affects a (small) number of firms is more targeted than extending the existing own funds transitional period.
- Transparency – a transitional rule to address this specific issue is more transparent than a waiver-based approach in that all affected firms would be able to benefit from this measure, as opposed to a waiver that some firms may not consider applying for.

[34] The PRA set its expectations regarding the **Guidelines on the classification of own funds** in line with the approach described in the **Statement of Policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU**.

- Consistency – the proposed approach ensures consistency of treatment across affected firms by having a single rule for all, in particular compared to a waiver-based approach.
- More efficient use of PRA resources – the proposed approach would lead to more efficient use of PRA resources than, for example, individually assessing waiver applications from affected firms.

PRA objectives analysis

PRA objectives analysis for Proposals 1, 2, and 3 of this chapter

7.50 Chapter 1 – Overview of this CP contains analysis explaining how the proposals to restate assimilated law in the PRA policy framework would advance the PRA's primary and secondary objectives. The analysis is also relevant for Proposal 1: Restatement of own funds requirements, Proposal 2: Approach to own funds permissions, and Proposal 3: Amendments to CDR Articles to remove uncertainty and align with current practice.

7.51 The PRA considers that its proposal to introduce a new SoP, as set out in Proposal 2: Approach to own funds permissions, would further advance its primary objectives of firm safety and soundness, and policyholder protection. The SoP would consolidate assimilated law, relevant legislation, and relevant EU guidelines relating to own funds permissions in a single policy document, providing additional clarity, transparency, and consistency around how the PRA would assess applications under s138BA of FSMA. This would reduce the risk that firms determine, classify, or manage their own funds inappropriately.

7.52 The changes to the relevant CDR articles when restating them in PRA rules as set out in Proposal 3 are also intended to remove any uncertainty and improve clarity in the practical policy relating to Own Funds for firms. In turn, this would advance the PRA's primary objectives by contributing to a more robust and transparent regulatory regime for Own Funds and promote financial stability. For example:

- The proposal to amend the wording from Article 82(3) would remove any ambiguity for firms around the 20% eligibility limit, which would ensure the limit is correctly applied to all rT1 capital regardless of how it was classified – and the amendment to Article 73(1)(j) would clarify how rT1 capital in excess of this limit should be classified.
- The proposed amendments to the wording from Articles 68(5)(b) and 81(1), and the inclusion of part of recital 35 in PRA rules, would remove uncertainty for firms about the relevant calculations within those provisions and mitigate the risk of inaccurate or inconsistent outcomes.

7.53 The PRA considers that Proposal 2: Approach to own funds permissions and Proposal 3: Amendments to CDR Articles to remove uncertainty and align with current practice also

align with its secondary objective to facilitate effective competition. By removing ambiguity in the restated provisions and by providing additional clarity and consistency in own funds permissions processes, the proposals contribute to a more transparent and predictable regulatory regime. This would help to ensure that all firms operate on a level playing field, which could promote fairness and competition within the market – particularly by ensuring that all rT1 instruments are treated consistently by all firms and are subject to the same restrictions. Generally, clearer regulatory requirements may also encourage entry to the market and may make it easier for firms to comply with the rules, thereby removing potential compliance burdens for smaller firms and reducing the need for firms and the PRA to spend time clarifying the relevant approaches on a case-by-case basis.

7.54 The PRA considers that Proposals 2 and 3 in this chapter also align with its secondary objective to facilitate the international competitiveness and growth of the economy in the UK. By improving the transparency of the own funds requirements for the UK and contributing to a robust regulatory regime, the proposals could help to generate and maintain trust in the UK as an attractive place to do business. The proposals also help to maintain strong standards and set clear expectations for own funds requirements in the UK, without increasing the burden on firms. The PRA considers its proposal to ensure the consistent treatment of rT1 instruments is aligned with international standards, which also ensure the consistent treatment of capital instruments of the same quality that display the same features.

PRA objectives analysis for Proposal 4 of this chapter

7.55 The PRA considers that Proposal 4: New own funds transitional rule would continue to advance its primary objectives of safety and soundness and policyholder protection for the following reasons:

- The proposal to introduce a new, time-limited transitional rule would prevent the disqualification of ordinary shares from SII unrestricted T1 own funds for any firms with legacy paid-in preference shares in issue at the end of the current own funds transitional period. This would prevent a decrease in the T1 own funds of those firms that the PRA would consider to be disproportionate in relation to the small amount of legacy paid-in preference shares in issue.
- It would also avoid potential market disruption associated with firms having to act to implement market-based approaches to avoid disqualification of their ordinary shares as unrestricted T1 own funds at the expiry of the current own funds transitional period.
- The number of legacy paid-in preference shares in issue would decrease as firms take steps to ensure compliance of their capital instruments with the SII own funds requirements before the expiry of the time-limited transitional rule, thereby reducing or eliminating any remaining prudential risk associated with those instruments.

7.56 The PRA considers that Proposal 4 in this chapter would also advance its secondary competition objective. The proposed new transitional rule would help to facilitate effective competition between UK firms, some of which would be disproportionately affected by

expiration of the current own funds transitional measures on 1 January 2026, due to having issued legacy paid-in preference shares prior to the development of SII.

7.57 The PRA further considers that Proposal 4 would have the following impact on its secondary objective on international competitiveness and growth:

- The proposed new transitional rule is targeted to address a very specific issue that affects a small number of UK firms. As such, the PRA expects that it would not materially affect the attractiveness of the UK insurance market as a destination for new market entrants.
- The proposed new transitional rule would preserve the predictability and stability of the UK's prudential framework, which is one of the regulatory foundations of international competitiveness. The rule would give affected firms increased certainty about the qualification of their ordinary shares as SII unrestricted T1 own funds over the duration of the transitional rule. This may support the ability of those firms to make longer-term business and investment decisions.
- The proposed new transitional rule would prevent a sudden disproportionate reduction in capital for affected firms at the end of the current own funds transitional period, which could cause them to contract their investment, which would be negative for growth.
- As described in the previous paragraph, the proposed new transitional rule would facilitate effective competition, which would support growth.
- The PRA considers that Proposal 4 provides outcomes consistent with the emerging Insurance Capital Standard being developed by the International Association of Insurance Supervisors. The proposed new transitional rule being consulted on is tightly specified to target a known issue that affects only a small number of UK insurance firms. This approach enables the PRA to address the issue while maintaining the SII own funds requirements, thereby safeguarding the quality of capital, which is in line with the ICS.

Cost benefit analysis

Cost benefit analysis for Proposals 1, 2, and 3 of this chapter

7.58 Chapter 1 – Overview of this CP provides a CBA for proposals to restate assimilated law in the PRA policy framework, in line with Proposal 1: Restatement of own funds requirements in this chapter. This section sets out an additional CBA for Proposal 2: Approach to own funds permissions, and Proposal 3: Amendments to CDR Articles to remove uncertainty and align with current practice.

7.59 The baseline for the CBA is the current rules, requirements, and policy for own funds under the existing SII regime, including relevant EIOPA guidelines.

7.60 Given these proposals would simply clarify rather than change the PRA's approach to the regulation of SII firms, the PRA considers there would be no material costs or benefits compared with the baseline.

Benefits

7.61 The benefits of Proposals 1, 2, and 3 in this chapter include:

- **Clarity and transparency in PRA policy:** The PRA considers that its proposed amendments to the relevant CDR articles, following their restatement to the PRA policy framework, would provide clarity to firms and ensure there is greater transparency around the own funds requirements applied by the PRA. Similarly, the proposal to restate the provisions and guidelines relevant to the PRA's current approval processes to a new SoP could benefit firms and the PRA by making the process for obtaining own funds permissions clearer and more transparent, thereby enhancing operational efficiency. These proposals would also reduce the need for the PRA to clarify its approach or provide further explanation on a case-by-case basis, including regarding the interpretation of certain PRA rules and with respect to the evidential requirements necessary for particular permissions processes.
- **Consistency with the wider PRA policy framework:** The PRA considers that these proposals would improve the consistency of the PRA Rulebook as a whole. This includes the proposal to restate part of Recital 35 to Own Funds 3C, which would ensure PRA rules are better aligned with the PRA's broader policy on reporting and disclosure for EPIFP.

Costs

7.62 The PRA considers there would no material costs associated with Proposals 1, 2, or 3 in this chapter, but it has made the following assessments as part of its CBA:

- **Approach to own funds permissions in Proposal 2:** The PRA considers that the administrative costs of managing own funds permissions applications in accordance with s138BA of FSMA would be broadly the same for firms and the PRA as the costs currently incurred when firms request own funds approvals directly from their usual supervisory contacts. Although the PRA also notes that reducing the need to clarify the approach and requirements on a case-by-case basis could help reduce compliance costs for firms.
- **Amendments to Articles 82(3) and 73(1)(j) of the CDR in Proposal 3**: No firms are currently reporting eligible rT1 own funds greater than 20% of total Tier 1 own funds. Where a small number of firms have reported rT1 greater than 20% of total Tier 1 own funds, these firms are treating rT1 in excess of the 20% limit as Tier 2 own funds, in

line with the policy intent and the proposals in this chapter.[35] Therefore, the PRA considers that all affected firms understand that Articles 82(3) and 73(1)(j) apply to all rT1 capital as the policy intends. Given no firms currently holding rT1 capital would be required to alter their own funds position following the amendments to these articles, and the clarification of these rules is in line with industry's current understanding of the position, the PRA does not consider there to be any related costs to firms.

- **Amendments to Article 68(5)(b) of the CDR in Proposal 3:** The PRA considers that there would be no significant impact on firms from this amendment. Only a small number of firms currently make deductions under Article 68 and only a small number of these firms also report rT1 'items not on the list' for which they have received approval to recognise under Article 79.[36] The PRA considers that where this is the case, there is no indication that firms are calculating the deduction inconsistently with the original policy intent. On this basis, the PRA anticipates that there would be no related changes to firms' Own Funds positions and, therefore, no related costs.
- **Amendments to Article 81(1) of the CDR in Proposal 3:** The PRA considers that there should not be any increased costs to firms from the proposals. The PRA considers that all firms generally understand the calculation that this amendment would clarify and so no firms would be required to alter their own funds position.
- **Exclusion of Article 70(2) of the CDR from the proposed restatement in Proposal 3:** As explained in paragraph 7.37 above, it is clear from the definition in Article 70(1) of the CDR (proposed to be Own Funds 3C) that EPIFP would be included in the reconciliation reserve, so Article 70(2) is not an operating provision. Therefore, the PRA considers there would be no change to the current policy position for firms from the proposal not to restate Article 70(2) to the PRA policy framework, and no increase in associated costs.

Cost benefit analysis for Proposal 4 of this chapter

7.63 The baseline for the costs benefit analysis of Proposal 4: New own funds transitional rule is the PRA's policy framework relating to SII that is scheduled to come into force on 1 January 2025. That is, the situation assuming the restatement of assimilated law to the PRA's policy framework as proposed in the chapters in this CP, but without the new own funds transitional rule proposed in this section (which, in terms of policy intent, is the same as the status quo of the current SII framework).

7.64 In the baseline scenario, firms with legacy paid-in preference shares in issue could seek to implement and complete market-based solutions (eg either repurchase or amend the terms of preference shares with dividend stoppers) in advance of the end of the current own funds transitional period on 1 January 2026, with associated costs and potential market disruption. If the affected firms decided not to implement market-based solutions or were

[35] This analysis is based on year end data for financial periods ending in 2022.
[36] This analysis is based on year end data for financial periods ending in 2022.

unable to fully complete those approaches before 1 January 2026, then those firms' ordinary shares would be disqualified from unrestricted T1 own funds from 2 January 2026 (as described in paragraph 7.41). At that point, it is possible that the ordinary shares could be included in a lower tier of own funds, provided they meet the relevant features determining classification and subject to the SII tiering limits.[37]

7.65 Compared with the baseline, there are no additional costs for firms associated with the proposed new transitional rule, which the PRA proposes would take effect when the current own funds transitional period expires on 1 January 2026. The new rule would benefit affected firms by preventing the disqualification of their ordinary shares from unrestricted T1 own funds at the end of the current own funds transitional period for a period of 25 years. The PRA therefore considers that the benefits of Proposal 4 in this chapter outweigh the costs.

'Have regards' analysis

'Have Regards' analysis for Proposals 1, 2, and 3 of this chapter

7.66 Chapter 1 – Overview of this CP provides 'have regards' analysis for the restatement of assimilated law in the PRA policy framework, which applies to Proposals 1, 2, and 3 in this chapter. In addition, the following factors were significant in the PRA's analysis of its proposed approach to own funds permissions, and its proposed amendments to CDR articles when restating these in PRA rules:

1. **The principle that the PRA should exercise its functions transparently (FSMA regulatory principle):** The PRA considers that its proposed amendments to the CDR Articles would provide greater clarity in Own Funds requirements for all firms, which would also promote a more transparent and consistent application of the prudential framework. Similarly, the proposed SoP would improve transparency around how the PRA exercises its functions in relation to own funds permissions by bringing all relevant retained EU provisions and guidelines into a single PRA policy document. The proposal to use s138BA of FSMA would also enhance transparency by ensuring it is clear which powers the PRA is using when granting own funds permissions.
2. **The Legislative and Regulatory Reform Act (LRRA) five principles:** The PRA considers that, by improving transparency as described above, the proposals would ensure the PRA carries out its regulatory activities in a way that is accountable and consistent.

7.67 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for Proposals 1, 2, and 3 of this chapter, it is because the PRA considers that 'have regard' to not be a significant factor for these proposals.

[37] Tier 2 and Tier 3 own funds may only be used to cover up to 50% of the SCR, and Tier 3 own funds may only cover 15% of the SCR.

