



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP24/14

# Solvency II: further measures for implementation

November 2014

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Responses are requested by Friday 30 January 2015.

Please address any comments or enquiries to:  
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Email: [CP24\\_14@bankofengland.co.uk](mailto:CP24_14@bankofengland.co.uk)



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# 1 Overview

1.1 This consultation paper (CP) is of interest to all UK insurance firms within the scope of Solvency II, third country branches with a UK (re)insurance branch and to the Society of Lloyd's and may be of general interest to firms not under the scope of the Solvency II Directive. It follows CP16/14: Transposition of Solvency II: Part 3 which made proposals for the transposition of the Solvency II Directive into the Prudential Regulation Authority (PRA) Rulebook.<sup>(1)</sup>

1.2 This CP consists of three elements:

- chapters 2–3 — two sets of proposed rules on the appointment of actuaries and schemes of operations to align the PRA Rulebook with the Solvency II Directive;
- chapter 4 — two national specific templates (NSTs) and accompanying minor consequential changes proposed to the rules in the Reporting Part of the draft PRA Rulebook as consulted on in CP16/14 which are relevant to the Society of Lloyd's. NSTs address those areas which stem from specific national requirements which are not addressed in the set of Solvency II harmonised templates;
- five draft supervisory statements which set out the PRA's expectations of firms, and give further clarity, on:
  - Appendix 4 — regulatory reporting exemptions;
  - Appendix 5 — regulatory reporting, internal model outputs;
  - Appendix 6 — ORSA and the ultimate time horizon — non-life firms;
  - Appendix 7 — the quality of capital instruments; and
  - Appendix 8 — the treatment of pension scheme risk.

1.3 This CP should be read alongside the relevant European legislation and previous consultations on Solvency II and relevant parts of the PRA Rulebook.

1.4 In this CP, references to 'Parts' mean proposed Parts of the PRA's Rulebook.

1.5 With the exception of provisions recast from previous European directives, Solvency II<sup>(2)</sup> is largely maximum-harmonising. Therefore, as with previous CPs, the PRA has followed the approach of 'intelligent copy out' in its transposition of the Solvency II Directive. This means following the words of the Directive text as closely as reasonably possible in the PRA's transposition.

1.6 At the time of issuing this CP, the final Solvency II Regulations (the Delegated Acts<sup>(3)</sup>) and the Implementing Technical Standards (ITS)<sup>(4)</sup> have not been adopted. The

guidance proposed in this paper is therefore based on the draft versions of these Regulations and will be subject to change depending on the final versions. The PRA will communicate any changes as appropriate.

## Statutory obligations

1.7 As well as forming part of the United Kingdom's proposed transposition of Solvency II, this CP expands on the PRA's general approach detailed in the insurance approach document.<sup>(5)</sup> By clearly and consistently explaining its expectations of firms, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders. The PRA has considered matters to which it is required to have regard, and it considers that this CP is compatible with the Regulatory Principles and relevant provisions of the Legislative and Regulatory Reform Act 2006. In particular, it has regard to the benefits of providing appropriate levels of policyholder protection proportionate to the costs involved and to transparency and clarity for firms. Where appropriate, the individual chapters of this CP describe the PRA's consideration of costs and benefits in more detail.

## Impact on competition

1.8 The PRA has also assessed whether the content of this CP facilitates effective competition in markets for the services provided by PRA-authorised persons carrying out regulated

(1) CP16/14 covered the amendments made to the directive introduced by OMD II areas deferred from previous CPs and feedback on the previous CPs, consulted on by the Financial Services Authority (FSA). CP12/13 covered areas of the Solvency II Directive that were deferred in CP11/22, such as the treatment of Lloyd's and with-profits and contained feedback on CP11/22. CP11/22 covered the majority of the Solvency II Directive. *PRA Consultation Paper CP16/14*, 'Transposition of Solvency II: Part 3', August 2014; [www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf](http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf); *FSA Consultation Paper CP12/13*, 'Transposition of Solvency II Part 2', July 2012; [www.fsa.gov.uk/static/pubs/cp/cp12-13.pdf](http://www.fsa.gov.uk/static/pubs/cp/cp12-13.pdf); *FSA Consultation Paper CP11/22*, 'Transposition of Solvency II Part 1', November 2011; [www.fsa.gov.uk/pubs/cp/cp11\\_22.pdf](http://www.fsa.gov.uk/pubs/cp/cp11_22.pdf).

(2) Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (Text with EEA relevance): <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1412873282412&uri=CELEX:02009L0138-20140523>.

(3) Delegated Act on Solvency II: [http://ec.europa.eu/internal\\_market/insurance/solvency/solvency2/index\\_en.htm](http://ec.europa.eu/internal_market/insurance/solvency/solvency2/index_en.htm).

(4) At the time of publication, Set 1 of the draft ITS had been submitted to the European Commission: <https://eiopa.europa.eu/en/publications/technical-standards/draft-implementing-technical-standards-on-the-supervisory-approval-processes-for-solvency-ii/index.html>.

(5) *The Prudential Regulation Authority's approach to insurance supervision*, June 2014; [www.bankofengland.co.uk/publications/Documents/praadapproach/insuranceappr1406.pdf](http://www.bankofengland.co.uk/publications/Documents/praadapproach/insuranceappr1406.pdf).

activities in light of its secondary competition objective. This CP is designed to assist firms to prepare for the implementation of harmonised capital standards under Solvency II, enabling firms to compete within a regulatory framework that provides a consistent standard of policyholder protection. The PRA therefore considers the content of this consultation as compatible with the facilitation of effective competition.

## Impact on mutuals

1.9 The PRA has a statutory requirement to state whether the impact on mutuals will be significantly different from the impact on other firms. The provisions in Solvency II will affect mutuals. The cost benefit analysis outlined in CP11/22 sets out the extent to which mutuals would be differently affected. The proposed rules in this CP do not have an additional impact on mutual firms.

## Equality and diversity

1.10 The PRA may not act in an unlawfully discriminatory manner. It is also required under the Equality Act 2010 to

have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. As part of this, the PRA assesses the equality and diversity implications of any new policy proposals.

1.11 The Financial Services Authority's (FSA's) CP11/22 concluded that the implementation of the Solvency II Directive would not have any direct or indirect discriminatory impact under existing UK law. Changes proposed in this CP do not alter that conclusion.

## Responses and next steps

1.12 This consultation closes on Friday 30 January 2015. Views are welcomed on the proposals made in this CP and responses should be sent to CP24\_14@bankofengland.co.uk. Respondents are requested to structure their responses on a chapter-by-chapter basis.

1.13 As noted in CP16/14, the PRA will publish a Solvency II policy statement with feedback, including the finalised rules and the final supervisory statements, in 2015 Q1.

## 2 Appointment of actuaries

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2.1 This chapter sets out proposed changes to actuarial requirements for Solvency II firms and may be of general interest to firms not under the scope of the Solvency II Directive. The PRA currently imposes actuarial requirements in the Supervision Manual of its Handbook at SUP 4. The FSA consulted on the substance of these proposed rules changes in CP12/13 to align them with the Solvency II Directive. The PRA proposes to make those changes and move these rules to the Solvency II Firms Sector of the PRA Rulebook. The proposed draft rule is at Appendix 1.

### Proposals

#### Appointment of actuaries

2.2 Solvency II requires all firms to have an actuarial function. The proposed rules require firms to appoint an external actuary if the firm does not have the internal capability to provide that actuarial function.

2.3 The proposed rules in Appendix 1 define the relationship between firms and their actuaries, and the relationship between actuaries and the regulator.

2.4 The proposed rules place requirements on firms regarding the appointment of actuaries and the termination of their term of office, as well as setting out their respective rights and duties.

2.5 The purpose of the rules is to ensure that Solvency II firms have access to adequate actuarial advice, including external advice where appropriate, both in valuing liabilities to policyholders and in exercising discretion affecting the interests of with-profits policyholders.

### Cost benefit analysis

2.6 The PRA expects the proposed rules to ensure appropriate levels of policyholder protection through maintaining or enhancing standards of risk management. Where a firm needs to change its approach following actuarial advice it could incur higher costs. These costs were considered as part of the economic analysis presented in CP11/22.

# 3 Schemes of operations

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3.1 This chapter sets out proposed changes to the requirements in respect of run-off operations for Solvency II firms and may be of general interest to firms not under the scope of the Solvency II Directive. The PRA currently imposes such requirements in the Supervisory Manual of its Handbook at SUP App 2. The FSA consulted on the substance of these proposed changes in CP12/13 to align them with the Solvency II Directive. The PRA proposes to make these changes and move these rules to the Solvency II Firms Part of the PRA Rulebook. The proposed rule changes are at Appendix 2.

## Proposals

### Run-off operations

3.2 There are times when the PRA needs to monitor a firm more closely than it normally would. This is so that the PRA

can advance its objectives in terms of promoting the safety and soundness of firms and contributing to the securing of an appropriate degree of protection for policyholders.

3.3 The rules propose changes to terminology to meet the requirements of the Solvency II Directive, take account of the proposed rules for the Society of Lloyd's and UK Solvency II firms in difficulty (see Appendix 1.9 to CP16/14), and clarify the level at which information and documentation is to be provided in respect of third country branches.

## Cost benefit analysis

3.4 As a consequential amendment, this rule change does not lead to a change in policy. Therefore, the PRA considers the costs and benefits to this proposal to be of minimal significance.

# 4 Regulatory reporting national specific templates specific to the Society of Lloyd's

4.1 This chapter sets out the PRA's proposal for two national specific templates (NSTs) specific to the Society of Lloyd's. The proposed templates will ensure that the PRA receives quantitative data that is essential for the effective supervision of participants in the Lloyd's market after the implementation of Solvency II. To give effect to the PRA's requirement for the completion and submission of these two new national specific templates, the PRA is proposing to make some minor consequential changes to rules as set out in the Reporting Part of the PRA Rulebook which were consulted on in CP16/14.