'Have Regards' analysis for Proposal 4 of this chapter

7.68 In developing Proposal 4: New own funds transitional rule, 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 following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of Proposal 4:

1. **The need to use the PRA's resources in the most efficient and economical way (FSMA regulatory principles):** the PRA considers that the proposed new time-limited transitional rule that would apply to all affected firms would be an efficient way to address the issue described in paragraph 7.41, comparable to alternative options described in paragraph 7.48.
2. **Proportionality (FSMA regulatory principles):** Proposal 4 reflects the PRA's view that disqualification of affected firms' ordinary shares from SII unrestricted T1 own funds at the end of the current own funds transitional period would be a disproportionate outcome, considering: the number and amount of legacy paid-in preference shares in issue, the amount of ordinary shares that would be disqualified, and the amount of prudential risk posed by the dividend stoppers in firms' legacy paid-in preference shares and AoAs.
3. **Recognising differences in the nature of businesses carried on by different persons (FSMA regulatory principles):** the PRA considers that the proposed new transitional rule would prevent a small number of firms from being disproportionately affected (as regards disqualification of their ordinary shares from unrestricted T1 own funds) when the current own funds transitional measures expire on 1 January 2026, due to having issued legacy paid-in preference shares prior to the development of SII requirements on own funds.
4. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** Proposal 4 involves the PRA consulting on a proposed new transitional rule, which is transparent as it will give all firms (not only those specifically affected by this issue) an opportunity to comment on the proposals as part of the consultation process. The PRA considers its proposed approach to be more transparent than the alternative options considered (see paragraph 7.48).
5. **Consistent (Legislative and Regulatory Reform Act 2006):** the proposed approach ensures consistency of treatment across affected firms by having a single rule for all.
6. **Targeted only at cases in which action is needed (Legislative and Regulatory Reform Act 2006):** the proposed new transitional rule is targeted to address a very specific issue that affects a small number of UK SII firms relating to the interaction of their legacy paid-in preference shares and ordinary shares.
7. **Growth in the interests of consumers and businesses, and sustainable growth (HMT recommendation letter and FSMA regulatory principles):** the PRA considers that Proposal 4 would prevent the sudden disproportionate reduction in capital for

affected firms at the end of the current own funds transitional period, which could cause them to contract their investment, which would be negative for growth. Furthermore, the PRA considers that the proposal would give affected firms increased certainty about the qualification of their ordinary shares as SII unrestricted T1 own funds over the duration of the proposed new transitional rule. This may support the ability of those firms to make longer-term business and investment decisions. Lastly, as described in paragraph 7.56 above, the proposed new transitional rule would facilitate effective competition, which would support growth.

7.69 The PRA has had regard to other factors as required. Where analysis has not been provided against a ‘have regard’ in this section, it is because the PRA considers that ‘have regard’ to not be a significant factor for Proposal 4 in this chapter.

8: Solvency Capital Requirement – Standard Formula

Introduction

8.1 This chapter sets out the PRA's proposals to restate assimilated law pertaining to the Solvency II Standard Formula into the PRA's policy framework. The Standard Formula is the default methodology for calculation of Solvency Capital Requirement (SCR).

8.2 This chapter is structured as follows:

- Relevant material within assimilated law that is covered in this chapter
- Proposal 1: Restatement of assimilated law for the areas covered
- Proposal 2: Notifications and further use of section 138BA permissions
- Proposal 3: Conversion of EUR denominated amounts to GBP
- Proposal 4: Definition of the term 'Ring-Fenced-Fund' (RFF)

8.3 The proposals in this chapter would:

- amend the Glossary Part, Solvency Capital Requirement – Standard Formula Part, Conditions Governing Business Part, Third Country Branches Part, and Transitional Measures Parts of the PRA Rulebook (Appendix 3);
- create a new PRA Rulebook Part: Solvency Capital Requirement – Undertaking Specific Parameters (Appendix 3);
- amend the PRA's existing statement of policy (SoP) – The PRA's approach to the publication of Solvency II technical information (Appendix 4); and
- create a new SoP – Solvency II: The PRA's approach to Standard Formula adaptations (Appendix 10, herein referred to as the 'SF SoP').

Areas covered

8.4 The following material within assimilated law is covered in this chapter:

- SII Commission Delegated Regulations (CDR) Chapter V 'Solvency Capital Requirements Standard Formula';
  - Articles 83 to 221;
- SII CDR Annexes II to XVII and XXII to XXVI;
- Solvency 2 Regulations 2015: Regulation 47 (Basic Solvency Capital Requirement);

- the following Implementing Technical Standards (ITS) and Binding Technical Standards (BTS);
  - ITS 2015/498 – supervisory approval procedure to use undertaking-specific parameters;
  - BTS 2015/2011 – lists of regional governments and local authorities, exposures to whom are to be treated as exposures to the central government;
  - BTS 2015/2015 – procedures for assessing external credit assessments;
  - BTS 2015/2016 – equity index for the symmetric adjustment of the standard equity capital charge (SAECC);
  - BTS 2016/1630 – procedures for the application of the transitional measure for the equity risk sub-module; and
  - BTS 2015/2017 – adjusted factors to calculate the capital requirement for currency risk for currencies pegged to the euro.

8.5 The following material in assimilated law is relevant to the calculation of the SCR in accordance with the Standard Formula, but is not covered in this chapter (or CP more generally):

- **BTS 2016/1800** – allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps: as set out in Chapter 1 – Overview, the PRA will consult on proposals to restate and revise that content in its policy framework in due course.

Proposal 1: Restatement of assimilated law for the areas covered

8.6 This proposal covers the majority of the assimilated law listed in paragraph 8.4 above, which the PRA proposes to address in line with the approach described in Chapter 1 – Overview. The policy intent relating to that material would not change as a result of this proposal.

Restatement of SII CDR articles in the PRA Rulebook and other policy materials

8.7 The part of the PRA Rulebook that would be most impacted by the restatement of assimilated law into the PRA's policy framework is the Solvency Capital Requirement – Standard Formula (SCR-SF) Part of the PRA Rulebook. The proposed new structure of the SCR-SF Part is set out in Table 8A. In the middle column, new chapters are set in bold typeface. The right-hand column lists the CDR articles, annexes, and BTS/ITS material that the PRA proposes to restate in the various chapters in that Part of the PRA Rulebook. The PRA's proposals that go beyond the restatement of assimilated law in relation to the policy material listed in Table 8A are explained in detail later in this chapter.

Table 8A: Proposed structure of the SCR-SF Part of the PRA Rulebook.

Chapter	Chapter title	New rules to be added
1	Application and Definitions	
2	Structure of the SCR Standard Formula	CDR Art 84
3	The Basic SCR	CDR Art 83, 87, 113, 114(1)(c),(2),(3), 136(3), 144, 164(2),(3), 189
3A	**Non-Life Underwriting Risk Module**	CDR Art 115 to 135, Annex II, III, XIII *
3B	**Life Underwriting Risk Module**	CDR Art 137 to 143
3C	**Health Underwriting Risk Module**	CDR Art 145 to 148, 150 to 163, Annex XIV, XV
3D	**Market Risk Module**	BTS 2015/2011 Art 1, CDR Art 164a to 169, 171 to 172, 174 to 188, BTS 2015/2017, BTS 2015/2016
3E	**Counterparty Default Risk Module**	BTS 2015/2011 Art 1, CDR Art 190 to 202
3F	**Intangible Asset Module**	CDR Art 203
3G	**Risk Mitigation Techniques**	CDR Art 208 to 210, 86, 211 to 215
4	Calculation of the Equity Risk Sub-Module and Application of the Symmetric Adjustment Mechanism	
5	Capital Requirement for Operational Risk	CDR Art 204
6	Adjustment for the Loss-Absorbing Capacity of Technical Provisions and Deferred Taxes	CDR Art 205 to 207

Chapter	Chapter title	New rules to be added
7	Simplification in the Standard Formula	CDR Art 88 to 112b
8	Lloyd's	
9	**Ring-Fenced Funds**	CDR Art 216(1), 217

* For CDR annexes that are not included in rules, the PRA proposes to set those out in separate PDF documents accessible via links included in relevant PRA rules.

8.8 The PRA also proposes to create a new Part of the PRA Rulebook entitled 'Solvency Capital Requirement – Undertaking Specific Parameters' (SCR-USPs) in which to restate CDR articles and Annex XVII relating to USPs. The PRA's proposals relating to USPs are set out in paragraphs 8.17 to 8.24 below.

8.9 Table 8B includes a high-level mapping of the Standard Formula provisions within the SII CDR and the PRA's proposed approach for restating them in the PRA's policy framework. The vast majority are requirements on firms, which the PRA proposes to restate within the PRA Rulebook. There is a small number of provisions that the PRA considers are no longer relevant or needed, and therefore proposes to not restate (see Table 8C below). Finally, the PRA's proposal to restate part of CDR Article 207 within the proposed new SF SoP is addressed in more detail in paragraphs 8.29 to 8.31 below. See Appendix 2 for a more detailed mapping table for material within the areas covered in this chapter.

Table 8B: High-level mapping of CDR Standard Formula articles to the PRA's policy framework.

Title	CDR Articles	Proposed destination
General Provisions	83 to 113	83, 87, 113: Existing Chapter 3 of the SCR-SF Part: The Basic SCR 84: Existing Chapter 2 in the SCR-SF Part: Structure of the SCR Standard Formula 85: Not restated * 86: New Chapter 3G in the SCR-SF Part: Risk Mitigation Techniques 88 to 112b: Existing Chapter 7 of the SCR-SF Part: Simplification in the Standard Formula

Title	CDR Articles	Proposed destination
Non-life underwriting risk module **	114 to 135	114(1)(a), (b): Not restated * 114(1)(c), (2), (3): Existing Chapter 3 of the SCR-SF Part: The Basic SCR 115 to 135: New Chapter 3A in the SCR-SF Part: Non-Life Underwriting Risk Module
Life underwriting risk module	136 to 143	136(1), (2)(a), (c): Not restated * 136(2)(b), (3): Existing Chapter 3 of the SCR-SF Part: The Basic SCR 137 to 143: New Chapter 3B in the SCR-SF Part: Life Underwriting Risk Module
Health underwriting risk module	144 to 163	144: Existing Chapter 3 of the SCR-SF Part: The Basic SCR 145 to 148, 150 to 163: New Chapter 3C in the SCR-SF Part: Health Underwriting Risk Module 149: Not restated – see Chapter 2 – General Provisions of this CP *
Market risk module **	164 to 188	164(1): Not restated * 164(2), (3): Existing Chapter 3 of the SCR-SF Part: The Basic SCR 164a to 169, 171 to 172, 174 to 188: New Chapter 3D in the SCR-SF Part: Market Risk Module 170: Not restated * 173: Not restated *
Counterparty default risk module **	189 to 202	189: Existing Chapter 3 of the SCR-SF Part: The Basic SCR 190 to 202: New Chapter 3E in the SCR-SF Part: Counterparty Default Risk Module
Intangible asset module	203	New Chapter 3F in the SCR-SF Part: Intangible Asset Module
Operational risk	204	Existing Chapter 5 in the SCR-SF Part: Capital Requirement for Operational Risk

Title	CDR Articles	Proposed destination
Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes	205 to 207	Existing Chapter 6 in the SCR-SF Part: Adjustment for the Loss-Absorbing Capacity of Technical Provisions and Deferred Taxes Part of 207 would be restated in the proposed new SF SoP
Risk mitigation techniques	208 to 215	New Chapter 3G in the SCR-SF Part: Risk Mitigation Techniques
Ring-fenced funds **	216 to 217	216(1), 217: New Chapter 9 in the SCR-SF Part: Ring-Fenced Funds 216(2): Not restated *
Undertaking-specific parameters	218 to 220	Chapters 1 to 3 of new PRA Rulebook Part: SCR-USPs
Procedure for updating correlation parameters	221	Not restated *

* See Table 8C for additional information relating to CDR provisions that the PRA proposes to not restate within its policy framework.
** Denotes where a section contains proposals that go beyond the restatement of assimilated law, which are addressed in separate proposals in this chapter.

8.10 The PRA's proposals for restating SII CDR Articles in the PRA Rulebook leverage the existing structure of the SCR-SF Part of the PRA Rulebook. Where possible, the PRA has proposed to restate sections of CDR articles within new chapters of the PRA Rulebook, or to append them to existing chapters, rather than interfere with the current structure by inserting CDR articles before or between existing rules. The main exception to this approach is existing Chapter 3 in the SCR-SF Part on 'The Basic SCR', which includes rules relating to all the risk modules and sub-modules relevant to the calculation of the SCR using the Standard Formula.

8.11 Table 8C sets out the SII CDR articles within scope of this chapter that the PRA proposes to not restate in the PRA Rulebook or other policy material, along with the rationale. The PRA considers that its proposal to not restate the articles listed in Table 8C does not

alter the policy intent of the calculation of the SCR using the Standard Formula by UK Solvency II insurance firms.

Table 8C: CDR Standard Formula articles that the PRA proposes to not restate in its Rulebook or other policy material.

Article	Reason for proposal to not restate
85 – Regional governments and local authorities	The PRA considers that the content is covered by Article 1 of BTS 2015/2011, which the PRA proposes to restate in new chapter 3D in the SCR-SF Part: Market Risk Module and new chapter 3E in the SCR-SF Part: Counterparty Default Risk Module.
114(1)(a), (b) – Non-life underwriting risk module	The PRA considers that the content is already covered by existing rule SCR-SF 3.6.
136(1), (2)(a), (c) – correlation coefficients, Life underwriting risk module	The PRA considers that: • 136(1) is already covered by existing rules SCR-SF 3.8(1) and 3.9; and • 136(2)(a), (c) are already covered by existing rule SCR-SF 3.8(2).
149 – Health risk equalisation systems	This proposal is covered in Chapter 2 – General Provisions.
164(1) – Correlation coefficients, Market risk module	The PRA considers that the content is already covered by existing rule SCR-SF 3.11.
170 – Duration-based equity risk sub-module	Not relevant in a UK context (note: the UK did not transpose SII Directive Article 304).
173 – Criteria for the use of transitional measure for standard equity risk	The transitional measure for the equity risk sub-module has now expired.

Article	Reason for proposal to not restate
216(2) – Calculation of the SCR in the case of RFFs and MAPs	See row above for Article 170: Not relevant in a UK context (note: the UK did not transpose SII Directive Article 304).
221 – Procedure for updating correlation parameters	The PRA considers that this article does not need to be restated within its policy framework, as subsequent changes to Standard Formula rules would follow the PRA's approach to making policy, which would include collection of relevant data in order to formulate evidence-based proposals prior to consultation.

Restatement of SII CDR annexes in the PRA Rulebook

8.12 There are 21 CDR annexes that are relevant to the calculation of the SCR using the Standard Formula. There are two approaches that the PRA has identified to restate the content of CDR annexes in its policy framework:

- Restate in the PRA Rulebook as rules. This approach is generally suitable for shorter annexes and/or where the structure of the content is compatible with the format of rules in the PRA Rulebook.
- Leave as a stand-alone PDF document with relevant rules linking to the document requiring firms to comply with the content of that document. This approach is more appropriate for longer annexes with a large amount of information, such as long tables.