## NST number NS.12

4.2 The PRA proposes a requirement for the Society of Lloyd's to complete NST number NS.12 because:

- The nature of the capital structure for the Society of Lloyd's needs to be reflective in the way in which the PRA applies the requirements of Solvency II to the calculation of the solvency capital requirement (SCR) and the format of its reporting. In particular, the Society of Lloyd's members' capital (funds at Lloyd's (FAL)) is not fully fungible as members underwrite with several liability bases and a significant proportion of the FAL is in the form of letters of credit.
- In CP12/13 the FSA consulted on the approach for the calculation of the Society of Lloyd's SCR. The CP stated that in calculating the SCR for the Society of Lloyd's, it must ensure that the SCR is calibrated to include all quantifiable risks to which:
  - members are exposed as a consequence of those members carrying out underwriting activities in the Society of Lloyd's market; and
  - the funds and property of the Society of Lloyd's is exposed (including risks to the assets and liabilities available to meet the liabilities of members).

## NST number NS.13

4.3 The PRA proposes a requirement for the Society of Lloyd's to complete NST number NS.13 so that it can collect information necessary to assess whether any shortfall in a syndicate's own funds compared to its reporting point can be met by the Society of Lloyd's own funds.

4.4 The PRA believes NST number NS.13 is proportionate and costs are kept to a minimum since the Society is required to carry out these calculations for each individual syndicate.

## The Society of Lloyd's completion of NS.12 and NS.13

4.5 The PRA will replace the placeholder text at rule 2.8 in the Reporting Part of the draft PRA Rulebook in CP16/14 with the new rule set out in Appendix 3 which will require the Society of Lloyd's to complete NST numbers NS.12 and NS.13.

4.6 For accuracy, a further consequential amendment to rule Reporting 2.11 in the Reporting Part of the draft PRA Rulebook in CP16/14 will occur where the reference to 'national specific templates' in the rule will become 'national specific template'.

## Collecting the Society of Lloyd's reporting templates from managing agents

4.7 In order for the Society of Lloyd's to meet its reporting obligations to the PRA under Solvency II, the Society of Lloyd's imposes reporting requirements under its byelaws on each managing agent in respect of each syndicate managed by it. The Society of Lloyd's collects the information it needs from managing agents by using four of its own devised templates ('the Lloyd's reporting templates'). These templates are then communicated to the PRA. In addition, the Society of Lloyd's submits the NS.12 and NS.13 to the PRA which includes an aggregation of the data reported by managing agents in respect of each syndicate managed by it.

4.8 The PRA's proposed approach of collecting the Lloyd's reporting templates from the Society of Lloyd's is a considerable enhancement over the current level of financial information supervisors of managing agents receive in respect of syndicates. The information would allow supervisors to understand the business performance of syndicates and the risk syndicates pose to the wider Lloyd's market and, in particular, to its central assets. This will be beneficial to supervisors in making forward-looking judgements and meeting the PRA's statutory requirements.

4.9 In order to ensure an efficient data collection, the PRA is proposing a new rule, 7.3, in the Reporting Part of the draft PRA Rulebook in CP16/14 requiring the Society of Lloyd's to submit the Lloyd's reporting templates to the PRA at the same time as the Society of Lloyd's submits its quantitative reporting templates. As the data that managing agents are required to submit to the Society of Lloyd's, pursuant to its byelaws, in Lloyd's reporting templates is akin to the quantitative reporting templates developed by EIOPA for Solvency II firms and as the Lloyd's reporting templates will be received by the Society of Lloyd's prior to the submission deadlines for its own quantitative reporting templates, the PRA is content to receive those templates and is not proposing to introduce any separate NSTs to apply directly to managing agents.

4.10 In taking this position, the PRA expects that the Lloyd's reporting templates will:

- be based upon the most up-to-date version of the quantitative reporting templates;
- continue to have submission deadlines prior to, or the same as, those set for the quantitative reporting templates;
- use the latest version of the taxonomy; and
- comply with all validation rules imposed on managing agents in respect of each syndicate managed by it.

4.11 If these assumptions were not met, the PRA would revisit this requirement and would consider imposing reporting requirements directly on managing agents.

### Cost benefit analysis

4.12 The proposed rules enable supervision of Solvency II capital requirements for the Society of Lloyd's, helping to ensure an appropriate degree of policyholder protection.

4.13 As the information requested is expected to be collected by the Society of Lloyd's to monitor and demonstrate it is meeting its incremental costs should be of minimal significance.

# Appendices

- 1 PRA Rulebook — Solvency II Firms: Actuaries Instrument [Year]
- 2 PRA Rulebook — Solvency II Firms: Run-off Operations Instrument [Year]
- 3 PRA Rulebook — Solvency II Firms: Reporting Instrument [Year]
- 4 Supervisory Statement — Regulatory reporting exemptions
- 5 Supervisory Statement — Regulatory reporting, internal model outputs
- 6 Supervisory Statement — ORSA and the ultimate time horizon — non-life firms
- 7 Supervisory Statement — The quality of capital instruments
- 8 Supervisory Statement — The treatment of pension scheme risk
- 9 National specific templates, regulatory reporting templates and LOG files

**PRA RULEBOOK: SOLVENCY II FIRMS: ACTUARIES INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (the PRA’s general rules);
  - (2) section 137T (general supplementary powers);
  - (3) section 340(1) and (4) (Appointment: requirements on firms);
  - (4) section 340(3A) (Appointment: requirements as to co-operation); and
  - (5) section 340(6) and (7) (Appointment: qualifications of actuaries).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook: Solvency II Firms: Actuaries Instrument [YEAR]**

- D. The PRA makes the rules in Annex A to this instrument.

**Commencement**

- E. This instrument comes into force on [DATE].

**Citation**

- F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Actuaries Instrument [YEAR].

**By order of the Board of the Prudential Regulation Authority**  
[DATE]

## Annex A

In this Annex, the text is all new and is not underlined.

Part

# ACTUARIES

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. APPOINTMENT OF ACTUARIES
3. ACTUARIES' QUALIFICATIONS
4. CONFLICTS OF INTEREST
5. WITH-PROFITS ACTUARY FUNCTION
6. DUTIES OF ACTUARIES
7. LLOYD'S

Links

## 1 APPLICATION AND DEFINITIONS<sup>1</sup>

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- 1.1 This Part applies to:
- (1) a *UK Solvency II firm*;
  - (2) in accordance with General Application 3<sup>2</sup>, the *Society*, as modified by 7;
  - (3) in accordance with General Application 3, *managing agents*, as modified by 7; and
  - (4) *third country branch undertakings* excluding *Swiss general insurers*.

1.2 This Part applies to an *actuary* appointed under 2 or appointed under or as a result of a statutory provision other than in *FSMA*.

1.3 In this Part, the following definition shall apply:

*Principles and Practices of Financial Management*

means the principles and practices in respect of a *firm's with-profits insurance business* that is established, maintained and recorded in accordance with any relevant provisions of the *FCA Handbook*.

## 2 APPOINTMENT OF ACTUARIES

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- 2.1 A *firm* must appoint an external *actuary* if it does not have the internal capability to comply with Conditions Governing Business 6.1<sup>3</sup> or the relevant requirements of the *Solvency II Regulations*.
- 2.2 A *firm* carrying on *with-profits insurance business* must appoint one or more *actuaries* to perform the *With Profits Actuary function* in respect of all classes of its *with-profits insurance business*.
- 2.3 A *firm* must:
- (1) when it becomes aware that a vacancy in the office of an *actuary* will arise or has arisen:
    - (a) notify the *PRA*; and
    - (b) give reasons for the vacancy,
 without delay, using the form referred to in Notifications 10.3;
  - (2) appoint an *actuary* to fill any vacancy in the office of an *actuary*;
  - (3) ensure that the replacement *actuary* can take up office at the time the vacancy arises or as soon as reasonably practicable after that; and

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<sup>1</sup> Defined terms referred to in this Part (which are not specific to this Part under rule 1.2) either appear in the PRA Rulebook Glossary or are being consulted on in the PRA's consultation paper CP16/14 "Transposition of Solvency II: Part 3".

See <http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf>.

<sup>2</sup> This Part is being consulted on in CP16/14.

See <http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf>

<sup>3</sup> This Part is being consulted on in CP16/14.

See <http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf>

- (4) when a new *actuary* is appointed:
- (a) notify the *PRA* of that appointment; and
  - (b) advise the *PRA* of the name and business address of the *actuary* appointed and the date from which the appointment has effect,
- using the form referred to in Notifications 10.3.

2.4 Where a *firm* fails to appoint an *actuary* under 2.1 or 2.2 within 28 days of a vacancy arising the *PRA* may appoint an *actuary* to perform either of the functions in 2.1 or 2.2 for that *firm* on the following terms:

- (1) the *actuary* to be remunerated by the *firm* on the basis agreed between the *actuary* and *firm* or, in the absence of agreement, on a reasonable basis; and
- (2) the *actuary* to hold office until he resigns or the *firm* appoints another *actuary*.

2.5 A *firm* must comply with and is bound by the terms on which an *actuary* has been appointed by the *PRA*.

2.6 Where the *PRA* appoints an *actuary* to perform either of the functions in 2.1 or 2.2 for a *firm*, the requirements under 2.1 and 2.2 to make appointments under those *rules* still apply to that *firm*.

### 3 ACTUARIES' QUALIFICATIONS

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3.1 Before a *firm* appoints an *actuary* under 2.1 or 2.2, it must take reasonable steps to ensure that the *actuary* has the required skill and experience to perform his functions under the *regulatory system* commensurate with the nature, scale and complexity of the *firm's* business and the requirements and standards under the *regulatory system* to which it is subject.

3.2 A *firm* must not appoint as *actuary* a *person* who is disqualified under Part XXII of *FSMA* (Auditors and Actuaries) from acting as an *actuary* either for that *firm* or for a relevant class of *firm*.

3.3 A *firm* must take reasonable steps to ensure that an *actuary*, which it is planning to appoint or has appointed, provides information to the *PRA* about the *actuary's* qualifications, skills, experience and any other relevant matters in accordance with the reasonable requests of the *PRA*.

### 4 CONFLICTS OF INTEREST

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4.1 A *firm* must take reasonable steps to ensure that an *actuary* that it appoints:

- (1) does not perform the function of *Chief Executive function*;
- (2) does not, if he is to perform the *With Profits Actuary function*, become a member of the *firm's governing body*; and
- (3) does not perform any other function on behalf of the *firm* which could give rise to a significant conflict of interest.

### 5 WITH-PROFITS ACTUARY FUNCTION

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5.1 An *actuary* appointed to perform the *With Profits Actuary function* must:

- (1) advise the *firm's* management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the *with-profits insurance business* of the *firm* in respect of which he has been appointed;
- (2) advise the *firm's governing body* as to whether the assumptions used to calculate the future discretionary benefits within the *technical provisions* under Technical Provisions 5.1<sup>4</sup> are consistent with the *firm's Principles and Practices of Financial Management* in respect of those classes of the *firm's with-profits insurance business*;
- (3) at least once a year, report to the *firm's governing body* on key aspects (including those aspects of the *firm's* application of its *Principles and Practices of Financial Management* on which the advice described in (1) has been given) of the discretion exercised in respect of the period covered by his report affecting those classes of *with-profits insurance business* of the *firm*;
- (4) request from the *firm* such information and explanations as he reasonably considers necessary to enable him properly to perform the duties in (1) to (3);
- (5) advise the *firm* as to the data and systems that he reasonably considers necessary to be kept and maintained to provide the duties in (4); and
- (6) in the case of a *friendly society* to which this section applies, perform the function of appropriate actuary under section 12 (Reinsurance) of the Friendly Societies Act 1992 or section 23A (Reinsurance) of the Friendly Societies Act 1974 as applicable, in respect of those classes of its *with-profits insurance business* covered by his appointment.

## 6 DUTIES OF ACTUARIES

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- 6.1 An *actuary* appointed under this Part must be objective in performing his duties.
- 6.2 An *actuary* appointed under this Part must take reasonable steps to satisfy himself that he is free from bias, or from any conflict of interest from which bias may reasonably be inferred. He must take appropriate action where this is not the case.
- 6.3 When carrying out his duties, an *actuary* appointed under this chapter must pay due regard to generally accepted actuarial practice.
- 6.4 An *actuary* must notify the *PRA* without delay if the *actuary*:
  - (1) is removed from office by a *firm*;
  - (2) is formally notified of such removal from office;
  - (3) resigns before the term of office expires;
  - (4) is not re-appointed by a *firm*; or
  - (5) is disqualified from being the *actuary* of:
    - (a) any *undertaking* or particular class of *undertaking*; or
    - (b) any *firm* or particular class of *firm*.

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<sup>4</sup> This Part is being consulted on in CP16/14.

See <http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp1614.pdf>

6.5 In the circumstances set out in 6.4, the *actuary* must notify the *PRA* without delay:

(1) of any matter connected with the removal or ceasing of the office of *actuary* that the *actuary* thinks ought to be drawn to the *PRA*'s attention; or

(2) that there is no such matter.

## **7 LLOYD'S**

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7.1 This Part applies to the *Society* and *managing agents* separately.

**PRA RULEBOOK: SOLVENCY II FIRMS: RUN-OFF OPERATIONS INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
  - (1) section 137G (The PRA’s general rules); and
  - (2) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G (2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook: Solvency II Firms: Run-off Operations Instrument [Year]**

- D. The PRA makes the rules in the Annex A to this instrument.

**Commencement**

- E. This instrument comes into force on **[DATE]**.

**Citation**

- F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Run-off Operations Instrument [Year].

**By order of the Board of the Prudential Regulation Authority**  
**[DATE]**

Annex A

Part

# **RUN-OFF OPERATIONS**

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## **Chapter content**

- 1. APPLICATION AND DEFINITIONS**
- 2. CEASING TO EFFECT CONTRACTS OF INSURANCE**
- 3. CONTENT OF SCHEME OF OPERATIONS**
- 4. SUBMITTED SCHEMES OF OPERATION**
- 5. THIRD COUNTRY BRANCHES**

## 1 APPLICATION AND DEFINITIONS<sup>1</sup>

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*; and
- (2) in accordance with 5, *third country branch undertakings* except *Swiss general insurers*.

1.2 In this Part, the following definitions shall apply:

*close links*

means (in accordance with paragraph 3 of Threshold Condition 5F in Schedule 6 to *FSMA*) the relationship between a person ("A") and another person ("CL") which exists if:

- (a) CL is a *parent undertaking* of A; or
- (b) CL is a *subsidiary undertaking* of A; or
- (c) CL is a *parent undertaking* of a *subsidiary undertaking* of A; or
- (d) CL is a *subsidiary undertaking* of a *parent undertaking* of A; or
- (e) CL owns or controls 20% or more of the voting rights or capital of A; or
- (f) A owns or controls 20% or more of the voting rights or capital of CL.

*index linked benefits*

means benefits:

- (1) provided for under a *linked long-term contract of insurance*; and
- (2) determined by reference to an index of the value of property of any description (whether specified in the contract or not).

*liability to a policyholder*

means (in relation to a *firm* carrying out *contracts of insurance*) any liability or obligation of that *firm* to, or in respect of, a *policyholder*.

*linked liabilities*

means *property-linked liabilities* or *index-linked liabilities*.

*material transaction*

means a transaction (when aggregated with any similar transactions) in which:

- (1) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or

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<sup>1</sup> Defined terms referred to in this Part (which are not specific to this Part under rule 1.2) either appear in the PRA Rulebook Glossary or are being consulted on in the PRA's consultation paper CP16/14 "Transposition of Solvency II: Part 3".

See <http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf>.

- (2) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties;

exceeds:

- (a) in the case of a *firm* which carries on *long-term insurance business*, but not *general insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *long-term insurance business*, excluding *property-linked liabilities* and net of *reinsurance ceded*; or
- (b) in the case of a *firm* which carries on *general insurance business*, but not *long-term insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *general insurance business*, net of *reinsurance ceded*; or
- (c) in the case of a *firm* which carries on both *long-term insurance business* and *general insurance business*:
- (i) where the transaction is in connection with the *firm's long-term insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *long-term insurance business*, excluding *property-linked liabilities* and net of *reinsurance ceded*; and
- (ii) in all other cases, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *general insurance business*, net of *reinsurance ceded*.

and

- (d) in the case of *third country branch undertakings*, a reference to the "*firm's liabilities*" is to be interpreted as a reference only to the liabilities relevant to the operations effected by the *third country branch*.

*property-linked liabilities*

means insurance liabilities in respect of *property-linked benefits*.

*property-linked benefits*

means benefits other than *index-linked benefits* provided for under a *linked long-term contract of insurance*.

*scheme of operations*

means a scheme which:

- (a) describes the nature of the risks which the *insurer* is underwriting, or intends to underwrite, and the guiding principles which it intends to follow in reinsuring or covering those risks; and
- (b) contains the information required under 3.1.

## 2 CEASING TO EFFECT CONTRACTS OF INSURANCE

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- 2.1 If a *firm* decides to cease to effect new *contracts of insurance* in respect of the whole of its *insurance business*, it must, within 28 days of that decision, submit a run-off plan to the *PRA* including:
- (1) a *scheme of operations*, in accordance with 3; and
  - (2) an explanation of how, or to what extent, all *liabilities to policyholders* will be met in full as they fall due.
- 2.2 For the purposes of 2.1, a new *contract of insurance* excludes contracts effected under a term in a subsisting *contract of insurance*.
- 2.3 A *third country branch undertaking* must apply the requirements in 2.1 and 2.2 taking account only of the operations effected by the *third country branch*.

## 3 CONTENT OF A SCHEME OF OPERATIONS

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- 3.1 In accordance with 3.2, a *scheme of operations* must:
- (1) describe the *firm's* run-off strategy;
  - (2) include a description of the business underwritten by the *firm*;
  - (3) include financial projections (including appropriate scenarios and stress-tests) as follows:
    - (a) a forecast summary profit and loss account in accordance with 3.3;
    - (b) a forecast summary balance sheet in accordance with 3.4; and
    - (c) forecast *MCR* and *SCR* at the end of each *financial year* or part *financial year*.
  - (4) as at the end of each *financial year* which falls (in whole or part) within the period to which the *scheme of operations* relates:
    - (a) describe the assumptions which underlie those forecasts and the reasons for adopting those assumptions; and
    - (b) identify any *material transactions* proposed to be entered into or carried out with, or in respect of, any associate or any other person with whom the *firm* has *close links*.
  - (5) cover the run-off period until all *liabilities to policyholders* are met.
- 3.2 The information required by 3.1 must:
- (1) reflect the nature and content of the *rules* relating to *eligible own funds* applicable to a *firm*;
  - (2) where a *firm* carries on both *long-term insurance business* and *general insurance business*, be separated for *long-term insurance business* and *general insurance business*; and

- (3) in the case of *third country branch undertakings*, take account only of matters relevant to the operations effected by the *third country branch*.
- 3.3 The forecast summary profit and loss account referred to in 3.1(3)(a) must contain the following information:
- (1) *premiums* and claims (gross and net of *reinsurance*) analysed by accounting *class* of *insurance business*;
  - (2) investment return;
  - (3) expenses;
  - (4) other charges and income;
  - (5) taxation; and
  - (6) dividends paid and accrued.
- 3.4 The forecast summary balance sheet referred to in 3.1(3)(b) must contain the following information:
- (1) investments analysed by type;
  - (2) assets held to cover *linked liabilities*;
  - (3) other assets and liabilities separately identifying cash at bank and in hand;
  - (4) capital and reserves analysed into called up share capital or equivalent funds, share premium account, revaluation reserve, other reserves and profit and loss account;
  - (5) subordinated liabilities;
  - (6) the fund for future appropriations;
  - (7) *technical provisions* gross and net of *reinsurance* analysed by accounting *class* of *insurance business* and separately identifying the provision for *linked liabilities*, unearned *premiums*, unexpired risks and equalisation; and
  - (8) other liabilities and credits.

#### **4 SUBMITTED SCHEMES OF OPERATION**

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- 4.1 A *firm* which has submitted a *scheme of operations* to the *PRA* must during the period covered by that *scheme of operations*:
- (1) notify the *PRA* at least 28 days before entering into or carrying out any *material transaction* with, or in respect of, an associate or any other *person* with whom the *firm* has *close links*, unless that transaction is in accordance with a *scheme of operations* which has been submitted to the *PRA*;
  - (2) notify the *PRA* promptly of any matter which has happened or is likely to happen and which represents a significant departure from the *scheme of operations* and either:
    - (a) explain the nature of the departure and the reasons for it and provide revised forecast financial information in 3.1(3) in the *scheme of operations* for its remaining term; or

- (b) include an amended *scheme of operations* and explain the amendments and the reasons for them.