8.13 Table 8D sets out the CDR annexes within the scope of this chapter that the PRA proposes to restate as rules within the PRA Rulebook, along with the proposed PRA Rulebook location.

Table 8D: CDR annexes that the PRA proposes to incorporate as rules into the Rulebook.

Annex	Annex title	Proposed location
Annex II	SEGMENTATION OF NON-LIFE INSURANCE AND REINSURANCE OBLIGATIONS AND STANDARD DEVIATIONS FOR THE NON-LIFE PREMIUM AND RESERVE RISK SUB-MODULE	New Chapter 3A in the SCR-SF Part: Non-Life Underwriting Risk Module
Annex III	FACTOR FOR GEOGRAPHICAL DIVERSIFICATION OF PREMIUM AND RESERVE RISK	New Chapter 3A in the SCR-SF Part:

Annex	Annex title	Proposed location
		Non-Life Underwriting Risk Module
Annex XIII	LIST OF REGIONS FOR WHICH NATURAL CATASTROPHE RISK IS NOT CALCULATED BASED ON PREMIUMS	New Chapter 3A in the SCR-SF Part: Non-Life Underwriting Risk Module
Annex XIV	SEGMENTATION OF NSLT HEALTH INSURANCE AND REINSURANCE OBLIGATIONS AND STANDARD DEVIATIONS FOR THE NSLT HEALTH PREMIUM AND RESERVE RISK SUB-MODULE	New Chapter 3C in the SCR-SF Part: Health Underwriting Risk Module
Annex XV	CORRELATION MATRIX FOR NSLT HEALTH PREMIUM AND RESERVE RISK	New Chapter 3C in the SCR-SF Part: Health Underwriting Risk Module
Annex XVII	METHOD-SPECIFIC DATA REQUIREMENTS AND METHOD SPECIFICATIONS FOR UNDERTAKING-SPECIFIC PARAMETERS OF THE STANDARD FORMULA	Chapters 4 to 10 in new Rulebook Part: SCR-USPs

8.14 The PRA proposes to include the following CDR annexes that are within the scope of this chapter as separate PDF files linked within relevant rules in the PRA Rulebook:

- Annex IV: CORRELATION MATRIX FOR NON-LIFE PREMIUM AND RESERVE RISK
- Annex V: PARAMETERS FOR THE WINDSTORM RISK SUB-MODULE
- Annex VI: PARAMETERS FOR THE EARTHQUAKE RISK SUB-MODULE
- Annex VII: PARAMETERS FOR THE FLOOD RISK SUB-MODULE
- Annex VIII: PARAMETETERS FOR THE HAIL RISK SUB-MODULE
- Annex IX: THE GEOGRAPHICAL DIVISION OF REGIONS SET OUT IN ANNEX V INTO RISK ZONES
- Annex X: RISK WEIGHTS FOR CATASTROPHE RISK ZONES
- Annex XI: LIABILITY RISK GROUPS, RISK FACTORS AND CORRELATION COEFFICIENTS FOR THE LIABILITY RISK SUB-MODULE
- Annex XII: GROUPS OF OBLIGATIONS AND RISK FACTORS FOR THE SUB-MODULE FOR OTHER NON-LIFE CATASTROPHE RISK
- Annex XVI: HEALTH CATASTROPHE RISK SUB-MODULE OF THE SOLVENCY CAPITAL REQUIREMENT STANDARD FORMULA

- Annex XXII: CORRELATION COEFFICIENTS FOR WINDSTORM RISK
- Annex XXIII: CORRELATION COEFFICIENTS FOR EARTHQUAKE RISK
- Annex XXIV: CORRELATION COEFFICIENTS FOR FLOOD RISK
- Annex XXV: CORRELATION COEFFICIENTS FOR HAIL RISK
- Annex XXVI: CORRELATION COEFFICIENTS FOR SUBSIDENCE RISK

Restatement of ITS and BTS relevant to the Standard Formula

8.15 Table 8E lists the six ITS and BTS that form part of assimilated law that are relevant to the calculation of the SCR using the Standard Formula and specifies the PRA's proposed approach to restating that material in the PRA Rulebook or other policy materials.

Table 8E: Proposals for ITS and BTS relevant to the Standard Formula.

BTS number and name	Proposal
ITS 2015/498 – supervisory approval procedure to use undertaking-specific parameters	Restate in proposed new SF SoP. Restate part of Article 6(b) in Chapter 2 in the new SCR-USPs Part of the PRA Rulebook: USPs
BTS 2015/2011 – lists of regional governments and local authorities, exposures to whom are to be treated as exposures to the central government	Restate in new Chapter 3D in the SCR-SF Part of the PRA Rulebook: Market Risk Module and in new Chapter 3E in the SCR-SF Part of the PRA Rulebook: Counterparty Default Risk Module
BTS 2015/2015 – procedures for assessing external credit assessments	Restate in existing Chapter 3 in the Conditions Governing Business Part of the PRA Rulebook: Risk Management
BTS 2015/2016 – equity index for the symmetric adjustment of the standard equity capital charge (SAECC)	Restate in new Chapter 3D in the SCR-SF Part of the PRA Rulebook: Market Risk Module
BTS 2016/1630 – procedures for the application of the transitional measure for the equity risk sub-module	Do not restate within the PRA's policy framework, as the transitional measure has already expired.
BTS 2015/2017 – adjusted factors to calculate the capital requirement for	Restate in new Chapter 3D in the SCR-SF Part of the PRA Rulebook: Market Risk Module

BTS number and name	Proposal
currency risk for currencies pegged to the Euro	

8.16 The majority of the material listed in Table 8E contains requirements on firms, which the PRA proposes to restate within the PRA Rulebook. One exception to this approach is in respect of the PRA's proposals to restate the content of ITS 2015/498, which contains both requirements on firms and requirements that apply to the PRA. The PRA proposes to restate all of ITS 2015/498 in the proposed new SF SoP, except for part of Article 6(b), as described in more detail in the next section. The PRA considers it appropriate to include within the SF SoP material that applies to both firms and the PRA, so that all relevant information for firms relating to USP applications would sit alongside information on how the PRA would assess those applications and grant USP permissions. This treatment is consistent with the PRA's approach to reformulating other Solvency II approvals granted under Part 4 of the Solvency 2 Regulations 2015 as permissions to be granted under s138BA of FSMA. The PRA's proposals relating to USPs are set out in more detail in the next section.

Proposals relating to assimilated law pertaining to USPs

8.17 The policy relating to USPs is the only approval process associated with the Standard Formula set out in Part 4 of the Solvency II Regulations 2015. The material within assimilated law relating to USPs and USP approvals include:

- Regulation 47 of the Solvency 2 Regulations 2015;
- CDR Articles 218 to 220 and Annex XVII; and
- ITS 2015/498 – supervisory approval procedure to use USPs.

8.18 CDR Articles 338 and 356 set out requirements relating to Group Specific Parameters (GSPs). The PRA's proposals relating to GSPs are covered in more detail in Chapter 14 – Insurance Groups.

8.19 Regulation 47 of the Solvency 2 Regulations 2015 sets out requirements on the PRA and firms in respect of supervisory approval of USPs. The PRA understands that, following the revocation of the Solvency 2 Regulations 2015, it is not expected that the content of Regulation 47 will be restated in legislation by HMT. As noted in Chapter 1 – Overview, the PRA intends to replace the framework for approvals under Part 4 of the Solvency 2 Regulations 2015 with a new permissions framework, where permissions will be granted using s138BA of FSMA. This includes permissions relating to the use of USPs by firms to calculate the SCR using the Standard Formula, which will replace the USP approvals process under Regulation 47 of the Solvency 2 Regulations 2015. The PRA does not expect these changes to have any impact on firms with existing USP approvals, firms considering

applying for USP approvals before year end 2024, or firms considering applying for USP permissions after year end 2024 (see paragraph 1.32 in Chapter 1 – Overview).

8.20 The PRA proposes to restate the substantive requirements of Regulation 47 that apply to the PRA, covering the content in paragraphs (3) and (4), in a chapter on USP permissions in the proposed new SF SoP.[38] This includes the criteria that the PRA would consider when deciding whether to grant a firm permission to use a USP, ie those corresponding to the conditions currently set out in Regulation 47(3).

8.21 The PRA's proposal to restate the contents of Regulation 47(4) in the chapter on USP permissions in the proposed new SF SoP would provide context as regards the circumstances that may lead to variation or revocation of USP permissions, so that it is clear to firms when the PRA may consider it appropriate to take those actions.

8.22 As set out in Table 14B above, the PRA proposes to restate CDR Articles 218 to 220 in a new SCR-USPs Part of the PRA Rulebook. When restating those articles, the PRA proposes the following:

- To amalgamate the requirements on firms within Articles 218 and 220.
- To replace the existing implicit obligation on firms to comply with requirements on data criteria relating to USPs within Article 219 with an explicit requirement for firms in a rule within the new SCR-USPs Part of the PRA Rulebook. The PRA considers that this would clarify the existing policy intent and does not amount to a policy change.
    - The PRA proposes to support this rule with a statement in the chapter on USP permissions in the proposed new SF SoP. The PRA proposes to explain that, when assessing a firm's application for permission to use a USP, it will consider data used to calculate a USP to be complete, accurate and appropriate only where they satisfy the requirements in the SCR-USPs Part of the PRA Rulebook (ie those corresponding to the requirements currently set out in CDR Article 219).

8.23 ITS 2015/498 sets out the current supervisory approval procedure for USPs and contains requirements on firms and the PRA. As set out in Table 8E above, the PRA proposes to restate all substantive articles of ITS 2015/498 in the chapter on USP permissions in the new SF SoP. The exception to this is Article 6(b) where the PRA proposes the following:

[38] Paragraph (1) of Regulation 47 is an application provision that sets the scope for USP approvals. Paragraph (2) permits a firm to apply to the PRA for approval to use a USP specific to the firm to calculate its SCR using the Standard Formula, relevant for a subset of parameters of the Standard Formula. The PRA proposes to not restate the content of those paragraphs in its policy framework. The PRA considers that this approach would not have any impact on policy intent and would not change the rights of firms conferred by Regulation 47(2), as a firm's ability to apply for USP permission would be implicit within the PRA's policy framework. This is consistent with the PRA's approach to reformulating other existing Solvency II approvals as permissions under s138BA of FSMA.

- To restate the current implicit requirement for a firm with USP approval to not revert to using the standard parameter of the Standard Formula (for which USP approval has been granted) without prior approval from the PRA as a rule in the new SCR-USPs Part of the PRA Rulebook, thereby making it an explicit requirement. The PRA considers that this would clarify the existing policy intent and does not amount to a policy change.
- To restate the supervisory request portion of that article (where a firm wishes to revert to using the standard parameter of the Standard Formula) in the chapter on USP permissions in the proposed new SF SoP.

8.24 The PRA also proposes to consolidate the USP-specific content in its existing SS15/15 (paragraphs 4.12 to 4.14) into the chapter on USP permissions in the proposed new SF SoP. This is in order to retain that content in PRA policy materials, as the PRA is also proposing to delete SS15/15 as part of this CP (see Chapter 15 – Consequential Amendments).

Minor changes and consequential amendments

8.25 As part of the PRA's proposals relating to the restatement of assimilated law set out in the preceding paragraphs, the PRA proposes to make a number of minor clarificatory changes to material to be restated within the PRA Rulebook, including the following:

- to replace the following references in the CDR with existing defined terms in the PRA Rulebook Glossary, in order to better reflect the terminology within the PRA's existing policy framework – the PRA considers that these substitutions do not amount to a change in policy intent:
  - 'life insurance contracts' with 'long-term insurance contracts';
  - 'life insurance and/or reinsurance obligations' with 'long-term insurance and/or reinsurance obligations';
  - 'non-life insurance contracts' with 'general insurance contracts'; and
  - 'non-life insurance and/or reinsurance obligations' with 'general insurance and/or reinsurance obligations';
- to introduce new defined terms for 'SLT health' and 'NSLT health' in the SCR-SF Part of the PRA Rulebook;
- to correct incorrect paragraph numbering and incorrect or missing cross-references in the assimilated law, eg in CDR Annex XVII F1(4)(c), F2(4)(c).

8.26 As part of the PRA's proposals relating to the restatement of assimilated law set out in the preceding paragraphs, the PRA proposes the following minor consequential amendments to the existing PRA Rulebook and other policy materials:

- To amend rule 7.5(4) in the Third Country Branches Part of the PRA Rulebook, to ensure that the new rule Conditions Governing Business 3.6B to 3.6F resulting from

the proposed restatement of the content of BTS 2015/2015 within the PRA Rulebook applies to Third Country Branches, with appropriate caveats.

- To remove references to the defined term 'claim' (defined by reference to s.214(1B) FSMA) in existing SCR-SF rules 3.6(1) and 3.10(2)(b). The term 'claim' in FSMA is defined in the context of the Financial Services Compensation Scheme. As the SCR-SF Part does not use the word claim in this context, the PRA instead considers it more appropriate to leave the term undefined in the SCR-SF Part to align with other parts of the PRA Rulebook (eg the Technical Provisions and Reporting Parts), given the meaning is clear from the context.
- To delete existing rules 5.2 to 5.4 of Chapter 5 of the Transitional Measures Part of the PRA Rulebook, as consequential amendments to the PRA's proposal to not restate CDR Article 173 in the PRA Rulebook, since those rules relate to the transitional measure for the equity risk sub-module, which has already expired.
- To add a statement to the existing SoP – The PRA's approach to the publication of Solvency II technical information, clarifying that it will prepare and publish an equity index and symmetric adjustment consistent with the relevant PRA Rulebook provisions, to facilitate firms' compliance with those requirements.

8.27 The PRA considers that the proposals listed in the two previous paragraphs do not alter the policy intent of the calculation of the SCR using the Standard Formula by UK Solvency II insurance firms.

Proposal 2: Notifications and further use of Section 138BA permissions

8.28 As described in Chapter 1 – Overview, the PRA has identified two approaches when restating within the PRA's policy framework provisions within assimilated law that allow firms to take an alternative approach where they are able to demonstrate to the PRA's satisfaction that they comply with a set of criteria. Table 8F sets out the PRA's proposals to deal with such provisions that occur within CDR articles relating to the Solvency II Standard Formula (except for CDR Article 207, which is covered in more detail in the next sub-section). For each of the cases within Table 8F, when restating the CDR article in the SCR-SF Part of the PRA Rulebook, the PRA proposes to retain the underlying requirement to comply with the criteria, but to replace the requirement to demonstrate compliance to the PRA with a notification requirement.

Table 8F: Restatement of CDR articles that allow firms to take an alternative approach where they are able to demonstrate to the PRA's satisfaction that they comply with a set of criteria.

Article	Proposed destination in the SCR-SF Part	Requirement in CDR article
Article 164a(1)(d) on qualifying infrastructure investments	New Chapter 3D ('Market Risk Module')	Requires a firm to be able to demonstrate to the PRA that it is able to hold a bond or loan investment to maturity in order for it to be considered a qualifying infrastructure investment.
Article 164b(5) on qualifying infrastructure corporate investments	New Chapter 3D ('Market Risk Module')	Requires a firm to be able to demonstrate to the PRA that it is able to hold a bond or loan investment to maturity in order for it to be considered a qualifying infrastructure corporate investment.
Article 171a(1) on long-term equity investments	New Chapter 3D ('Market Risk Module')	Requires a firm demonstrate to the satisfaction of the PRA that it meets all of the conditions set out in Article 171a(1)(a) to (h) in order for it to treat an equity investment as a long-term equity investment.
Article 176b(c) on own internal credit assessments	New Chapter 3D ('Market Risk Module')	Requires a firm to demonstrate to the satisfaction of the PRA that its own internal credit assessment, and allocation of a credit quality step to a bond or loan on the basis of that assessment, are reliable and properly reflect the spread risk of the asset in order for it to meet the requirements of CDR Article 176a(3)(a), which is relevant to assigning a credit quality step to the asset.

CDR Article 207(2a) on the adjustment for the loss-absorbing capacity of deferred taxes (LACDT)

8.29 CDR Article 207(2a) is relevant to all firms for which the calculation of LACDT is not within the scope of an internal model approval. This provision prohibits a firm from utilising an increase in deferred tax assets for the purposes of calculating the adjustment for LACDT, unless it is able to demonstrate to the PRA's satisfaction that it is probable that future taxable profit will be available against which that increase can be utilised. The projections and

assumptions supporting the demonstration are required to comply with CDR Article 207(2a)(a) to (c), (2b), and (2c).

8.30 When restating Article 207 in the existing Chapter 6 ('Adjustment for Loss-Absorbing Capacity of Technical Provisions and Deferred Taxes') of the SCR-SF Part of the PRA Rulebook, the PRA proposes to prohibit the utilisation of an increase in deferred tax assets for the purposes of calculating the adjustment for LACDT. The PRA also proposes to permit modification of that rule where a firm is able to demonstrate that it is probable that future taxable profits will be available after the instantaneous loss described in CDR Article 207(1), and where the projections and assumptions comply with criteria set out in CDR Articles 207(2a)(a) to (c), (2b), and (2c), which the PRA proposes to restate in the proposed new SF SoP. These proposals would result in outcomes that the PRA considers to be consistent with the policy intent of the article, given that currently under Article 207(2a), the PRA must be satisfied that probable future taxable profits will be available.

8.31 The PRA proposes that any permission for such a rule modification would be granted under the provisions of s138BA of FSMA. The PRA proposes two options for permission relating to rule modification, as set out below. The PRA has set out additional detail pertaining to these options in Chapter 4 of the proposed new SF SoP.

a) A limited modification of the rule by consent, which would be available to firms reporting a ratio of eligible own funds to SCR not less than 175%, where the contribution of an increase in deferred tax assets to the LACDT adjustment would be capped at a moderate percentage of the instantaneous loss specified in the scope of the permission (eg 5%). This would allow eligible firms to recognise a limited amount of probable future taxable profits within their LACDT calculations, based on their own assessment of whether probable future taxable profits would be available, where the assessment complies with the criteria in the PRA's proposed new SF SoP, without having to submit a detailed application to the PRA.[39]

b) Firms which do not maintain the required SCR ratio set out in option a) or which seek to recognise future taxable profits which are probable and exceed the amount permitted by the modification by consent option would be able to submit an application to the PRA for consideration. A firm would have to demonstrate in its application that the projections and assumptions comply with the criteria in the PRA's proposed new SoP on the Standard Formula, ie those corresponding to CDR Article 207(2a)(a) to (c), (2b), and (2c).

[39] Firms would have to apply to the PRA for the modification by consent, as described in Chapter 4 of the proposed new SF SoP. For the avoidance of doubt, while this option would be based on a firm's own assessment, the PRA would still have the power to review the firm's assessment and refuse to grant the modification by consent or revoke the permission if it does not agree with the firm's assessment.

PRA objectives analysis for Proposals 1 and 2

8.32 The assessment of the impact of Proposals 1 and 2 on the PRA's primary and secondary objectives is generally as set out in Chapter 1 – Overview. Additional considerations in respect of specific proposals are set out in the following paragraphs.

Additional objectives analysis considerations for the proposal relating to restatement of CDR Article 207

8.33 Given the potential materiality of LACDT adjustments and inherent uncertainties relating to projection of future taxable profits following a 1:200 stress, the PRA considers it appropriate to propose a waiver/permission approach for restatement of CDR Article 207, consistent with the second approach set out in paragraph 1.33 of Chapter 1 – Overview. The PRA considers that this approach would advance its primary objectives, in that the default position in the PRA rules would be a presumption that recognition of probable future taxable profits is not permitted. This would be supplemented by a framework to permit limited recognition of probable future taxable profits by a firm within its LACDT adjustment, where it meets the 175% SCR ratio requirement and criteria specified in paragraph 8.31(a), to be applied through a proportionate mechanism (ie modification by consent). Recognition of probable future taxable profits by a firm that doesn't meet the 175% SCR ratio requirement, or recognition of a larger amount would be subject to a more extensive waiver or modification application, as described in paragraph 8.31(b).

8.34 The PRA further considers that its proposal to restate Article 207 would advance its secondary competition objective. Particularly relevant to this consideration is the proposed new modification by consent option described in paragraph 8.31(a), which would make it easier and less costly for some firms to recognise a limited amount of probable future taxable profits in their LACDT adjustments, where they meet the 175% SCR ratio requirement and other specified criteria.

8.35 The PRA also considers that its proposal to restate CDR Article 207 would contribute to advancing its secondary competitiveness and growth objective, by introducing a new, proportionate option for firms as regards recognition of probable future taxable profits in the calculation of their LACDT adjustments (as described in paragraph 8.31(a)). This would increase the attractiveness of the UK's insurance prudential regulatory framework to potential new entrants.

Cost benefit analysis for Proposals 1 and 2

8.36 The assessment of the costs and benefits associated with Proposals 1 and 2 are generally as set out in Chapter 1 – Overview. Additional considerations in respect of specific proposals are set out in the following paragraphs.

Additional cost benefit analysis considerations for the proposal relating to restatement of CDR Article 219 and ITS 2015/498 Article 6(b)

8.37 The PRA considers that its proposal to change the current implicit requirements in CDR Article 219 (as described in paragraph 8.22) and Article 6(b) of ITS 2015/498 (as described in paragraph 8.23) to explicit requirements in the PRA Rulebook would not introduce additional costs for firms. Furthermore, the PRA considers that its proposal would benefit firms by providing additional clarity without changing the substance of the requirements.

Additional cost benefit analysis considerations for the proposal relating to restatement of CDR Article 207

8.38 The PRA considers that both the nature and the costs to firms of preparing documentation for the application described above in paragraph 8.31(b) are not expected to differ from those necessary to demonstrate compliance with the criteria in the matters currently required by CDR Article 207, for which a firm must demonstrate 'to the satisfaction of the PRA' that future taxable profits are probable and available. The PRA expects no material change to the costs and benefits of these proposals for firms from those associated with firms' compliance with the current provisions of CDR Article 207. In assessing the costs and benefits of the provisions relating to recognition of future taxable profits and LACDT, the PRA considers that the costs of administering and complying with those provisions will continue to be commensurate with the potential for the LACDT adjustment to materially affect a firm's SCR.

8.39 The PRA expects that the costs to firms of the proposed modification by consent option described above in paragraph 8.31(a) would not be material and the potential benefits to a firm's SCR calculation would exceed the cost of application. The PRA considers that the proposed modification by consent would be a proportionate mechanism to give firms which meet the 175% SCR ratio requirement and other specified criteria the option to recognise a limited amount of probable future taxable profits within their LACDT adjustments without incurring the costs associated with an application in respect of the option described in paragraph 8.31(b).

'Have regards' analysis for Proposals 1 and 2

8.40 The 'have regards' analysis of Proposals 1 and 2 is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview. Additional considerations in respect of specific proposals are set out in the following paragraphs.

Additional 'have regards' considerations for the proposal relating to restatement of CDR Article 219 and ITS 2015/498 Article 6(b)

8.41 The PRA considers that its proposal to change the current implicit requirements in CDR Article 219 (as described in paragraph 8.22) and Article 6(b) of ITS 2015/498 (as described in paragraph 8.23) to explicit requirements in the PRA Rulebook is consistent with the principle of transparency in the following 'have regards'. The proposal is intended to provide firms with increased clarity as regards those requirements:

- transparent exercise of the PRA's functions, and
- LRRA principles of good regulation (in particular relating to transparency and consistency).

Additional 'have regards' considerations for Proposal 2

8.42 The PRA considers the following factors, to which the PRA is required to 'have regard', as significant in shaping Proposal 2, including its proposal to restate CDR Article 207 as set out in paragraphs 8.29 to 8.31 above:

1. **Proportionality (FSMA regulatory principles):** The PRA considers that the proposed approach to restate CDR articles set out in Table 8F, ie retention of objective criteria in rules coupled with a notification requirement in lieu of PRA assessment, would lead to more proportionate outcomes for firms. In terms of recognition of probable future taxable profits in firms' LACDT adjustments, the PRA considers the proposed modification by consent option described in paragraph 8.31(a) to be a proportionate mechanism to permit firms which meet the 175% SCR ratio requirement and other specified criteria to recognise a limited amount of probable future taxable profits within the calculation of their LACDT adjustments.
2. **The need to use the PRA's resources in the most efficient and economical way (FSMA regulatory principles):** The PRA considers that the proposed approaches to restatement of the CDR articles set out in Table 8F and CDR Article 207 on LACDT would lead to an efficient and economical use of its resources. For the areas covered in Table 8F, firms would notify the PRA where they comply with the relevant objective criteria set out in the rules, instead of the existing requirement to demonstrate their compliance to the satisfaction of the PRA, thereby freeing up supervisory resources to consider more material matters. With regard to reviewing firms' recognition of probable future taxable profits in their LACDT calculations, the PRA would rely on firms' own assessments in respect of modest recognition of such amounts in the circumstances set out in paragraph 8.31(a). This would permit the PRA to devote supervisory resources to reviewing applications from firms in respect of the option described in paragraph 8.31(b), ie for firms that don't meet the 175% SCR ratio requirement for modification by consent, or those seeking more material recognition.

Proposal 3: Conversion of EUR-denominated amounts to GBP

8.43 Several Standard Formula articles in the CDR contain amounts denominated in euros (EUR). The PRA proposes to convert all EUR-denominated amounts appearing in CDR articles to pounds sterling (GBP) when restating them in the PRA Rulebook, using the same approach set out in Chapter 10 of CP12/23 and subsequently adopted in PS2/24.

8.44 The proposed approach 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. The same substantive reasons for taking this approach apply as previously set out in CP12/23 and subsequently confirmed in PS2/24 (ie 31 December 2020 being an appropriate reference date as it was the day on which EU law ceased to apply in the UK).

8.45 The conversion of EUR-denominated amounts to GBP goes beyond the restatement of assimilated law. However, the PRA does not expect this proposal to have a material impact on UK Solvency II insurance firms.

8.46 Table 8G lists the CDR articles for which the PRA proposes to convert EUR-denominated monetary values to GBP, together with the proposed GBP value using an exchange rate of £1 = €1.13, rounded to two significant figures (to ensure the resulting GBP figures remain clear and simple for firms). It also contains the same information for values in GBP converted using a counterfactual rate of £1 = €1.14 (see CBA paragraphs 8.50 to 8.60 below).

Table 8G: Conversion of amounts denominated in euros (€) to GBP (£) and comparison of the impact of using different conversion rates.

Article	Title of article	EUR (€)	Proposed rate of 1.13 GBP (£)	Counterfactual rate of 1.14 GBP (£)
Non-Life Underwriting risk module				
129(1)	Motor vehicle liability risk sub-module	6,000,000 50,000	5,300,000 44,000	5,300,000 44,000
129(1)(a), (b)	Motor vehicle liability risk sub-module	24,000,000	21,200,000	21,100,000
130(2)(a)	Marine risk sub-module	250,000	220,000	220,000

Article	Title of article	EUR (€)	Proposed rate of 1.13 GBP (£)	Counterfactual rate of 1.14 GBP (£)
Market risk module				
168a(1)(f)(i), (ii)	Qualifying unlisted equity portfolios	10,000,000	8,800,000	8,800,000
176a(3)(g)(v)	Internal assessment of credit quality steps of bonds and loans	10,000,000	8,800,000	8,800,000
176c(3)(e)	Assessment of credit quality steps of bonds and loans based on an approved internal model	10,000,000	8,800,000	8,800,000
Counterparty default risk module				
191(4)	Mortgage loans	1,000,000	880,000	880,000

PRA objectives analysis for Proposal 3

8.47 The PRA considers that its proposal to convert EUR-denominated amounts in CDR articles to GBP when restating them within the PRA Rulebook would provide greater certainty to firms by removing the potential effects of exchange rate fluctuations, thereby advancing the PRA's primary objectives of safety and soundness and policyholder protection. For example, the proposals would ensure that exchange rate fluctuations observed over time would not affect the values used within the calculation of the SCR using the Standard Formula.

8.48 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. The proposal would also increase stability in the SCR calculation for Standard Formula firms by removing uncertainty from fluctuating exchange rates.

8.49 The PRA also considers that the proposals would contribute to advancing its secondary competitiveness and growth objective. Removing uncertainty from fluctuating exchange rates

would increase the stability and predictability of the UK's prudential regulatory framework for insurers, which in turn would increase its attractiveness to potential new entrants. The PRA considers that there are no international standards relevant to this assessment.

Cost benefit analysis for Proposal 3

8.50 The baseline for the CBA for Proposal 3 is the simple restatement of requirements as for the majority of the proposals in this CP, without the proposal to convert EUR denominated amounts in CDR articles to GBP when restating them in the PRA Rulebook.