## 5 THIRD COUNTRY BRANCHES

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- 5.1 This Chapter applies to *third country branch undertakings*.
- 5.2 In this Part, reference to “SCR”, “*eligible own funds*”, “MCR” and “*technical provisions*” is to be interpreted in accordance with Third Country Branches 10.2(1)-(4)<sup>2</sup>.

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<sup>2</sup> This part is currently being consulted on in the PRA’s consultation paper CP16/14 “Transposition of Solvency II: Part 3”. See <http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf>.

**PRA RULEBOOK SOLVENCY II FIRMS: REPORTING INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
  - (1) section 137G (the PRA’s general rules); and
  - (2) section 137T (general supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook Solvency II Firms: Reporting Instrument [Year]**

- D. The PRA makes the rules in Annex A to this instrument.

**Commencement**

- E. This instrument comes into force on 1 January 2016.

**Citation**

- F. This instrument may be cited as the PRA Rulebook Solvency II Firms: Reporting Instrument [Year].

**By order of the Board of the Prudential Regulation Authority**

[DATE]

## Annex A

In this Annex, underlining denotes new text and striking through indicates deleted text as compared to the version of this Part which, at the time of publication, is being consulted on in the PRA's consultation paper CP16/14 Transposition of Solvency II: Part 3<sup>1</sup>.

### Part

# REPORTING

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### Chapter content

1. APPLICATION AND DEFINITIONS
2. REPORTING TO THE PRA
3. PUBLIC DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT
4. PERMITTED NON-DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT
5. UPDATES AND ADDITIONAL VOLUNTARY INFORMATION: SOLVENCY AND FINANCIAL CONDITION REPORT
6. POLICY AND APPROVAL: SOLVENCY AND FINANCIAL CONDITION REPORT
7. LLOYD'S: PROVISION OF INFORMATION BY MANAGING AGENTS

### Links

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<sup>1</sup> see <http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp1614.pdf> Appendix 1.15

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*; and
- (2) in accordance with General Application 3, the *Society*.
- (3) in accordance with General Application 3, *managing agents*, for the purposes of 7.

1.2 In this part, the following definitions shall apply:

*aircraft*

means the *class of contract of insurance*, specified in paragraph 5 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

*aircraft liability*

means the *class of contract of insurance*, specified in paragraph 11 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

*assessable mutual*

means a *mutual* whose articles of association, rules or bye-laws provide for the calling of additional contributions from members.

*general insurer*

means an *insurer* with *permission* to effect contracts of insurance or carry out contracts of insurance that are contracts of general insurance.

*general liability*

means the *class of contract of insurance*, specified in paragraph 13 of Part I of Schedule 1 to the *Regulated Activities Order*.

*goods in transit*

means the *class of contract of insurance*, specified in paragraph 7 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

*liability of ships*

means the *class of contract of insurance*, specified in paragraph 12 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

Lloyd's templates

means the:

- (1) annual solvency return;
- (2) quarterly solvency return;
- (3) annual asset data; and

(4) quarterly asset data;

reporting templates that the Society has made available to managing agents to collect information from syndicates in order to complete the Society's reporting under this Part.

*long-term insurer*

means an *insurer* with *permission* to effect contract of insurance or carry out contracts of insurance that are contracts of long-term insurance.

*material pooling agreement*

means an arrangement in which:

- (1) insurance or *reinsurance undertakings* only are members;
- (2) the members have assumed joint liability between themselves for a portfolio of insurance or *reinsurance* obligations in defined proportions (which are adjustable should one of the members default to ensure that any claim is fully met);
- (3) the members have the capacity to accept pooled insurance risks with a gross exposure to any one loss exceeding USD 1 Billion.

*mixed commercial package*

means *contracts of insurance* (other than *treaty reinsurance* contracts) against more than one of:

- (1) loss or damage to property;
- (2) risks to the *person* insured incurring liabilities to third parties;
- (3) risks of loss to the *persons* insured arising from the failure of debtors of theirs to pay their debts when due;
- (4) risks of loss to the *persons* insured attributable to interruptions of business carried on by them;
- (5) risks of loss to the *persons* insured attributable to their incurring unforeseen expenses; or
- (6) any other risk of loss to a commercial operation;

where the risks and losses covered in the contract are rated on a single package basis and no separately identifiable *premium* is charged or recorded for internal management purposes for any one group of risks or losses specified in the contract.

*motor vehicle liability*

means the *class of contract of insurance*, specified in paragraph 10 of Part I of Schedule 1 to the *Regulated Activities Order*.

*professional indemnity*

means *contracts of insurance* (other than *treaty reinsurance* contracts), including directors' and officers' liability and error and omissions liability, against the risks of the

*persons* insured incurring liabilities to third parties arising from wrongful acts (such as breach of duty, breach of trust, negligence, error or omissions) by professionals, named individuals or businesses occurring in the course of the insured's professional activities.

*public and products liability*

means *contracts of insurance* (other than *treaty reinsurance* contracts) against the risks of *persons* insured incurring liabilities to third parties for damage to property, injury, illness or death, arising in the course of the insured's business.

*ships*

means the *class of contract of insurance*, specified in paragraph 6 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

*suretyship*

means the *class of contract of insurance*, specified in paragraph 15 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

*Railway rolling stock*

means the *class of contract of insurance*, specified in paragraph 4 of Part 1 of Schedule 1 to the *Regulated Activities Order*.

## 2 REPORTING TO THE PRA

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- 2.1 A *firm* must submit to the *PRA* information which is necessary for the purposes of the *PRA*'s supervision of the *firm*.

**[Note: Art. 35(1) of the *Solvency II Directive*]**

- 2.2 The information referred to in 2.1 must:
- (1) be submitted in the applicable format or template (if any) provided in the *Solvency II Regulations* or in the form of any *national specific template* where applicable; and
  - (2) include at least the information necessary to enable the *PRA* to assess the matters set out below when performing the supervisory review process:
    - (a) the *firm's* system of governance;
    - (b) the business pursued by the *firm*;
    - (c) the valuation principles applied by the *firm* for solvency purposes;
    - (d) the risks faced by the *firm*;
    - (e) the risk management systems of the *firm*; and
    - (f) the capital structure, capital needs and capital management of the *firm*, and
  - (3) enable the *PRA* to make any appropriate decisions resulting from the exercise of their supervisory rights and duties.

**[Note: Art. 35(1) of the *Solvency II Directive*]**

2.3 The information referred to in 2.1 and 2.2 must comprise the following:

- (1) qualitative or quantitative elements, or any appropriate combination thereof;
- (2) historic, current or prospective elements, or any appropriate combination thereof; and
- (3) data from internal or external sources, or any appropriate combination thereof.

**[Note: Art. 35(3) of the Solvency II Directive]**

2.4 The information which a *firm* submits to the *PRA* in accordance with 2.1 and 2.2 must comply with the following principles:

- (1) it must reflect the nature, scale and complexity of the business of the *firm*, and in particular the risks inherent in that business;
- (2) it must be accessible, complete in all material respects, comparable and consistent over time; and
- (3) it must be relevant, reliable and comprehensive.

**[Note: Art. 35(4) of the Solvency II Directive]**

2.5 A *firm* must have in place appropriate systems and structures to fulfil the requirements set out in 2.1 – 2.4, as well as a written policy approved by its *governing body* ensuring the ongoing appropriateness of the information submitted by the *firm* to the *PRA*.

**[Note: Art. 35(5) of the Solvency II Directive]**

2.6 Subject to 2.7, a *firm* falling within categories (1) – (7) must submit to the *PRA* the corresponding *national specific templates* on an annual basis:

- (1) A *firm* carrying on *with-profits insurance business* must submit template NS1: With-Profits Value of Bonus and template NS2: With-Profits Assets and Liabilities;
- (2) A *firm* which manages a *material pooling agreement* must submit template NS3: Pools;
- (3) An *assessable mutual* which:
  - (a) has called for an additional contribution after 1 January 2006; or
  - (b) has received approval for *ancillary own funds* as contemplated in Own Funds 2.3(4)
 must submit template NS4: Assessable Mutuals;
- (4) A *firm* writing *suretyship* business the effect of which is to improve the credit rating of the underlying *security* must submit template NS8: Business Model Analysis – Financial Guarantee Insurers;
- (5) A *long term insurer* must submit:
  - (a) NS5: Revenue Account (Life);
  - (b) NS9: Best Estimate Assumptions for Life Insurance Risks; and
  - (c) NS6: Business Model Analysis (Life);

- (6) A *general insurer* must submit template NS7: Business Model Analysis (Non-life);
- (7) A *general insurer* carrying on *insurance business* and proportional and non-proportional *reinsurance* obligations relating to:

- (a) *railway rolling stock*;
- (b) *aircraft*;
- (c) *ships*;
- (d) *goods in transit*;
- (e) *motor vehicle liability*;
- (f) *aircraft liability*;
- (g) *liability of ships*; or
- (h) *general liability*;

must submit template NS10: Projection of Future Cash Flows (Best Estimate - Non Life: Sub-classes);

- (8) A *general insurer* carrying on *insurance business* relating to:
- (a) *employers' liability* (including as part of a *mixed commercial package*);
  - (b) *public and products liability* (including as part of a *mixed commercial package*; or
  - (c) *professional indemnity*;

must submit template NS11: Non-life Insurance Claims Information (General Liability Sub-classes).

- 2.7 A *firm* falling within 2.6(2), 2.6(3)(a) or 2(6) that does not have a *Part 4A permission* to effect *contracts of insurance* is not subject to the obligation to complete the corresponding *national specific template*.
- 2.8 ~~A *firm* falling within categories [x] must submit to the PRA the corresponding *national specific template* on a quarterly basis. [placeholder for templates e.g. Lloyds]~~ The *Society* must submit to the PRA:
- (1) template NS.12: Lloyd's SCR and MWSCR on an annual basis; and
  - (2) template NS.13: Lloyd's MCR on a quarterly basis.
- 2.9 For the purposes of 2.6 and 2.8, all amounts shown in Units must be reported in *United Kingdom* sterling unless the *national specific templates* expressly states otherwise.
- 2.10 A *firm* shall submit the annual *national specific templates* referred to in 2.6 and 2.8(1), after the end of the transitional period set out in Transitional Measures 3.1, no later than 14 weeks after the *firm's* financial year end.
- 2.11 ~~A *firm*~~ The *Society* shall submit the quarterly *national specific templates* referred to in 2.8(2) after the end of the transitional period set out in Transitional Measures 3.3, no later than 5 weeks ~~related to~~ after any quarter ending.

- 2.12 If the due date for the *national specific template* falls on a day which is not a *business day*, the documents must be submitted no later than the next *business day* after the due date.
- 2.13 A *firm* shall submit to the *PRA*, the *national specific templates* referred to in 2.6 and 2.8 in electronic format.
- 2.14 Where a *firm* notifies the *PRA* that any of its submissions of *national specific template* submissions under 2.6 or 2.8 is incorrect, or where the *PRA* notifies a *firm* that any part of the *national specific template* appears to it to be inaccurate or incomplete, the *firm* must promptly make any appropriate corrections or adjustments and if necessary re-submit the *national specific template* (or relevant part of it).

### 3 PUBLIC DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT

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- 3.1 A *firm* must disclose publicly, on an annual basis, a *SFCR*.

**[Note: Art. 51(1) of the *Solvency II Directive*]**

- 3.2 The information which a *firm* discloses in its *SFCR* must include the information required in 2.3 and must comply with the principles in 2.4.

**[Note: Art. 51(1) of the *Solvency II Directive* and the *Solvency II Regulations*]**

- 3.3 A *firm's SFCR* must contain the following information, either in full or by way of reference to equivalent information, both in nature and scope, disclosed publicly under other legal or regulatory requirements:
- (1) a description of the business and performance of the *firm*;
  - (2) a description of the system of governance of the *firm* and an assessment of its adequacy for the risk profile of the *firm*;
  - (3) a description of the risk exposure, risk concentration, risk mitigation and risk sensitivity separately for each category of risk of the *firm*;
  - (4) a description, separately for assets, *technical provisions* and other liabilities, of the bases and methods used for their valuation, together with an explanation of any major differences in the bases and methods used for the valuation of those assets, *technical provisions* and other liabilities in financial statements of the *firm*; and
  - (5) a description of the capital management of the *firm*, including at least the following:
    - (a) the structure, amount and quality of *own funds* of the *firm*, together with the information specified in 3.5;
    - (b) the amount of the *MCR* and *SCR* of the *firm*, together with the information specified in 3.6;
    - (c) information showing and explaining the main differences between the underlying assumptions of the *standard formula* and the underlying assumptions of any *internal model* for which the *firm* has received *internal model approval*; and
    - (d) the amount of any non-compliance with the *MCR* or any significant non-compliance with the *SCR* during the reporting period, even if subsequently resolved, with an explanation of the origin of that non-compliance and its

consequences, as well as any remedial measures taken in respect of that non-compliance.

**[Note: Art. 51(1)(a)–(e) of the Solvency II Directive]**

3.4 For the purposes of 3.3(4), where a *firm* applies:

- (1) a *matching adjustment* in accordance with Technical Provisions 4B, the firm must include in the description:
  - (a) a description of the matching adjustment and of the portfolio of obligations and assigned assets to which the *matching adjustment* is applied; and
  - (b) a quantification of the impact of a change to zero of the *matching adjustment* on the *firm's* financial position;
- (2) a *volatility adjustment* in accordance with Technical Provisions 4D, the firm must include in the description:
  - (a) a statement on whether the volatility adjustment referred to in Technical Provisions 4D is used by the *firm*;
  - (b) quantification of the impact of a change to zero of the volatility adjustment on the *firm's* financial position.

**[Note: Art. 51(1a) of the Solvency II Directive [and the Solvency II Regulations]]**

3.5 The disclosure required by 3.3(5)(a) must include the following:

- (1) an analysis of any significant change in the structure, amount and quality of *own funds* of the *firm* as compared to the previous reporting period of the *firm*;
- (2) an explanation of any major differences in relation to the value of elements of *own funds* items in the financial statements of the *firm*; and
- (3) a brief description of the capital transferability of the *own funds* of the *firm*.

**[Note: Art. 51(2) of the Solvency II Directive]**

3.6 The disclosure required by 3.3(5)(b) must include the following:

- (1) the amount of the SCR calculated by the *firm* using the *standard formula* or, where the *firm* has received *internal model approval*, the amount of the SCR calculated using its *internal model* and, where applicable in the case of a *partial internal model*, the *standard formula*;
- (2) the amount of any *capital add-on* imposed upon the *firm* in accordance with Article 37 of the *Solvency II Directive*, together with concise information on the justification given by the *PRA* for its imposition; and
- (3) the impact of any *undertaking specific parameters* the *firm* is required to use in calculating the *standard formula* in accordance with Article 110 of the *Solvency II Directive*, together with concise information on the justification given by the *PRA* for requiring the use of those *undertaking specific parameters*.

**[Note: Art. 51(2) of the Solvency II Directive]**

- 3.7 The disclosure of the *SCR* required by 3.3(5)(b) must be accompanied, where applicable, with a statement indicating that the final amount of the *SCR* is subject to supervisory assessment.

**[Note: Art. 51(2) of the Solvency II Directive]**

- 3.8 Where a *firm*, in its *SFCR*, makes use of, or refers to, public disclosures made by the *firm* under other legal or regulatory requirements, those disclosures must be equivalent to the information required to be disclosed under 3.3 – 3.7, in both their nature and scope.

**[Note: Art. 53(3) of the Solvency II Directive]**

#### **4 PERMITTED NON-DISCLOSURE: SOLVENCY AND FINANCIAL CONDITION REPORT**

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- 4.1 Where a *firm* is granted a *waiver* by the *PRA* permitting the *firm* not to disclose information otherwise required to be disclosed pursuant to 3.3(1) – (4) and 3.4 in its *SFCR*, the *firm* must make a statement to this effect in its *SFCR* and state whether the non-disclosure is permitted because:
- (1) the disclosure of that information would enable competitors of the *firm* to gain a significant, undue advantage; or
  - (2) the *firm* has obligations to *policyholders* or other counterparty relationships which bind the *firm* to secrecy or confidentiality.

**[Note: Arts. 53(1) and 53(2) of the Solvency II Directive]**

#### **5 UPDATES AND ADDITIONAL VOLUNTARY INFORMATION: SOLVENCY AND FINANCIAL CONDITION REPORT**

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- 5.1 In the event of any major development affecting significantly the relevance of the information disclosed in accordance with:
- (1) 3.3 – 3.8; or
  - (2) 4.1;
- a *firm* must disclose publicly appropriate information on the nature and effects of that major development.

**[Note: Art. 54(1) of the Solvency II Directive]**

- 5.2 Without limiting the general application of 5.1, for the purposes of that *rule* the following will be regarded as a major development:
- (1) non-compliance with the *MCR* by the *firm* and either the *PRA* considers that the *firm* will not be able to submit, or the *PRA* does not receive within one month of the date of observation by the *firm* of non-compliance with the *MCR*, a *finance scheme* in accordance with Undertakings in Difficulty 4.1; and/or
  - (2) significant non-compliance with the *SCR* by the *firm* and the *PRA* does not receive, within two *months* from the date when non-compliance with the *SCR* was first observed by the *firm*, a *recovery plan* as required by Undertakings in Difficulty 3.1(2).

**[Note: Art. 54(1) of the Solvency II Directive]**

- 5.3 Where the circumstances described in 5.2(1) or 5.2(2) arise, the *firm* must immediately publicly disclose the amount of non-compliance with the *MCR* or *SCR* as the case may be,

together with an explanation of the origin and consequences of that non-compliance, and a description of any remedial measures taken.

**[Note: Art. 54(1) of the Solvency II Directive]**

- 5.4 Where compliance with the *MCR* has not been restored by a *firm* within three *months* after the first observation of non-compliance by the *firm*, then the *firm* must publicly disclose at the end of that three-*month* period the non-compliance with the *MCR*, together with an explanation of the origin and consequences of that non-compliance, a description of any remedial measures taken and of any further remedial measures planned.

**[Note: Art. 54(1) of the Solvency II Directive]**

- 5.5 Where compliance with the *SCR* has not been restored by a *firm* within six *months* after the first observation of non-compliance by the *firm*, then the *firm* must publicly disclose at the end of that six-*month* period the non-compliance with the *SCR*, together with an explanation of the origin and consequences of that non-compliance, a description of any remedial measures taken and of any further remedial measures planned.

**[Note: Art. 54(1) of the Solvency II Directive]**

## **6 POLICY AND APPROVAL: SOLVENCY AND FINANCIAL CONDITION REPORT**

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- 6.1 A *firm* must have in place:
- (1) appropriate systems and structures to fulfil the requirements of 3 – 5; and
  - (2) a written policy ensuring the ongoing appropriateness of any information disclosed:
    - (a) in accordance with the requirements referred to in (1); and
    - (b) on a voluntary basis as further information or explanation related to the *SFCR* which is not already required to be disclosed.

**[Note: Art. 55(1) of the Solvency II Directive]**

- 6.2 A *firm* must ensure that its *SFCR* is:
- (1) subject to approval by its *governing body*; and
  - (2) not publicly disclosed until the approval referred to in (1) is received.

**[Note: Art. 55(2) of the Solvency II Directive]**

## **7 LLOYDS: PROVISION OF INFORMATION BY MANAGING AGENTS**

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- 7.1 A *managing agent* must, as promptly as possible, submit any information to the *Society* that is necessary for the *Society* to comply with its obligations in this Part or under the *Solvency II Regulations*.
- 7.2 The information in 7.1 must be submitted in the form that the *Society* requires.
- 7.3 The *Society* must provide to the *PRA* in electronic format the *Lloyd's templates* it receives from each *managing agent* on behalf of each respective *syndicate* that the *managing agent* manages at the same time it submits its *national specific templates* required by 2.8.



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Supervisory Statement | SS[xx]/14

# Solvency II: regulatory reporting exemptions

November 2014

## 1 Introduction

1.1 This draft supervisory statement is of interest to all UK insurance firms within the scope of Solvency II. This statement should be read alongside all relevant European legislation and relevant parts of the draft PRA Rulebook.

1.2 The Prudential Regulation Authority (PRA) considers that some firms may be eligible for the exemption set out in Article 35(6) of the Solvency II Directive.<sup>(1)</sup> Specifically, the PRA considers that firms designated as category four and five by the PRA, whether solo or part of a group, may meet the requirements of exemption from quarterly reporting. While the PRA expects that all other firms should report on a quarterly basis, on an exceptional basis it may also consider exemptions for firms not in category four or five on a case-by-case basis. These cases could include small firms that are part of groups where the group is designated as category one, two or three by the PRA.