8.51 The PRA has also identified a counterfactual exchange rate of £1 = €1.14 as at year end 2023, in line with the PRA's latest annual guidance on interpreting the Euro-Sterling value for insurance regulatory purposes.[40] The PRA recognises that there are some limitations associated with this counterfactual rate in that it represents just a point in time exchange rate, as opposed to the average of daily exchange rates (over the year 2020) in the central proposal. Relying on a point in time exchange rate to convert EUR denominated amounts to GBP would be subject to happenstance. Use of the counterfactual rate to convert EUR-denominated amounts in Table 8G would also be inconsistent with the conversion of other EUR-denominated numerical values within assimilated law restated by the PRA in its Rulebook following PS2/24. Nevertheless, the PRA considers that this is an appropriate counterfactual, given that it is the exchange rate firms would use for regulatory purposes when converting the EUR amounts in Table 8G to GBP for year end 2023 regulatory returns.

8.52 For the purposes of the CBA, the same considerations identified for the proposals set out in Chapter 10 of CP12/23 (which were subsequently adopted in PS2/24) apply to Proposal 3.

Benefits

8.53 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 considers that the proposal would benefit firms by changing the currency of amounts in capital requirements rules in Table 8G to match the currency of the majority of UK Standard Formula firms' assets and liabilities. The proposal would remove the need for firms to convert EUR-denominated amounts to GBP when calculating their SCRs, thereby making it easier for firms to comply with PRA rules.

8.54 The PRA also considers that Proposal 3 would benefit firms by removing variability in SCR Standard Formula requirements and the potential impacts on firms' SCRs stemming from fluctuations in the EUR/GBP exchange rate.

[40] **EUR-Lex - C/2023/00273 - EN - EUR-Lex (europa.eu)**.

8.55 In addition, the PRA considers that there are benefits in proposing an exchange rate derived from the average of daily exchange rates over a suitably long period (eg the 12-month period up to the date on which EU law ceased to apply in the UK) as compared to the use of a point in time exchange rate (eg the year end 2023 exchange rate). Ie the proposed rate is less exposed than the counterfactual rate to short-term variations in the EUR/GBP exchange rate.

8.56 Furthermore, Proposal 3 is consistent with the conversion of other EUR-denominated amounts confirmed in PS2/24, and the PRA considers that there are benefits in adopting a consistent currency conversion rate when restating EUR-denominated numerical amounts in assimilated law within the PRA Rulebook.

Costs

8.57 UK Solvency II Standard Formula firms that are exposed to the risks covered by the CDR articles identified in Table 8G would be affected by the proposal. The PRA expects that the additional costs for firms associated with Proposal 3 would stem from updates to the methodologies, processes and documentation relating to calculation of their SCRs using the Standard Formula, to reflect the new GBP-denominated amounts. However, the PRA does not expect these additional costs to be material.

8.58 The impact on firms' SCRs would vary for each firm depending on its individual risk profile. The exact impact on SCRs is not clear, given that the euro-denominated amounts appear in non-linear functions within SII formulas and in threshold criteria where the outcome and resulting treatment is binary (eg for CDR Article 168a, where a company either has an annual turnover exceeding EUR 10 million or it does not). For the purposes of this CBA, it is not possible to say what the general impact of the proposal on firms' SCRs would be, as it would depend on firm-specific circumstances. However, the PRA expects the overall impact of the proposal on capital requirements would be minimal, as described in the next paragraph.

8.59 The PRA has considered the costs associated with using the proposed exchange rate (£1 = €1.13) as compared to a counterfactual exchange rate of £1 = €1.14 (as described above in paragraph 8.51), to convert the EUR-denominated amounts in Table 8G to GBP. The results, also presented in Table 8G, indicate that there is no difference in the GBP values produced between the proposed and counterfactual rates, except for an immaterial difference in the figure within CDR Article 129(1)(a) and (b), which is £100,000 higher (0.5%) when converted at the proposed rate compared with the counterfactual rate.

8.60 Overall, the PRA considers that the benefits of its proposal would outweigh the costs.

‘Have regards’ analysis for Proposal 3

8.61 The ‘have regards’ analysis for Proposal 3 is substantially covered by the ‘have regards’ analysis set out in Chapter 1 – Overview. In addition, the PRA considers the following factors, to which the PRA is required to have regard, as significant in shaping this proposal:

1. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The PRA considers that Proposal 3 would lead to a more proportionate and transparent application of the prudential framework, by removing scope for changes in the requirements applicable to firms that stem 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 Proposal 3 would remove any potential uncertainty in SCR Standard Formula requirements arising from fluctuating exchange rates, thereby making it easier for firms to comply with PRA rules. The PRA considers this would enhance the competitiveness of the UK insurance market by making it more attractive to potential new entrants, eg for third-country insurers considering establishing a subsidiary or branch in the UK.

Proposal 4: Definition of the term ‘ring-fenced fund’ (RFF)

8.62 The Solvency II framework includes the concept of a RFF to identify arrangements where restrictions apply on the use of assets. Where a firm has such an arrangement, it has to make adjustments to the calculation of: i) own funds, to reflect the lack of availability of RFF own funds; and ii) the SCR, to reflect the reduction in diversification related to a RFF. The concept of a RFF features in the following CDR articles within assimilated law considered in this CP:

- Article 80: Ring-fenced funds requiring adjustments;
- Article 81: Adjustment for RFFs and MAPs;
- Article 216: Calculation of the SCR in the case of RFFs and MAPs; and
- Article 217: SCR calculation method for RFFs and MAPs.

8.63 The PRA’s proposals to restate CDR Articles 80 and 81 in the PRA Rulebook are set out in Chapter 7 – Own Funds, and the proposals to restate Articles 216 and 217 in the PRA Rulebook are set out above in Table 8B.

8.64 The PRA notes that the term RFF is not formally defined in the SII Directive or CDR.[41] The concept is described in a number of recitals in the SII Directive and CDR,[42] most notably Directive recital 49 and CDR recitals 37 and 39. Those three recitals collectively describe the key defining characteristics of a RFF, and also identify specific arrangements that should not be considered as RFFs. The recitals are supported by the content in Guideline 1 of EIOPA's Guidelines on RFFs, which sets out the characteristics and scope of RFFs.

8.65 The PRA notes that, while it has previously set its expectations as regards firms' continued compliance with the Guidelines on RFFs,[43] the SII Directive and CDR recitals will not be retained in the UK's domestic prudential regulatory insurance framework. To preserve the policy intent of those recitals and facilitate the restatement of this concept from assimilated law within PRA rules, the PRA proposes to make explicit the existing implied definition of RFF by introducing the following definition of the term in the PRA Rulebook Glossary:

> **Ring-fenced fund** means an identifiable unit of assets and liabilities where the assets are subject to restrictions that prevent them from being made available on a going concern basis to meet liabilities outside that unit.

8.66 The PRA considers that the proposed definition captures the essential defining features of a RFF set out in the key SII recitals and RFF Guideline 1, ie the restriction on a going concern basis of the use of assets for certain liabilities that form an identifiable unit. The PRA also considers that this definition is consistent with the description of RFFs set out in all relevant SII Directive and CDR recitals, and the rest of the Guidelines on RFFs (in particular, Guidelines 2 to 7). As such, the PRA considers that this definition preserves the original policy intent as regards RFFs within Solvency II.

8.67 In proposing this definition of the term RFF, the PRA expects the arrangements that would meet the definition would be the same as those that firms previously identified as RFFs and treated as such for the purposes of Solvency II. Therefore, the PRA does not intend for this proposal to have a material impact on UK Solvency II insurance firms.

PRA objectives analysis for Proposal 4

8.68 The PRA considers that the proposed definition of RFF would have no quantitative impact on firms' calculation of Solvency II own funds or SCR. The PRA also considers that the proposed definition, along with the PRA's statement of preservation of policy intent as

[41] In that the term is not defined in SII Directive Article 13 or CDR Article 1.
[42] Directive 2009/138/EC recital (49), Directive 2014/51/EU recital (36), CDR recitals (37) to (39).
[43] The PRA set its expectations regarding the **Guidelines on ring-fenced funds** in line with the approach described in the **statement of policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU**, November 2022.

regards RFFs, would provide more clarity for firms, thereby advancing its primary objectives of policyholder protection and safety and soundness.

8.69 The PRA considers that the proposed definition would advance both its secondary competition objective and secondary competitiveness and growth objective, owing to the improved clarity provided both to existing firms and potential new entrants. The PRA considers that there are no international standards relevant to this assessment.

Cost benefit analysis for Proposal 4

8.70 The baseline for the CBA for Proposal 4 is the restatement of assimilated law as set out in this CP, without the proposal to define the term RFF in the PRA Rulebook Glossary (which, in terms of policy intent, is the same as the status quo of the current Solvency II framework).

8.71 Compared with the baseline, the PRA considers that there are no additional costs for firms associated with the proposed definition of RFF.

8.72 The proposed definition of RFF would marginally benefit firms by providing added clarity on how to interpret the term RFF in the PRA's Solvency II requirements.

8.73 Overall, the PRA expects the benefits of its proposal to define the term RFF would outweigh the costs.

'Have regards' analysis for Proposal 4

8.74 The 'have regards' analysis for Proposal 4 is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview. In addition, the PRA considers the following factor, to which the PRA is required to have regard, is significant in shaping this proposal:

- **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006):** The proposal aids transparency by clarifying the meaning of the term RFF in the PRA Rulebook.

9: Investments in securitisation positions

Introduction

9.1 This chapter sets out the PRA's proposals to restate assimilated law relating to CDR Article 257 on 'Investments in Securitisation Positions' into the PRA's policy framework.

9.2 The proposal in this chapter would:

- amend the Investments Part of the PRA Rulebook by adding a new chapter 7 'Requirements for Investments in a Securitisation' (Appendix 3);
- add a new chapter to the new SoP proposed in Chapter 8 – Standard Formula (SF) – Solvency II: The PRA's approach to Standard Formula adaptations (Appendix 10) ('the SF SoP'); and
- amend the PRA's existing SoP – Solvency II: Capital add-ons (Appendix 11) to restate the reference to significant deviation from the system of governance standards of the Solvency II Directive in CDR Article 257(5).

Areas covered

9.3 CDR Article 257 is the only material within assimilated law that is covered in this chapter, it being the only article in Title I, Chapter VIII Investments in Securitisation Positions in the CDR. Article 257 comprises the following:

- Paragraph 1 contains requirements on firms relating to supervisory notification where a firm becomes aware of a failure to comply with requirements relating to risk retention in Article 6 and due diligence requirements set out in Articles 5(1), (2), and (3) of Regulation (EU) 2017/2402,[44] respectively.
- Paragraphs 2 to 4 contain requirements that apply to the PRA relating to what the PRA must do if it becomes aware of non-compliance with due diligence requirements set out in Articles 5(1), (2), and (3) of Regulation (EU) 2017/2402 by a firm which uses the Standard Formula to calculate the capital requirement for spread risk as referred to in CDR Article 178. The PRA is also consulting on restating Article 178 in its Rulebook in Chapter 8 – Solvency Capital Requirement – Standard Formula of this CP.
- Paragraph 5 implicitly places obligations on firms to comply with requirements relating to on-going management of a securitisation investment set out in Article 5(4) of Regulation (EU) 2017/2042. It also requires the PRA to assess whether failure to comply with that requirement should be considered a significant deviation from the

[44] www.legislation.gov.uk/eur/2017/2402/contents.

system of governance requirements set out in Solvency II, relevant in particular in the context of setting capital add-ons.

Proposal 1: Restatement of Article 257

9.4 The PRA proposes to restate the contents of Article 257 in its policy framework as set out in Chapter 1 – Overview. Specifically, the PRA proposes to restate:

- The requirements on firms in paragraphs 1 and 5 of Article 257 as a rule in a new chapter 7 called 'Requirements for Investments in a Securitisation' in the Investments Part of the PRA Rulebook:
    - In doing so, the PRA proposes to include within the new rule an explicit reference to Article 5(4) of Regulation (EU) 2017/2042, thereby extending the requirement on firms to report non-compliance with that article, in addition to the requirement to report breaches of Articles 5(1), (2), (3), and Article 6.
    - The PRA considers that this does not amount to a policy change, since the requirement to report non-compliance with Article 5(4) of Regulation (EU) 2017/2042 is currently implicit within paragraph 5 of Article 257. That is, the PRA proposes to change the current implicit requirement to an explicit one, thereby clarifying the existing policy intent.
    - The proposed rule combining the requirements on firms in paragraphs 1 and 5 of Article 257 is set out in Appendix 3.
- The requirements applying to the PRA in paragraphs 2 to 4 of Article 257 in Chapter 3 of the new SF SoP. This would set out the PRA's approach to imposing a proportionate increase to a firm's SCR when the circumstances described in those paragraphs of Article 257 are engaged. The proposed SoP content is included in Appendix 10.
- The requirement applying to the PRA in paragraph 5 of Article 257 in its existing SoP – Solvency II Capital add-ons (Appendix 11). This would specify that the PRA will assess whether failure by a firm to comply with the relevant requirement in Regulation (EU) 2017/2402 should be considered a significant deviation from the Solvency II system of governance requirements set out in the PRA Rulebook.

9.5 Paragraph 1 of Article 257 contains references to the terms 'originator', 'sponsor', and 'original lender', which are currently defined in Regulation (EU) 2017/2402. The PRA has already consulted on restating those terms and other relevant parts of Regulation 2017/2402 within PRA rules in CP15/23 – **Securitisation: General Requirements**. Although the terms 'originator', 'sponsor', and 'original lender' are italicised in the proposed new rule 7.1 in the Investments Part of the PRA Rulebook set out in Appendix 3, they cross refer to the local

definitions already consulted on as part of CP15/23.[45] In the event the Securitisation Rule Instrument comes into force later than planned, the PRA will set out the definitions of those terms in full in the Investments Part of the PRA Rulebook when publishing the final policy following on from the proposals in this CP.

9.6 Paragraph 1 of Article 257 also contains cross references to Regulation (EU) 2017/2042. The PRA has already consulted on restating relevant parts of Regulation (EU) 2017/2402 within PRA rules in CP15/23. The PRA proposes to update the relevant cross references to Regulation (EU) 2017/2402 in the proposed new rule 7.1 in the Investments Part of the PRA Rulebook when publishing the final policy following on from the proposals in this CP.