1.3 In particular, this statement:

- lists the reporting requirements that are subject to this exemption;<sup>(2)</sup> and
- explains the steps a firm must take to apply for the exemption, and how the decision will be communicated to the firm.

## 2 Scope of quarterly reporting exemption

2.1 The reporting requirements are set out in the Solvency II Regulations and in Reporting 2.1–2.14 in the Reporting Part of the draft PRA Rulebook. Article 35(6) of the Solvency II Directive states that supervisory authorities may limit reporting with a frequency shorter than one year where 'submission of the information would be overly burdensome in relation to the nature, scale and complexity of the risks inherent in the business of insurance firms'. This exemption is only available to firms that cumulatively represent less than 20% of a Member State's life and non-life insurance and reinsurance market shares respectively.<sup>(3)</sup> On this basis, the PRA has determined that firms designated by the PRA as category four and five, both solo and part of a group, may be eligible for the exemption from quarterly reporting. Other firms may also, exceptionally, be eligible.

2.2 Firms that are granted this exemption will only have to submit the quarterly reporting templates (QRT) identified in **Table A**.

2.3 As shown in the table, the exemption from quarterly reporting does not apply to:

- minimum capital requirement (MCR) quarterly reporting, as this is a separate requirement set out in Article 129(4) of the

- Solvency II Directive;
- second quarter reporting of own funds and balance sheet templates; and
- the basic information and content of submission templates. The latter templates will help the PRA understand basic information about each submission and facilitate validation checks.

2.4 The PRA may, where necessary to meet its objectives, make *ad hoc* requests for quarterly reporting from firms holding an exemption. Firms granted an exemption from quarterly reporting should therefore maintain their ability to respond to such *ad hoc* requests in a timely manner.

### Application for Solvency II quarterly reporting exemptions

2.5 Firms that believe they are eligible for exemptions to quarterly reporting should discuss this exemption with their supervisor prior to submitting a formal application. An application should then be submitted using the usual waiver process by completing the questionnaire that will be on the Bank of England website in 2015 Q1. Any applications for quarterly reporting exemptions intended to apply for the 2016 reporting year should be submitted by Tuesday 1 September 2015.

2.6 Once the PRA has assessed an application it will inform the firm of its decision. Where an application is approved, the firm will be sent a Direction letter that sets out the duration of the exemption. The PRA expects firms to have a contingency plan in place in case their application is rejected and maintain contingency plans in case the exemption should expire without being extended. The PRA expects firms to notify their supervisory contact as soon as they believe there are any circumstances which may impact their suitability to hold an exemption.

## 3 Cost benefit analysis

3.1 The PRA regards the costs are proportionate to the benefits as the impact on policyholder protection are likely to be minimal. The PRA would still receive sufficient information to enable a proportionate level of supervision but with lower administrative compliance costs for exempted firms.

(1) Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (Text with EEA relevance): <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1412873282412&uri=CELEX:02009L0138-20140523>.

(2) Subject to confirmation with the publication of the ITS.

(3) EIOPA has set out the approach by which Member States are to calculate market share in draft guidelines.

**Table A** Aspects of QRT required of firms granted a QRT exemption

Quarter 1	Quarter 2	Quarter 3	Quarter 4
Basic information — S.01.02.a			
Content of the submission — S.01.01.a			
	Balance sheet — S.02.01.a		
	Information on own funds — S.23.01.a		
Minimum capital requirement — non-composite undertakings S.28.01.a			
Minimum capital requirement — composite undertakings S.28.02.a			



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Supervisory Statement | SS[xx]/14

# Solvency II: regulatory reporting, internal model outputs

November 2014

## 1 Introduction

1.1 This draft supervisory statement is of interest to all UK insurance firms within the scope of Solvency II and to the Society of Lloyd's. The Prudential Regulation Authority (PRA) expects firms to read this statement alongside all relevant European legislation and relevant parts of the draft PRA Rulebook.

1.2 This statement sets out the PRA's expectations of firms, and provides further clarity on the information to be reported by firms using an internal model to calculate the solvency capital requirement (SCR).

## 2 Reporting internal model outputs

2.1 The PRA expects firms using an approved internal or partial internal model to calculate their SCR to report the internal model outputs using the relevant templates provided in the Appendices. The templates capture selected percentiles of the probability distributions for specified variables (eg risk drivers and lines of business) as well as some information (eg correlation factors) relevant for the PRA to monitor internal models. These should be submitted at the time firms report their annual quantitative reporting template in accordance with the rules for deadlines to be set out in the draft PRA Rulebook.<sup>(1)</sup> Firms using an approved partial internal model should only complete the parts of the templates relevant to the scope of their business.

2.2 The ongoing appropriateness of internal models is an important component of the internal model framework under Solvency II. To monitor the performance of the approved internal models over time, the PRA expects firms with an approved internal model to report the outputs of the model so that the PRA can supervise internal models on an ongoing basis. The PRA has developed templates that allow firms to capture outputs of different structures of internal models (for instance, using different sets of lines of business) recognising the differences in the structure of internal models and main risk drivers between life and non-life insurance activities. The PRA considers that these templates will make it easier and simpler for firms to supply the relevant information. The templates also allow the PRA to take a consistent view of the performance of approved internal models across firms.

2.3 The PRA will keep the content of the templates under review to assess the value of the information and take account of European Insurance and Occupational Pensions Authority (EIOPA) initiatives in this area.

2.4 Life insurance firms calculating their SCR using an approved internal or partial internal model should use the templates in Appendix 9.

2.5 General insurance firms calculating their SCR using an approved internal or partial internal model should use the templates in Appendix 9.

2.6 Composite insurers calculating their SCR using an approved internal model should contact their usual supervisory contact to agree the templates they should use.

2.7 In the situation where the Society of Lloyd's seeks and is granted approval to use an internal model to calculate its SCR, the PRA expects the Society of Lloyd's to report the internal model outputs produced by the managing agents for each syndicate it manages using the templates in the appendices and following the instruction for general or life insurers as appropriate. The PRA also expects the Society of Lloyd's to report its internal model outputs using the templates in Appendix 9 with appropriate amendments as agreed following discussion with its usual supervisory contact.

2.8 For groups where the PRA is the group supervisor, the group should speak with their usual supervisory contact to determine which templates should be completed.

## 3 Cost benefit analysis

3.1 This section provides an economic analysis of the impact that the PRA's expectations will have on firms addressed in this statement. The baseline for the cost benefit analysis is the absence of setting any expectations by the PRA. The benefits of setting expectations for the reporting of model outputs include:

- allowing the PRA to ensure policyholder protection by monitoring models across the insurance sector;
- promoting effective competition by ensuring consistent standards are applied to the use of internal models;
- providing clarity to firms as to the information related to internal model outputs the PRA expects to receive; and
- reducing the need for *ad hoc* information requests.

3.2 The PRA expects that the additional costs for firms will be minimal considering that firms will be monitoring the outputs of their internal model as part of their duty under Solvency II.

(1) See the Draft PRA Rulebook as set out in *PRA Consultation Paper CP16/14*, 'Transposition of Solvency II: Part 3', August 2014; [www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf](http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf).



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Supervisory Statement | SS[xx]/14

# Solvency II: ORSA and the ultimate time horizon — non-life firms

November 2014

## 1 Introduction

1.1 This draft supervisory statement is of interest to all UK solo insurance firms within the scope of Solvency II that carry out non-life business and the Society of Lloyd's, in respect of each of their Syndicates and in respect of outputs of the Lloyd's Internal Model (LIM).

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations of how firms should identify and manage all risks to which their business could be exposed over the long term, as well as the short term. In particular it includes the PRA's expectation that firms consider and are able to demonstrate that they have considered risk over the time horizon of the run-off of a firm's obligations to its policyholders, including obligations relating to business planned to be written in the twelve months following the relevant reference date ('the ultimate time horizon').

1.3 The PRA requests firms review the proposals in the statement and provide feedback before 30 January on whether they are considered appropriate.

### PRA expectations regarding the ultimate time horizon

1.4 The PRA expects firms to consider risk over the ultimate time horizon. This is because not all risks may emerge over a shorter time horizon. This enables firms to assess their ability to meet obligations to policyholders including when the firm decides to cease writing business beyond that which it plans to write over the next twelve months. This expectation reflects existing market practice in the United Kingdom.

1.5 In December 2013, the PRA issued SS4/13<sup>(1)</sup> which set out the PRA's approach to firms' development of their Own Risk and Solvency Assessment (ORSA). It states that firms are encouraged to work towards ensuring that their ORSAs adequately capture all known risks. It also stated that the PRA would not prescribe the format or content of the ORSA, recognising that it needs to reflect the specific risk profile and governance mechanism of each firm and group.

1.6 The PRA expects that firms may find it appropriate and beneficial to consider the ultimate time horizon as part of their ORSA to ensure that it can adequately capture all known risks and, in doing so, contribute to an appropriate degree of policyholder protection.

1.7 The PRA also expects firms to be able to demonstrate that they have done this. Firms may wish to do this in the ORSA supervisory report. Consistent with our messaging in SS4/13 that in relation to larger and higher-risk firms, the PRA may ask to see additional information that supports the supervisory report, the PRA recognises that it may be easier for firms to do this by providing information in potentially a more cost effective way, as explained in this supervisory statement.

### Demonstrating due consideration of the ultimate time horizon

1.8 The Solvency II Directive provides for a supervisory report describing the outcome of the ORSA assessment. Firms are required to exercise various discretions in determining the appropriate level of detail and granularity to include and what, if any, additional information is necessary to support the supervisory report. If a firm chooses to address the issue of risks to the ultimate time horizon in that supervisory report, the PRA will consider it and may, where proportionate and appropriate, request additional information that supports the supervisory report.

1.9 However, the PRA recognises that firms may gain efficiencies from generating ultimate time horizon internal model outputs at the same time as they are producing their internal model output reporting templates proposed under the Solvency II reporting of internal model outputs supervisory statement. In that event, firms may use the set of templates and reporting instructions specified in the same chapter in order to provide the PRA with that information.

1.10 Should firms choose to use that set of templates for this purpose, it would be beneficial to:

- submit all internal model outputs using the same frequency, reporting reference date and submission date;
- ensure that two separate sets of templates are completed and submitted where the firm is using the same reference date for reporting ultimate time horizon outputs as for internal model outputs (SS4/14);
- ensure that all templates within each set should follow a consistent basis (ie templates submitted will not be prepared on a mixed basis, to include both twelve months and the ultimate time horizon data);
- prepare the templates on the basis stated in cell BAS005 (templates provided under non-life model outputs guidance); and
- submit the templates to the PRA in electronic format via Excel files via the new data collection system the PRA is developing for Solvency II.

### Templates

1.11 The following table illustrates the template references for internal model outputs (as set out in SSXX/14) and the corresponding template references that firms may use for submission of their ultimate time horizon outputs:

(1) *PRA Supervisory Statement SS4/13*, 'Solvency II: applying EIOPA's preparatory guidelines to PRA-authorized firms', December 2013; [www.bankofengland.co.uk/pradocuments/publications/ss/2013/ss413.pdf](http://www.bankofengland.co.uk/pradocuments/publications/ss/2013/ss413.pdf).

Template name	Template ID (as per SSXX/14)	Suggested Template ID for ultimate time horizon
Basic information	NL-IMS-01	NL-MUO-01
Reserving risk	NL-IMS-02	NL-MUO-02
Premium risk	NL-IMS-03	NL-MUO-03
Premium risk — historical LRs	NL-IMS-04	Not applicable
Premium and reserve risk correlations	NL-IMS-05	NL-MUO-05
Catastrophe risk	NL-IMS-06	NL-MUO-06
Market risk	NL-IMS-07	Not applicable
Total risk distributions	NL-IMS-08	NL-MUO-08
Total risk correlations	NL-IMS-09	NL-MUO-09
Comments	NL-IMS-10	NL-MUO-10

1.12 For clarification, ultimate time horizon outputs in the non-life underwriting risk templates (reserve risk, premium risk excluding catastrophe, and catastrophe claim risk) mean modelled outputs of scenarios of the quantum of future cash flows (from the Reference Date) as would be known when the obligations are fully run-off (ie modelled outputs of scenarios of the ultimate quantum of future cash flows).

1.13 The Society of Lloyd's is expected to agree with its supervisor how to complete the templates.

## 2 Cost benefit analysis

2.1 The PRA regards the expected cost as proportionate to the benefits from the collection of this information. The PRA understands that most general insurance firms assess their economic capital on the basis of running-off the business for their own internal risk management purposes (and have been supplying this information to the PRA since 2012). As a result, there should not be any incremental costs. In addition to enabling the PRA to see that firms have properly considered the long-term risks to their business, this information will also help to inform the PRA's assessment of firms' capital requirements over a one-year horizon, enabling it to promote appropriate standards of policyholder protection in line with Solvency II requirements.



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Supervisory Statement | SS[xx]/14

# Solvency II: the quality of capital instruments

November 2014

## 1 Introduction

1.1 This draft supervisory statement is of interest to all UK insurance firms within the scope of Solvency II and the Society of Lloyd's and firms that are part of a Solvency II group that will determine and classify capital instruments under the Solvency II own funds regime, together with their advisors. This statement should be read alongside all relevant European legislation and relevant parts of the Prudential Regulation Authority (PRA) Rulebook.

1.2 This statement clarifies the PRA's expectations of the quality of capital instruments in the period prior to 1 January 2016, and after the commencement of Solvency II. By clarifying its expectations in relation to the quality of capital instruments, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

1.3 The PRA has already made clear in its approach to insurance supervision<sup>(1)</sup> that it expects firms issuing or amending capital instruments to anticipate the enhanced quality of capital that will be required under Solvency II. Many firms have engaged actively with their supervisors to meet these expectations. However, some firms have encountered difficulty in applying some of the Solvency II concepts in advance of greater clarity as to the likely content of the Solvency II regulations. While this statement comments on a number of these concepts, firms should continue to be aware of and meet all the relevant features.

1.4 The PRA's proposed timeline for transposition of the transitional provisions for own-fund items ('own-fund transitionals') was provided in CP16/14.<sup>(2)</sup> As the Solvency II Regulations are likely to come into force during the first half of 2015, the PRA expects the date at which this occurs to be the cut-off date for the issue of instruments which will qualify for consideration under the own-fund transitionals.<sup>(3)</sup> After the cut-off date firms' capital instruments will need to comply with Solvency II, as transitional treatment will no longer be available.

1.5 This supervisory statement covers the following topics:

- prohibition on redemption of instruments within five years of the date of issue;
- liability management and capital reduction;
- principal loss-absorbency mechanism for Tier 1 instruments subject to limitation ('restricted Tier 1'); and
- additional considerations for instruments intended to contribute to group own funds.

## 2 Prohibition on redemption prior to five years from date of issue

2.1 Under the General Prudential sourcebook (GENPRU of the PRA Handbook) firms are prohibited from redeeming an instrument under Tier 1 or Tier 2 prior to five years from the date of issue.<sup>(4)</sup> However GENPRU also provides<sup>(5)</sup> that firms may seek a waiver to redeem an instrument in the event of changes to the tax or regulatory treatment of an instrument within five years, where it would have been reasonable for firms to conclude at issue that such changes would not occur.<sup>(6)</sup> These calls prior to five years from issue are often referred to as tax calls, regulatory calls or more generally early calls.

2.2 The PRA expects that the corresponding provisions under Solvency II<sup>(7)</sup> will similarly prohibit calls prior to five years from issue, but will not include a waiver provision in respect of early calls. This difference in approach has attracted many questions from firms during the development of Solvency II.

2.3 The Solvency II Regulations have provisions<sup>(8)</sup> that a transaction does not constitute a repayment or redemption if it is:

- exchanged or converted into another instrument of the same or higher quality; or
- repaid or redeemed out of the proceeds of a new instrument of the same or higher quality.

2.4 The PRA considers that this reflects an approach similar in nature to the current GENPRU rule on the 'meaning of redemption'.<sup>(9)</sup>

2.5 In order to satisfy the Solvency II provisions, the PRA expects firms to ensure that any terms or conditions relating to early calls make clear that this call could only occur when the instrument is exchanged or converted, or redeemed out of the proceeds of a new instrument of the same or better quality. The PRA expects that terms covering this matter should be drafted with clarity and transparency, making clear the need for prior supervisory approval.

(1) At the time of publication of CP24/14, the available draft Solvency II Regulations are as follows:

European Commission, Delegated Act on Solvency II; available at [http://ec.europa.eu/internal\\_market/insurance/solvency/solvency2/index\\_en.htm](http://ec.europa.eu/internal_market/insurance/solvency/solvency2/index_en.htm). Set 1 of the Draft Implementing Technical Standards; available at <https://eiopa.europa.eu/en/publications/technical-standards/draft-implementing-technical-standards-on-the-supervisory-approval-processes-for-solvency-ii/index.html>.

(2) *PRA Consultation Paper CP16/14*, 'Transposition of Solvency II: Part 3', August 2014; [www.bankofengland.co.uk/pru/Documents/publications/cp/2014/cp1614.pdf](http://www.bankofengland.co.uk/pru/Documents/publications/cp/2014/cp1614.pdf).

(3) The PRA's draft rules at Transitional Measures 4.1 and 4.2 as consulted on in CP16/14 state that one of the requirements for a basic own-fund instrument to be eligible for treatment under the transitional arrangements is that it was issued before the earlier of (a) 1 January 2016 or (b) the entry into force of the delegated acts.

(4) GENPRU 2.2.70 and GENPRU 2.2.172 respectively.

(5) GENPRU 2.2.71 and 2.2.173.

(6) GENPRU 2.2.71.

(7) Articles 71(1)(f), 73(1)(c) and 77(1)(c) of the Draft Regulation (EU) [ ].

(8) Articles 71(2), 73(2) and 77(2) of the Draft Regulation (EU) [ ].

(9) GENPRU 2.2.77.

2.6 The PRA considers that any instrument containing an early call option that only provides for redemption and therefore a reduction in capital resources, would not comply with the Solvency II provisions whatever the circumstances giving rise to that call.

### 3 Liability management and capital reduction

3.1 In recent years some firms have conducted 'liability management' exercises in which they have bought back some of their outstanding capital instruments. Firms have generally engaged with their supervisors prior to carrying out such exercises. In accordance with the relevant Solvency II provisions,<sup>(1)</sup> the PRA expects that any means by which capital instruments are reduced, repaid or bought back (including share repurchases), will be subject to prior supervisory approval. The PRA also expects firms to ensure that any relevant terms and conditions in their capital instruments include the requirement for such prior supervisory approval. Buyback exercises would also fall within the scope of the minimum period of five years from issue date described in paragraph 2.6.

### 4 Principal loss-absorbency mechanism

4.1 The PRA recognises that firms issuing restricted Tier 1 instruments will need to achieve clarity as to the manner in which a principle loss-absorbency mechanism (PLAM) would operate<sup>(2)</sup> and expects the instrument's terms and conditions to be sufficiently clear, for the PRA to be confident that the mechanism works as expected and meets the requirements of the Solvency II Regulations. The PRA expects that the Solvency II Regulations will contain a number of high-level requirements which instruments with a PLAM will have to meet and European Insurance Occupational Pensions Authority (EIOPA) guidelines will clarify some aspects of how these requirements might apply in practice.

4.2 The PRA considers that the minimum trigger points for an instrument with a PLAM will be those specified in the Solvency II Regulations<sup>(3)</sup> and recognises that firms may choose a higher point or points for the mechanism to operate should they so wish.

4.3 If a trigger higher than the minimum triggers is specified, the PRA expects this to be defined in a way that the firm could identify at any point in time whether or not that trigger is met.

4.4 Once the trigger point is reached, the PRA expects the instrument with a PLAM to achieve the write-down or conversion as required by the Solvency II Regulations so that the nominal or principal amount absorbs loss. The PRA considers that the conversion or write-down would need to

apply to the total of the nominal or principal amount so that the instrument converts or is written down in its entirety.

4.5 Similarly if firms issue several instruments with a PLAM with differing trigger points, the PRA expects them to be mindful of the need for clarity and transparency regarding how they interact with each other, and the firm's overall capital arrangements.

4.6 The PRA considers that any temporary write-down mechanism needs to be considered carefully in order to ensure that the potential for any subsequent write-up does not act to hinder recapitalisation through the raising of new ordinary share capital. The PRA considers that the potential for eligible future profits to be used to restore the position of holders of the written-down instrument could be viewed by future potential shareholders as limiting the extent to which they might receive dividends and thus could act as a disincentive to their providing investment.