PRA objectives analysis

9.7 The assessment of the impact of the proposal set out above on the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

Cost benefit analysis

9.8 The costs and benefits of the proposal to restate CDR Article 257 within PRA policy materials as set out above are generally as described in Chapter 1 – Overview. The PRA considers that there would be no additional costs for firms stemming from the proposals, but there would be one additional benefit: changing the current implicit supervisory notification requirement for breaches of Article 5(4) of Regulation (EU) 2017/2042 in paragraph 5 of CDR Article 257 to an explicit one in the Investments Part of the PRA Rulebook. The PRA considers that this proposal would clarify the notification requirement for firms but not change the substance of the notification obligation.

'Have Regards' analysis

9.9 The analysis of 'have regards' relevant to the proposal set out above is substantially covered by the 'have regards' analysis set out in Chapter 1 – Overview. In addition, the PRA considers its proposal to change the current implicit supervisory notification requirement for breaches of Article 5(4) of Regulation (EU) 2017/2042 in paragraph 5 of CDR Article 257 to an explicit one in the Investments Part of the PRA Rulebook is consistent with the principle of transparency in the following 'have regards', as the proposal is intended to provide firms with increased clarity over the relevant supervisory notification requirements:

- Transparent exercise of the PRA's functions; and

[45] 'Local definitions' here means defined terms that are included within a specific Part of the PRA Rulebook, rather than appearing within the Rulebook Glossary.

- LRRA principles of good regulation (in particular relating to transparency and accountability).

10: Systems of governance

Introduction

10.1 This chapter sets out the PRA's proposals to restate in the PRA Rulebook, with the relevant modifications described in this chapter but no substantive changes to the underlying policy, Articles 2, 304(1)(c) and 306, along with Articles 258-275 from CDR Title I, Chapter IX. The content of these provisions is outlined below, and covers in particular systems of governance, risk management system, remuneration, the use of expert judgement, and the appropriate management of any conflicts of interest that may arise within insurance firms and groups.

10.2 These proposals would result in changes to the Conditions Governing Business, Group Supervision, Third Country Branches, and Own Funds Parts of the PRA Rulebook.

Areas covered

10.3 The scope of this chapter is CDR Articles 2, 258-275, 304(1)(c) and 306.

Proposal 1: Restatement of systems of governance assimilated law

10.4 Good governance and risk management is fundamental to the effective and sound management of insurers, as well as being a key element of the regulatory framework to promote the safety and soundness of insurers and the protection of their policyholders. Key factors in many past failures of insurers[46] were a lack of effective governance and controls, or poor risk management.[47] In addition, the effective management of risk by insurers should help to facilitate the efficient allocation of capital and investment within the economy.

10.5 The PRA proposes to restate the provisions from Articles 2, 258-275, 304(1)(c) and 306 of the CDR in its PRA Rulebook with no material changes, though with some minor changes as described at paragraphs 10.8-10.15 below. As shown in the mapping table (see Appendix 2), most of these provisions would be added to the Conditions Governing Business (CGB) Part of the PRA Rulebook. Wherever possible, the CDR provisions have been added

[46] Failures and near misses in insurance: **www.eiopa.europa.eu/publications/failures-and-near-misses-insurance_en**.
[47] Available at: **www.knf.gov.pl/knf/pl/komponenty/img/Prudential_supervision_of_insurance_undertakings_18431.pdf**.

alongside the relevant current CGB rules deriving from the Solvency II Directive, so as to make the PRA Rulebook more accessible.

10.6 The amendments to the PRA Rulebook (Appendix 3) also show how the CDR Articles that have been considered in this chapter would be applied for groups and third country branches through the Group Supervision and Third Country Branches Parts of the PRA Rulebook respectively. For third country branches, all the CDR Articles, other than Article 258(4) and those Articles (or parts thereof) that refer to own funds, internal models, or the SCR (which, as indicated in Chapter 1 – Overview and after taking account of the reforms set out in PS2/24, are deemed not to be relevant for branch operations), are being restated through amendments to Third Country Branches 7 in the PRA Rulebook (Appendix 3). These rules for groups and third country branches would need to be applied in accordance with the other provisions in Group Supervision 17, and Third Country Branches 7, respectively of the PRA Rulebook.

10.7 The PRA considers that all the provisions in Chapter IX of the CDR, along with Articles 2 and 306, remain relevant to the ongoing sound governance and management of insurers, and is not proposing any substantive policy changes when it restates these provisions in the PRA Rulebook.

10.8 However, the PRA considers that the provisions in Article 273(2)-(4) of the CDR are already sufficiently covered by the rules in the Insurance – Fitness and Propriety 2 and Conditions Governing Business 2 Parts of the PRA Rulebook, along with the PRA's expectations that are set out in SS35/15 – **Strengthening Individual Accountability in Insurance**. Accordingly, the PRA proposes not to restate the material from Article 273(2)-(4).

10.9 The PRA proposes to restate CDR Article 267(3) by requiring firms to be able, upon request by the PRA, to undertake an external independent valuation or verification of the value of their material assets and liabilities. The PRA notes that it would be able to consider the exercise of its available powers, through either s166 or s55M of FSMA, to require such an external valuation to take place, if it has concerns over the valuation by firms of their assets or liabilities**.**

10.10 The PRA proposes not to restate the provisions in Article 260(2)-(4) which define the term 'expected profit in future premiums' in the PRA Rulebook, as this definition is no longer needed. The timing and volatility of future profits would still though need to be taken into account as part of the ongoing liquidity risk management of the insurer through application of the provisions in Article 260(1)(d) of the CDR which is being restated in the PRA Rulebook.

10.11 The PRA considers that the final sentence in Article 271[48] would be unnecessary, as the PRA is not proposing to prevent an insurer's internal audit function from carrying out additional audit activities, and in addition, the audit plan can be updated or supplemented with the agreement of the governing body**.** Accordingly, the PRA proposes not to restate the final sentence of Article 271 in its PRA Rulebook.

10.12 The PRA proposes to make some clarifications to the wording of these Articles when these are restated to its PRA Rulebook. In particular, the PRA proposes to clarify that, consistently with the application of international standards, investment risk management would include actions to be taken to ensure that the insurer's investments take account of its asset liability management policy (that is set in accordance with Articles 260(1)(b) and 260(1)(d)(ii) of the CDR). In addition, the PRA proposes to clarify that the two persons effectively running an insurer should be natural persons, as already envisaged in the operation of the Senior Managers Regime for insurers (see paragraph 2.4 of SS35/15).

10.13 The PRA proposes to amend the phraseology in CGB 2.4(1) to say that insurers must 'establish, implement, and maintain' policies and adequate procedures rather than 'have in place' written policies for consistency with the terminology of the corresponding Articles in the CDR. The PRA proposes to amplify the wording of CGB 2.5, so as to include also the relevant provisions that are being brought over from the CDR.

10.14 As discussed in Chapter 1 – Overview, the PRA proposes to replace the explicit and implicit references to 'compliance with rules, regulations and administrative provisions implementing the Solvency II Directive' in CGB 4.2(1) and CGB 7.1, by 'compliance with all of its obligations under the PRA rules and FSMA and any other laws, rules, regulations and administrative provisions deriving from FSMA that apply to UK Solvency II firms'.

10.15 The PRA proposes to refer to an insurer's 'governing body' in these rules rather than to the 'administrative, management and supervisory body' for consistency with the convention followed in the PRA Rulebook. Some of the phraseology of the CDR Articles has been amended slightly to reflect the language used in the PRA Rulebook.

PRA objectives analysis

10.16 The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview. The PRA considers that the clarifications of the provisions described at above would not change this assessment.

[48] 'Where necessary, the internal audit function may carry out audits which are not included in the audit plan.'

Cost benefit analysis

10.17 The costs and benefits of the proposals to restate existing CDR provisions into the PRA policy materials are as set out in Chapter 1 - Overview. The additional clarifications should improve the accessibility, proportionality, and transparency of the PRA Rulebook, without imposing any material additional costs on insurers as they would already be expected to have a governance and risk management framework in place that meets the proposed requirements in these restated provisions.

'Have regards' analysis

10.18 The Have Regards analysis for the restated CDR provisions is the same as the analysis described in Chapter 1 – Overview. In addition, the clarifications proposed in this chapter should help to facilitate the application of a transparent and proportionate approach for governance and risk management by insurers.

11: Extension of the recovery period

Introduction

11.1 This chapter sets out the PRA's proposals in relation to the extension of the 'permissible recovery period' for insurers that encounter financial difficulty, and the factors the PRA will consider in making such extension decisions. The 'permissible recovery period' is the maximum period that is allowed for an insurer to take the necessary measures to restore full cover and compliance with its Solvency Capital Requirement (SCR) following the observation of non-compliance, or where there is a risk of non-compliance with the requirement in the next three months.

11.2 The proposals in this chapter would not result in any substantive changes to the existing regulatory framework for determining a 'permissible recovery period', or the factors that will be relevant in making such determinations, but any changes in the approach have been clearly indicated.

11.3 These proposals should be read in conjunction with the PRA's proposals in CP2/24 – **Solvent exit planning for insurers**, as if an insurer were unable to take the necessary measures to restore full cover for its SCR during its permissible recovery period, then it would be expected to execute its 'solvent exit execution plan', subject to the proposals in CP2/24 being taken forward.

11.4 The proposals in this chapter would:

- amend the Undertakings in Difficulty and Group Supervision Parts of the PRA Rulebook (see Appendix 3); and
- introduce a new SoP – The PRA's approach to the permissible recovery period for insurers to restore full cover for their SCR ('the recovery period SoP') (see Appendix 12).

Areas covered

11.5 The scope of this chapter is Regulation 4A from the Solvency 2 Regulations 2015 as well as CDR Articles 288 and 289.

11.6 The existing rules in the Undertakings in Difficulty and Group Supervision Parts of the PRA Rulebook provide that a relevant insurer[49] must immediately inform the PRA as soon as

[49] UK Solvency II firms, the Society, and relevant insurance group undertakings as per rules 1.1 and 6 of the Undertakings in Difficulty Part, and rules 1.1 and 4.4 of the Group Supervision Part of the PRA Rulebook.

it observes that its SCR is no longer complied with, or there is a risk of non-compliance in the next three months. The regulatory framework specifies that a relevant insurer must take the necessary measures within six months (or such longer period as the PRA may determine) to re-establish the level of eligible own funds covering its SCR or the reduction of its risk profile to ensure compliance with the SCR.

11.7 Those rules were implemented in accordance with requirements transposed from the Solvency II Directive (Article 138) by Regulation 4A in the Solvency 2 Regulations 2015.[50] That regulation specifies that the PRA may extend the six month period by up to three months, or where the **Prudential Regulation Committee** (PRC) has declared the existence of an 'exceptional adverse situation' as per the conditions specified in the regulation, by up to a maximum of 7 years.

11.8 Articles 288 and 289 of the CDR set out the relevant factors and criteria that the PRC must consider before declaring the existence of an 'exceptional adverse situation', and when determining the length of any extension to the permissible recovery period for an individual relevant insurer.

Proposal 1: Restatement of Regulation 4A

11.9 The PRA proposes to restate Regulation 4A(1) through the application of the Undertakings in Difficulty and Group Supervision Parts of the Rulebook, and by setting out the PRA's policy for the maximum length of any extension in the proposed recovery period SoP. The PRA proposes to amend the relevant rules in those Parts to make clear that firms can be granted an extended recovery period through seeking a permission or rule modification.

11.10 The PRA proposes to restate Regulation 4A(2)-(6) in the proposed recovery period SoP. This will set out the circumstances and factors that the PRA would consider when determining whether to declare the existence of an 'exceptional adverse situation' affecting relevant insurers representing a significant share of the market or affected lines of business, and how it would consider whether to extend the permissible recovery period (by up to a maximum of seven years) for individual insurers in such a situation. The PRA proposes in the SoP that any such declaration would be made by the PRA, rather than directly by the PRC, as this is the normal convention, but this will not amount to any material change in process.

11.11 The PRA proposes in the recovery period SoP that the circumstances in which it would expect to make a declaration of an exceptional adverse situation would be the same as those

[50] S.I. 2015/575.

currently set out in the Solvency 2 Regulations (and Article 288 of the CDR – See Proposal 2 below).

11.12 In the absence of an 'exceptional adverse situation', the PRA proposes in the recovery period SoP that it would apply the criteria in s138A of FSMA when considering an application for an extension of the permissible recovery period, and would in particular take into account the impact of an extension on those who are or may become policyholders and beneficiaries of the insurer.

11.13 The PRA proposes in paragraph 3.4 of the recovery period SoP (see Appendix 12) to restate the approach set out in the Solvency 2 Regulations for the withdrawal of an extension of the permissible recovery period following the receipt of a report showing that unsatisfactory progress has been made. However, the PRA proposes not to make this withdrawal mandatory as is required currently by the Solvency 2 Regulations, rather it will be for the PRA to determine in the light of the particular circumstances at the time.

11.14 The PRA proposes in paragraph 3.5 of its recovery period SoP (see Appendix 12) to maintain the approach that was set out in Chapter VII of the Solvency II Directive and related UK law, as the PRA would need to take relevant action in the circumstances described in that paragraph to ensure that there would not be any adverse effect on the advancement of any of its objectives, including consideration of the effect that the carrying on of the business of effecting contracts of insurance might be expected to have on those who are or may become policyholders of the relevant insurer.

11.15 The PRA proposes to make the necessary consequential amendments to the Undertakings in Difficulty Part rules 3.1(3) and 3.2, and Group Supervision Part rule 4.4 to reflect the policy described above as a result of the revocation of the Solvency 2 Regulations and CDR.

Proposal 2: Restatement of CDR Articles 288 and 289

11.16 The PRA proposes to restate the content of CDR Article 288 regarding the factors to take into account when declaring an exceptional adverse situation in the recovery period SoP. As the PRA cannot be certain in advance of all the circumstances that could lead to, or appertain to, a declaration of an exceptional adverse situation, it proposes that it would take a decision at the relevant time in line with all the then relevant factors, its statutory objectives, and the legislative framework.

11.17 The PRA proposes to restate the content of CDR Article 289 regarding the factors and criteria to determine the extension of the recovery period in the recovery period SoP. The PRA proposes to include as a factor the level of cover for the insurer's Minimum Capital Requirement (MCR).

11.18 However, the PRA proposes not to commit itself in advance to the exact circumstances in which such an extension to the permissible recovery period would be considered, or to the length of this extension subject to the maximum limit; as this could pre-empt its normal decision making processes. In addition, the PRA would expect relevant insurers to maintain their own proper financial disciplines to maintain cover for their SCR, and to have detailed their preparations for a 'solvent exit' in their 'Solvent Exit Analysis' so that if the need arises, they can execute their 'Solvent Exit Execution Plan' in an orderly manner.

PRA objectives analysis

11.19 The proposals in this chapter generally relate to the restatement of assimilated law within the PRA's policy framework. The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

11.20 The proposal to include some additional flexibility in the framework in an exceptional adverse situation would also contribute to advancing the PRA's safety and soundness objective through seeking to minimise any adverse effect on financial stability, either from relevant insurers having to implement their recovery plans simultaneously in a short period of time, or from the potential exit of multiple insurers from the market in such adverse conditions, if the recovery period could not be extended.

11.21 The proposal to include the level of cover over the MCR as a relevant factor when deciding whether the recovery period should be extended is directly relevant to advancing the PRA's policyholder protection objective.

11.22 The PRA has assessed whether the proposals in this chapter facilitate effective competition and considers that this objective would be met as explained in Chapter 1 – Overview. In addition, the proposals in this chapter for some additional flexibility in the framework for enabling an extension of the recovery period in an exceptional adverse situation would facilitate effective competition through enabling insurers to have an appropriate length of time to implement their recovery plans to restore the cover for their SCR, following any non-compliance with this requirement, rather than necessitating an immediate exit of the insurer from the market.

Cost benefit analysis

11.23 The costs and benefits of the proposals to restate existing CDR provisions into the PRA policy materials are as set out in Chapter 1 – Overview. The PRA considers that its own costs to operate the proposed framework would not be materially higher than at present, notwithstanding the slightly greater flexibility contained in these proposals.

‘Have regards’ analysis

11.24 The Have Regards analysis for the proposals in this chapter is generally the same as the analysis described in Chapter 1 – Overview. The slight proposed changes to the framework should facilitate a proportionate regime that can take account of the corporate structure of insurers, as well as the nature and objectives of their business; and that makes efficient use of regulatory resources.

12: Public Disclosure

Introduction

12.1 The PRA proposes to restate certain public disclosure regulations from the SII CDR into the Reporting Part of the PRA Rulebook, SS40/15 and the PRA SoP on Solvency II regulatory reporting waivers. Additionally, the PRA proposes to restate certain parts of the **EIOPA Guidelines on reporting and disclosure** (Guidelines) into SS40/15 that continue to remain relevant to the application of the requirements set out in the Reporting Part of the PRA Rulebook.

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

- the Reporting Part of the PRA Rulebook (see Appendix 3);
- SS40/15 – Solvency II: reporting and public disclosure options provided to supervisory authorities (see Appendix 13);
- SoP – Solvency II regulatory reporting waivers (see Appendix 14); and
- SoP – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU (see Appendix 15) – deletion of single reference to the guidelines on reporting and public disclosure from Appendix 1 of this SoP.

Areas covered

12.3 This chapter will cover the restatement of CDR Public disclosure requirements in the PRA Rulebook. This encompasses the following CDR contents:

- Articles 290-303 on solo disclosure;
- Articles 359-371 on groups disclosure; and
- Annex XX on the structure of the Solvency and Financial Condition Report.

12.4 The PRA's approach has been to restate only those provisions that are still relevant. Therefore, irrelevant and outdated provisions, such as those relating to transitional arrangements or requirements deleted in PS3/24 – Solvency II review: Reporting Phase 2, are not proposed for restatement. This includes CDR Articles 303, 364 and 371. Appendix 2 to this CP includes a mapping exercise to identify the individual CDR articles, recitals, and Guidelines, to be restated, along with their new location in the PRA Rulebook.

12.5 In addition, some minor amendments have been made to provisions previously consulted on under PS3/24, in order to align them to the approach undertaken under this consultation.

Proposal 1: Restatement of Public Disclosure requirements

12.6 The PRA proposes to restate CDR Articles 290-298, 299(2), 300-302, 359-363, 365-370 and Annex XX in the Reporting Part of the PRA Rulebook. The provisions include those that pertain to the structure and detail of the required contents of the Solvency and Financial Condition Report (SFCR); and the means, format, and deadlines of disclosure; and where information is voluntarily disclosed or needs to be updated.

12.7 The PRA proposes not to restate Article 295(5) of the SII CDR regarding the disclosure of the total amount of the expected profit included in future premiums (EPIFP) in the SFCR. In **PS3/24**, the PRA set out its decision to amend the template instructions to clarify that the EPIFP requirement is being removed from all reporting, including disclosure. For this reason, the PRA considers that there would be little prudential value in retaining the requirement to disclose this information in the SFCR.

12.8 The PRA proposes restating CDR Article 299(1) in SoP – Solvency II regulatory reporting waivers, which informs firms of the PRA's expectation that waivers approved for non-disclosure of information in the SFCR are granted only for as long as the reason to not disclose exists.

Proposal 2: Restatement and consolidation of existing expectations into SS40/15

12.9 The PRA proposes to restate recital 115 of the CDR, relating to the PRA's proportionate expectation on disclosure into SS40/15. The PRA considers this a signpost to firms to the PRA's expectations in how disclosure information should be prepared.

12.10 Additionally the PRA proposes to restate part of the Guidelines on reporting and disclosure into SS40/15. The decision to review the Guidelines at this time was motivated by the deletion of the RSR as set out in PS3/24. As the Guidelines contain a significant volume of information specific to the RSR, the PRA considered the explicit removal of any expectation to comply with these Guidelines would provide clarity for firms on the PRA's expectations regarding reporting and disclosure.

12.11 The PRA considers that Guidelines 1 to 15 and 30-34 and 36-37 remain relevant and accordingly proposes that they should be restated in SS40/15, omitting any references to the RSR. The restated provisions include expectations related to: (a) information that should be

disclosed in the SFCR; and (b) when to notify the PRA about events that could reasonably lead to material changes; and expectations related to reporting, as well as firms' policies in relation to reporting and disclosure. These provisions supplement the SII CDR material being restated in PRA Rules. The proposed restatement of this content together aims to preserve and consolidate the existing requirements and expectations of firms in meeting their SFCR disclosure requirements.

12.12 The PRA would not restate any content in respect of the Regular Supervisory Report (RSR) which has been deleted following PS3/24. The PRA consequently proposes to delete reference to these Guidelines from its SoP on Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU.

12.13 The PRA proposes to restate select provisions from SS15/15 into SS40/15 as a result of the proposed deletion of SS15/15 mentioned in Chapter 15 – Consequential Amendments of this CP. The PRA proposes to restate content from 5.13 and 5.14 relating to SFCR dispensation, which remains relevant to firms.

PRA objectives analysis

12.14 The assessment of these proposals in terms of the PRA's primary and secondary objectives, apart from the one exception set out in the following paragraph, is described in Chapter 1 – Overview. The PRA considers the proposed removal of the requirement to disclose EPIFP in the SFCR advances its secondary competitiveness and growth objective by reducing disclosure requirements on firms that are deemed to have low prudential value.

Cost benefit analysis

12.15 The costs and benefits of the proposals to restate existing CDR provisions into the PRA policy materials are as set out in Chapter 1 – Overview. The PRA's proposal to remove the requirement to disclose EPIFP in the SFCR recognises that continuing to provide this information places a burden on firms and incurs costs. Removing the requirement to disclose EPIFP in the SFCR would reduce these costs.

12.16 The PRA has set out an expectation that firms should continue to comply with the Solvency 2 EIOPA Guidelines where these are relevant. Accordingly, the PRA considers that EIOPA Guidelines being retained should already be being followed by firms. The proposals therefore are not considered to result in any additional costs or benefits.

‘Have regards’ analysis

12.17 The Have Regards analysis is generally the same as the analysis described in Chapter 1 – Overview.

In addition, the following Have Regards were significant in the PRA’s analysis of the proposal:

1. **Promoting the government’s strategy to promote competitiveness and its priorities:** The proposal to remove the requirement to disclose EPIFP in the SFCR promotes competitiveness by reducing disclosure requirements on firms that are deemed to have low prudential value.
2. **Transparent exercise of the PRA’s functions:** The PRA proposals to incorporate relevant parts of the Guidelines into SS40/15 provides transparency to firms on the PRA's expectations of relevance of the remaining onshored EIOPA reporting and disclosure requirements.

13: Insurance Special Purpose Vehicles

Introduction

13.1 This chapter sets out the PRA's proposals to restate regulations relating to UK Insurance Special Purpose Vehicles (ISPVs) from the CDR and Commission Implementing Regulation 2015/462 (CIR) to the PRA Rulebook and policy materials. This consultation focuses on the restatement of ISPV requirements in PRA policy materials, which will be an enabler for future reform of the ISPV framework. Those reforms will be subject to a separate consultation in due course.

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

- the ISPV Part of the PRA Rulebook (see Appendix 3); and
- SS8/17 – Authorisation and supervision of UK insurance special purpose vehicles (see Appendix 16).

Areas covered

13.3 This chapter covers the restatement of CDR Articles 318-327 and Commission Implementing Regulation 2015/462 (CIR).

13.4 Some of these CDR and CIR Articles create requirements on UK ISPVs and the PRA proposes that they be restated in the PRA Rulebook. Conversely, certain CDR and CIR provisions set out considerations relevant for the authorisation of a UK ISPV, and the PRA proposes to amend SS8/17 to explain the PRA's approach, including in relation to authorisation of UK ISPVs.

13.5 Specifically, the PRA proposes to:

- restate to the ISPV Part of the Rulebook:
    - CDR Articles 319, 320, 321, 322, 323(2), 324, 325, 326(1) (3)(4) and 327; and
    - CIR Articles 2, 7(2), 13-18 and Annexes II and III.
- restate in SS8/17 only:
    - CDR Articles 318(c), (d) and (f)-(h) and CIR Articles 4, 6, 7(4) and Annex 1

Proposal 1: Restatement of UK ISPV requirements

13.6 The PRA proposes to restate, with some amendments:

- CDR Article 326(2) in the ISPV Part of the PRA Rulebook. This Article refers to ISPV's duty to ensure it has, at all times, assets held to cover its aggregate maximum risk exposure. This requirement is already in place, with the proposed amendments clarifying the firm-facing nature of the requirement;
- CDR Articles 318(a) and (b) in the ISPV Part of the PRA Rulebook. The proposed amendments are to clarify that these are requirements to be satisfied at all times. The PRA's expectations in relation to the conditions in Article 318 at the point of ISPV authorisation are proposed to be restate in SS8/17; and
- CIR Articles 5, 7(1) and 7(3) in SS8/17. These Articles relate to the conditions of authorisation for ISPVs and Multi-arrangement insurance special purpose vehicles (MISPVs). The proposed amendments are to clarify the ongoing nature of the expectations.

13.7 Minor amendments are proposed throughout, mainly to reflect Rulebook terminology, to restate as a firm-facing requirement where appropriate, and to update cross-references to assimilated law. The PRA considers that neither these minor amendments nor the clarifications set out in the previous paragraph, change the nature of the requirements on firms that currently apply under assimilated law.

Proposal 2: Fit and proper requirements for shareholders or members with a qualifying holding

13.8 To ensure the ongoing fitness and propriety of the qualifying holders of a UK ISPV, CDR Article 323 sets out a fit and proper requirement for UK ISPV shareholders or members with a qualifying holding. CDR Article 318(e) requires qualifying holders to be fit and proper in accordance with the criteria in CDR Article 323.

13.9 The PRA considers that the most appropriate way to restate this requirement is by requiring UK ISPVs to take reasonable steps to keep under assessment whether their shareholders or members with a qualifying holding are fit and proper, in accordance with the CDR Article 323 criteria (which will be restated in the Rulebook), and to notify the PRA if they become aware that any such shareholder or member may not be fit and proper.

13.10 On this basis, the PRA proposes that:

- the condition in CDR Article 318(e) requiring qualifying holders to be fit and proper in accordance with CDR Article 323 is restated in the ISPV Part of the PRA Rulebook and amended to reflect an ongoing requirement that the UK ISPV's assessment does not indicate that shareholders or members with a qualifying holding do not meet these criteria;

- the conditions in CDR Article 323(1) are restated in the ISPV Part of the PRA Rulebook and amended to require ISPVs to take reasonable steps to keep under assessment whether the shareholders or members with a qualifying holding in the ISPV are fit and proper; and
- A rule is added to the ISPV Part of the PRA Rulebook to require a UK ISPVs to notify the PRA as soon as it becomes aware that any shareholder or member having a qualifying holding may not be fit and proper.

PRA objectives analysis

13.11 These proposals restate assimilated law requirements within the PRA policy framework. The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

Cost benefit analysis

13.12 The baseline for the assessment of costs and benefits is the current Solvency II rules and legislation.

13.13 As noted above, the PRA considers that the minor amendments set out in Proposal 1 do not introduce additional requirements compared to the baseline. Accordingly, the costs and benefits of Proposal 1 are as described in Chapter 1 – Overview.

Costs

13.14 The PRA considers that Proposal 2 will represent minimal increased costs on ISPVs.

13.15 CDR Articles 318(e) and 323 implicitly refers to the PRA assessments of whether shareholders or members having a qualifying holding in the UK ISPV are fit and proper. The proposals as set out in Proposal 2 propose that UK ISPVs take reasonable steps to keep under assessment whether this condition of ISPV authorisation is satisfied on an ongoing basis.

13.16 The PRA considers that these proposals will impose a minimal increase in costs for UK ISPVs, as such vehicles are already required under Article 318 to meet the requirements of Articles 319 to 327 on an ongoing basis.

13.17 The PRA considers that the proposal to require a UK ISPV to notify the PRA as soon as it becomes aware that a shareholder or member with a qualifying holding may not be fit and proper, as set out in Proposal 2, should have minimal additional cost to UK ISPVs. The PRA expects that such notifications are already provided under Fundamental Rule 7, which states that an undertaking 'must disclose to the PRA appropriately anything relating to the

firm of which the PRA would reasonably expect notice'. On this basis, the PRA considers that any costs imposed on UK ISPVs by the introduction of this rule will be minimal.

13.18 The PRA expects that very few UK ISPVs will be affected by the proposals related to shareholders or members with a qualifying holding, as such undertakings typically have orphan status and are therefore structured as a separate entity with a qualifying holder that is distinct from both the ceding insurer and investors.

13.19 The PRA expects that the proposal to require a UK ISPV to notify the PRA as soon as it becomes aware that a shareholder or member with a qualifying holding may not be fit and proper, set out in Proposal 2, will result in minimal additional costs to the PRA for supervising against the proposed rules. Supervisory time and resource will be required to review and engage with UK ISPVs where notifications occur. However, given the expected infrequency of such notifications, and the expectation that such notifications should already occur as defined under Fundamental Rule 7, the PRA expects these costs to be minimal in practice.

Benefits

13.20 The PRA considers that, compared to the baseline, Proposal 2 will have minimal benefits beyond those already set out in Chapter 1 – Overview.

'Have regards' analysis

13.21 The Have Regards analysis is the same as the analysis described in Chapter 1 – Overview.

14: Insurance Groups

Introduction

14.1 This chapter sets out the PRA's proposals to restate the remaining group supervision regulations from the SII CDR in the Group Supervision Part of the PRA Rulebook. In PS2/24, the PRA published its near-final policies to restate the majority of group supervision assimilated law in the PRA Rulebook and other policy material. This chapter sets out proposals to restate the remaining assimilated law and make additional minor amendments.

14.2 The PRA proposes to:

- Proposal 1: restate CDR article 338 'Method 1 Group-Specific Parameters' into the Group Supervision Part of the PRA Rulebook, without changing its substance. This includes the restatement of two relevant EIOPA Guidelines in the relevant Statement of Policy, to clarify the continuation of the PRA's approach to permissions in this area;

- Proposal 2: specify it will give permissions to authorise the inclusion of ancillary own funds for intermediate insurance holding companies under s138BA of FSMA;

- Proposal 3: restate as guidance, without changing their substance EIOPA Guideline 6 on Mixed Activity Insurance Holding Company (MAIHC) to supervisory statement (SS) 9/15 Solvency II: group supervision;

- Proposal 4: amend cross-referencing in Group Supervision 17 to include the related PRA Rules transposing CDR articles on systems of governance that apply to insurance groups; and

- Proposal 5: make additional minor amendments.

14.3 While this chapter has been broken down into five separate proposals, none of them imply any changes from the PRA's current approach. All of the proposals relate to the restatement of current policy in different areas of the supervision of groups. This is reflected in the sections below relating to objectives analysis, cost benefit analysis and Have Regards analysis, which all refer to Chapter 1 – Overview of this CP.

14.4 The proposals in this chapter would amend:

- the Glossary and Group Supervision Part of the PRA Rulebook (Appendix 3);
- the proposed new SoP – Solvency II: The PRA's approach to Standard Formula adaptations (Appendix 10) ('the SF SoP');
- supervisory statement (SS) 9/15 – Solvency II: group supervision (Appendix 21); and

- SoP – The PRA's approach to insurance group supervision (Appendix 22) ('the group supervision SoP').

Areas Covered

14.5 This chapter will cover the restatement of CDR A338 and Regulation 45 of the Solvency 2 Regulations 2015.

Proposal 1: Group-Specific Parameters

14.6 The PRA proposes to restate CDR article 338 'Method 1: Group-Specific Parameters' (GSP) in the Group Supervision Part of the PRA Rulebook.

14.7 Currently insurance groups using method 1 may seek permission from the PRA, for the purposes of calculating their consolidated group SCR using the standard formula, to replace a subset of the standard parameters laid out in CDR article 218 by parameters specific to the group. This proposal would enable the continuation of this approach with PRA permissions.

14.8 When granting these permissions, the PRA would exercise its powers under s138BA of FSMA and would modify the PRA's rules in Group Supervision 11A on the calculation of the group SCR using the Standard Formula to allow the group to use GSP.

14.9 In assessing whether the use of GSP may be permitted, the PRA's assessment would be based on the same criteria and considerations as outlined for USP permission processes in the proposed new SF SoP. The PRA proposes not to restate CDR article 356 in the PRA Rulebook. The proposed new SF SoP sets out the PRA's policy that the application should be submitted in writing.

14.10 The PRA considers that EIOPA Guidelines 11 and 12 on USP provide important factors relevant to the approach the PRA will continue to take towards GSP permissions.[51] Accordingly, the PRA proposes to transfer those EIOPA Guidelines into the aforementioned SoP.

Proposal 2: Permissions for ancillary own funds for an intermediate insurance holding company

14.11 In PS2/24, the PRA published its near final policy on authorising the inclusion of ancillary own funds for intermediate insurance holding companies in the calculation of group solvency in paragraphs 3.9 to 3.11 of the group supervision SoP group.

[51] Paragraph 1.34 of Guideline 11 has not been brought into the SoP because it is now considered redundant given the proposal to transfer CDR A338 to the PRA Rulebook under the Method 1 sub-section of Group Supervision calculation methods.

14.12 Currently, the PRA would give approval under Regulation 45 of the Solvency 2 Regulations 2015. Going forward, when granting these permissions, the PRA would exercise its powers under s138BA of FSMA and modify Group Supervision 10.3(4). The PRA proposes changes to Group Supervision 10.3(4) and paragraph 3.9 of the group supervision SoP to reflect this approach.

Proposal 3: Group Solvency Calculations – MAIHC led group.

14.13 In PS2/24 the PRA published its near final policy on transferring and restating group supervision assimilated law relating to group solvency calculation, significant risk concentrations and significant intragroup transactions to the PRA Rulebook and other policy material.

14.14 The PRA considers that the application of group solvency rules to complex MAIHC led groups can be particularly problematic in practice given the difference in requirements for MAIHC led groups vs those applicable to an insurance holding company or a mixed financial holding company led ones. Accordingly, the PRA proposes to restate EIOPA Guideline 6 on Group Solvency in Supervisory Statement (SS) 9/15 Solvency II: group supervision. The proposal will provide clarity on the PRA's continuing expectations regarding application of group supervision when a group's ultimate parent is a MAIHC and another group type (as specified in Group Supervision 2.1 (1), (2) or (3) is present in a group structure.

14.15 In transferring at this point in time content of EIOPA Guideline 6 on Group Solvency, the PRA seeks to emphasise the fact that multiple instances of group supervision may occur within a complex insurance group and that as a result PRA group supervision will attach at multiple levels in that group, in continuation of existing policy and practice under current requirements.

Proposal 4: Group Risk Management and Internal Control requirements

14.16 Group Supervision 17 sets out the Risk Management and Internal Control requirements that apply at the level of the group, by means of cross-references to other parts of the PRA Rulebook. The PRA proposes to amend these cross-references to include areas where CDR articles on systems of governance are being transferred to the PRA Rulebook.

14.17 The PRA considers no policy change has occurred as the restatement gives effect to article 246 of the Solvency II Directive ensuring solo governance requirements apply at group level, with any necessary changes at the level of the group.

Proposal 5: Additional minor amendments

14.18 The PRA proposes to make additional amendments to the Group Supervision Part of the PRA Rulebook and the group supervision SoP, without changing their substance.

14.19 The proposed consequential amendments include:

- Basic own funds and ancillary own funds: The PRA proposes amendments to Group Supervision 6.1 and 9.6 to reflect that authorisation of own funds items not on the own funds lists and ancillary own funds will be given as a permission under s138BA FSMA as set out in Chapter 7 – Own Funds of this CP;
- Modifications in relation to Third Countries: The PRA proposes amendments to Group Supervision 20.4 to reflect the expected revocation of Regulation 36A. The possibility to modify Group Supervision 20.4, which previously referred to Regulation 36A, is proposed to be set out in a new section of the group supervision SoP. The permission will be granted based on the S138A statutory tests;
- PRA Rulebook reference to assimilated law being revoked: The PRA proposes to amend cross-references to the CDR in the Group Supervision Part of the PRA Rulebook and related policy documents. The assimilated law reference will be amended to reflect PRA rules and policy where the relevant CDR articles are restated; and
- Changes in Group Supervision 5: Group Supervision 5.2 and 5.3 set requirements that in specified circumstances firms must recalculate the group SCR and report it upon request by the group supervisor. The PRA proposes to amend these rules to clarify that in the specified circumstances firms must be able to carry out the relevant actions upon the request by the group supervisor.

PRA objectives analysis

14.20 The assessment of these proposals in terms of the PRA's primary and secondary objectives is described in Chapter 1 – Overview.

Cost benefit analysis

14.21 All of the proposals in this chapter relate to the restatement of assimilated law or reiteration of already-existing guidance. Accordingly, the costs and benefits of these proposals are as set out in Chapter 1 – Overview.

14.22 The PRA has set out an expectation that groups should continue to comply with the Solvency 2 EIOPA Guidelines where these are relevant. Accordingly, the PRA considers that EIOPA Guidelines being transferred should already be followed by groups where the PRA is group supervisor. The proposals to transfer and restate related EIOPA Guidelines is

therefore not considered to result in any additional costs or benefits to groups or the PRA other than those described in Chapter 1 – Overview.

'Have regards' analysis

14.23 The Have Regards analysis is the same as the analysis described in Chapter 1 – Overview.

15: Consequential amendments

Introduction

15.1 The PRA has previously consulted on policy materials relating to capital add-ons and the matching adjustment in **CP12/23** and **CP19/23**. The near-final policy materials relating to the proposals included in CP12/23 were subsequently published in **PS2/24.** The PRA intends to publish final policy and rules relating to the proposals in CP19/23 in 2024 Q2, in advance of implementation of the updated matching adjustment framework on 30 June 2024.

Areas covered

15.2 This chapter sets out PRA proposals relating to minor consequential amendments required as a result of the approach to restate existing Solvency II requirements in the PRA Rulebook and/or policy materials, additionally considering the reforms proposed in previous relevant consultations noted above. These amendments are intended to provide additional clarity for firms using the PRA's policy framework, and are not intended to change the nature of the proposals previously consulted on.

15.3 The proposals in this chapter would:

- add a minor consequential amendment to the SoP – Solvency II: Capital add-ons; and
- delete SS15/15: Solvency II approvals in its entirety.

Proposal 1: Capital add-ons in respect of the matching adjustment

15.4 The UK Solvency II framework currently includes a provision for the PRA to apply a capital add-on in circumstances where there is significant deviation from the assumptions underlying the MA (Article 37(1)(d) of Directive 2009/138/EC and CDR Article 278(1)). The PRA consulted in CP12/23 on bringing those provisions across to its policy framework, essentially unchanged from the framework inherited from the EU, and confirmed, in **PS2/24**, the content of the SoP – **Solvency II: Capital add-ons.**

15.5 The PRA proposed, in CP19/23, that no change would be made to its policy or practice about the potential use of capital add-ons for the MA. In the same CP, the PRA proposed setting out the conceptual and technical assumptions underpinning the MA in the new chapter 1A of SS7/18 – **Solvency II: Matching adjustment (proposed updated version)**, and noted that the PRA expects to consider these assumptions in the context of capital add-ons in respect of the MA when determining if the risk profile of a firm deviates significantly

from the assumptions underlying the MA. The PRA also noted in paragraph 7.20 of CP19/23 that it intended to consult in due course on reflecting this proposal in its proposed SoP – Solvency II: Capital add-ons. CP19/23 closed in January 2024, and the PRA will publish the details of the final policy in due course.

15.6 In order to provide further clarity for firms, a minor consequential amendment is proposed to the SoP – Solvency II: Capital add-ons as noted in paragraph 7.20 of CP19/23. This will reflect the PRA's position, set out in CP19/23, regarding 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.

Proposal 2: Deletion of SS15/15 - Solvency II: Approvals

15.7 The content of SS15/15 has been superseded by more recent policy materials, including the various proposed SoP included in this CP, as well as PS2/24 and the proposals of CP19/23. Where not separately considered elsewhere, the transfer of specific content from SS15/15 to other PRA policy materials is described below.

15.8 Following the deletion of SS15/15, the PRA proposes to transfer parts of paragraphs 4.10 and 4.11 of SS15/15 relating to ancillary own funds (AOF) into SS2/15 – **Solvency II: Own Funds**. This is to ensure that it remains clear that the PRA expects there to be no trigger event or restrictions affecting when the AOF item can be called and does not expect firms to treat AOF items as emergency capital when they are in danger of breaching their Solvency Capital Requirement (SCR). The resulting addition to SS2/15 is set out in Appendix 9.

15.9 Following the deletion of SS15/15, the PRA proposes to transfer parts of paragraph 2.5 of SS15/15 relating to transitional measures into the SoP – **Permissions for transitional measures on technical provisions and risk-free interest rates**. This is to ensure that it remains clear to firms applying for transitional measures alongside other permissions that the PRA may ask it to provide sensitivity tests if the other applications were to be rejected. The resulting addition to this SoP is set out in Appendix 6.

15.10 Following the deletion of SS15/15, the PRA proposes to transfer parts of paragraph 2.5 of SS15/15 relating to VA into the new SoP – VA permissions. This is to ensure that it remains clear to firms applying for VA alongside other permissions that the PRA may ask it to provide sensitivity tests if the other applications were to be rejected. The resulting addition to this SoP is set out in Appendix 5.

15.11 Following the deletion of SS15/15, the PRA proposes to transfer parts of paragraph 5.13 and 5.14 of SS15/15 relating to SFCR Dispensations into the new SS40/15 - **Solvency**

II: reporting and disclosure. This ensures that firms may continue to apply for reporting exemptions. The resulting addition to this SoP is set out in Appendix 13.

15.12 The PRA has therefore proposed the deletion of SS15/15, in order to streamline the set of policy materials for firms to consider and avoid repetition across policy documents.

PRA objectives analysis

15.13 The PRA considers that Proposal 1 would improve the clarity and coherence of PRA policy materials and provide relevant firms with a better understanding of the PRA approach regarding capital add-ons in relation to the MA.

15.14 Furthermore, the PRA considers that Proposal 2 would add further clarity and cohesion to the PRA's expectations for issuing permissions covered in PS2/24, CP19/23 and elsewhere in this CP.

15.15 The additional clarity afforded by both proposals would advance the PRA's primary and its secondary objectives.

Cost benefit analysis

15.16 The PRA considers that the minor amendments proposed in this chapter would enhance the clarity and coherence of PRA policy materials for firms, which is a benefit to firms by making it easier to understand the PRA's expectations in relevant areas.

15.17 The proposed changes would not affect the PRA's approach to the regulation or supervision of UK Solvency II firms. Any administrative costs to UK Solvency II firms of updating their knowledge of these changes is expected to be minimal.

'Have regards' analysis

15.18 The Have Regards analysis is the same as the analysis described in Chapter 1 – Overview.

15.19 Furthermore, the following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals in this chapter:

1. **Transparency (FSMA regulatory principles and Legislative and Regulatory Reform Act 2006)**: The proposals aid transparency by clarifying the PRA's policy materials for firms.
2. **Publication of information:** The consolidation of the sources of information applying to firms supports them in accessing the information they need.