4.7 In addition, the PRA expects the Solvency II provisions to require firms to demonstrate that any write-up mechanism has a basis for apportioning eligible future profits that does not undermine the loss absorbency of the instrument, eg if appropriate, by adopting a similar basis as between all Tier 1 instruments, including ordinary share capital and the reconciliation reserve.

### 5 Instruments intended to count towards group own funds

5.1 The PRA recognises that many of the Solvency II provisions at solo level apply with the necessary modifications for the purposes of group solvency calculations. In respect of own funds requirements, the PRA expects the Solvency II Regulations to require specific additional features that will be necessary if a capital instrument is to count towards group own funds. The PRA expects the detail of the additional features required by the Solvency II Regulations to differ depending on which type of company in the group has issued the instrument. The PRA will consider the inclusion, or not, of these specific features as well as assessing the availability of group funds.

5.2 Where a UK Solvency II firm has issued the instrument, the PRA expects that instrument to meet the features determining classification for the relevant tier at a solo level.<sup>(4)</sup> If that same item is to count towards group own funds, then the PRA expects that actions required in relation to the firm's solvency capital requirement (SCR) and minimum capital requirement (MCR) at solo level will also need to be triggered

(1) Articles 71(1)(h), 73(1)(d) and 77(1)(d) of the draft Regulation (EU) [ ].

(2) Article 71(1)(e) of the draft Regulation (EU) [ ].

(3) Article 71(8) of the draft Regulation (EU) [ ].

(4) Article 331 of the draft Regulation (EU).

by reference to the group SCR, and the minimum group SCR as proxy (since there is no group MCR) where method 1<sup>(1)</sup> applies in whole or part to the group solvency calculation).<sup>(2)</sup> The PRA considers that compliance with relevant group features for such an instrument does not obviate the need for the item's availability to be assessed.<sup>(3)</sup> In the absence of further features the PRA expects to apply the rebuttable assumption that the item was not effectively available to cover the group SCR.<sup>(4)</sup>

5.3 In the case of an instrument issued by a third country insurer,<sup>(5)</sup> the PRA expects groups to classify the item by reference to the solo features determining classification as set out in the Solvency II Regulations. Where method 1 applies in whole or part to the group solvency calculation, the PRA also expects appropriate references to the group SCR, the local capital requirement laid down by the third country supervisor and the minimum group SCR.<sup>(6)</sup>

5.4 The PRA recognises that many groups choose to issue capital instruments from the ultimate holding company, or sometimes from a subsidiary set up for the purpose of issuing capital. In such circumstances, the PRA expects firms to consider the extent to which the instruments satisfies the solo requirements as if the issuer were an insurance undertaking subject to Solvency II,<sup>(7)</sup> with suitable adjustments to the references to SCR to group SCR, and for MCR to the minimum group SCR in relation to method 1, and to the insolvency of the issuer.

5.5 The PRA expects all instruments classified at the group level to be free from any encumbrances and any connected arrangements which would undermine the quality of the instrument at group level. The PRA draws firms' attention to the fact that an instrument issued by an insurance holding company or a mixed financial holding company should be deemed to be encumbered, unless the claims relating to the

instrument rank after the claims of policyholders and beneficiaries of all group policyholders.<sup>(8)</sup> This is consistent with the detailed requirements of the group capital structure requirements. For example, pursuant to the PRA's draft rules at Own Funds 3.5(2)<sup>(9)</sup> the PRA expects groups to consider the development of terms providing that, in the case of winding up proceedings of any firm in the group, repayment of amounts due under that instrument are refused until all obligations by that member of the group to its policyholders and beneficiaries have been met.

5.6 Holding company issues must therefore satisfactorily address the position of all group policyholders and beneficiaries. The PRA expects firms to take steps to resolve how to address this matter. The PRA also expects firms when issuing instruments between now and the own-fund transitionals cut-off date not to omit this consideration. It also expects that instruments issued after the cut-off date for own-fund transitionals would not qualify for classification as own funds at the group level if this consideration is omitted.

5.7 In assessing the availability of own funds at group level where group solvency has been calculated on the basis of method 2, the PRA will apply similar consideration as to whether own-fund items of related undertakings meet the solo requirements and have suitable references to the undertaking's SCR and the group's SCR.

## 6 Cost benefit analysis

6.1 The PRA does not expect this statement to give rise to significant incremental costs as it clarifies, but does not add to, Solvency II requirements. The statement delivers benefit since without it firms may in future incur higher-than-expected capital compliance costs if they misinterpret the Solvency II requirements.

(1) The PRA's draft rules at Group Supervision 11 and 12 as consulted on in CP16/14 lay down two methods by which group solvency can be calculated. It refers to these as 'Method 1' and 'Method 2'. Method 1 (the default method) is an accounting consolidation-based method. The alternative Method 2 is a deduction and aggregation method.

(2) Article 331(2)(b) of the draft Regulation (EU).

(3) Article 330 of the draft Regulation (EU).

(4) Article 330(3)(b) of the draft Regulation (EU) [ ].

(5) Article 332 of the draft Regulation (EU) [ ].

(6) Article 332 of draft Regulation (EU) [ ].

(7) Article 333 of the draft Regulation (EU) [ ].

(8) Recital 127 of the draft Regulations (EU) [ ].

(9) See 3.5(2) of the Own Funds Part of the draft PRA Rulebook as consulted on in CP16/14.



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# Solvency II: the treatment of pension scheme risk

November 2014

## 1 Introduction

1.1 This draft supervisory statement is of interest to all UK insurance firms within the scope of Solvency II and to the Society of Lloyd's. The PRA expects firms to read this statement alongside all relevant European legislation and relevant parts of the Prudential Regulation Authority (PRA) Rulebook.

1.2 This statement sets out the PRA's expectations of firms, in relation to defined benefit pension schemes and provides guidance and further clarity to firms which are the sponsor of a defined benefit pension scheme, or that are part of a group that contains a company which sponsors a defined benefit pension scheme. In particular this statement:

- explains what the PRA expects of firms that are not the legal sponsor of a defined benefit pension scheme but are part of a group that contains a company that sponsors a defined benefit pension scheme; and
- highlights areas to which firms should pay particular attention when considering the risks posed by a defined benefit pension scheme for the purpose of determining the solvency capital requirement (SCR). This includes risks arising both from pension schemes sponsored by the firm itself and those sponsored by another group company. This is relevant to the calculation of both the solo and group SCR.

## 2 Pension schemes sponsored by intra-group service companies and the impact on authorised firms

### Impact on the determination of own funds at a solo level

2.1 The Solvency II Regulations<sup>(1)</sup> require that most financial liabilities, including pension liabilities, should be recognised and valued in accordance with International Financial Reporting Standards.<sup>(2)</sup>

2.2 There may be circumstances where International Financial Reporting Standards do not require a firm to recognise a pension scheme on its solo balance sheet.

2.3 In making the determination as to whether to recognise a pension scheme on their balance sheets, firms should have particular regard to the requirement in International Accounting Standard 19 that a pension scheme should be recognised on the balance sheet of a firm if there is contractual agreement or stated policy in place under which the firm will contribute to the scheme.<sup>(3)</sup>

2.4 Firms should pay particular attention to relationships with intra-group service companies, where provision of staff can be

regarded as having been outsourced to the service company for the purposes of rule 7 of the Conditions Governing Business Part of the draft PRA Rulebook as consulted in CP16/14.<sup>(4)</sup> The PRA expects the Solvency II Regulations to require that, where a firm outsources critical or important operational functions or activities, a written agreement should be entered into between the firm and the service provider which clearly defines the respective rights and obligations of each party.<sup>(5)</sup> Firms should consider whether a written agreement of this nature leads to a requirement under International Accounting Standard 19 to recognise the pension scheme on the balance sheet of the authorised firm.

2.5 Obligations in relation to a pension scheme sponsored by an intra-group service company will generally be recognised on the group's consolidated balance sheet, regardless of whether or not they are recognised on the balance sheet of an authorised firm. This will lead to obligations to a pension scheme being reflected in the calculation of group own funds and the group SCR.<sup>(6)</sup>

### Impact on the solo SCR

2.6 Firms should also consider the extent to which a pension scheme sponsored by an intra-group service company poses a risk to the safety and soundness of an authorised firm whether or not obligations in connection with a pension scheme are recognised on the solo balance sheet. An example of such a risk is that the firm might find it necessary to provide support for the scheme in the future in order to assist an intra-group service company on which the firm's operations depend. Firms should also consider the powers of the Pensions Regulator regarding entities that are considered to be connected to a pension scheme sponsor. These considerations would continue to apply if the sponsorship of the pension scheme were taken on by another group company, for example an intermediate holding company.

2.7 The PRA considers that pension schemes sponsored by intra-group service companies may generally pose a risk to authorised firms in that group. Therefore, where a firm intends to use an internal model to calculate its solo SCR, the model will need to take account of the risk posed by the pension scheme. Generally, such a model will need to take account of the risk of the firm needing to fund any existing pension scheme deficit that is not currently recognised on the

(1) At the time of publication of CP24/14, the available draft Solvency II Regulations are as follows:

The Delegated Act on Solvency II:  
[http://ec.europa.eu/internal\\_market/insurance/solvency/solvency2/index\\_en.htm](http://ec.europa.eu/internal_market/insurance/solvency/solvency2/index_en.htm).  
 Set 1 of the Draft Implementing Technical Standards:  
<https://eiopa.europa.eu/en/publications/technical-standards/draft-implementing-technical-standards-on-the-supervisory-approval-processes-for-solvency-ii/index.html>.

(2) Article 9(1) and 9(2) of the draft Regulation (EU) [ ].

(3) Paragraph 41 of International Accounting Standard 19:  
[http://ec.europa.eu/internal\\_market/accounting/docs/consolidated/ias19\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias19_en.pdf).

(4) *PRA Consultation Paper CP16/14*, 'Transposition of Solvency II: Part 3', August 2014; [www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf](http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp1614.pdf).

(5) Article 274(3) of the draft Regulation (EU) [ ].

(6) Article 335(1) of the draft Regulation (EU) [ ].

firm's balance sheet, as well as the risk of the pension scheme's financial position deteriorating.

2.8 Where a firm decides not to model the risk posed by a pension scheme sponsored by an intra-group service company, on the basis that modelling this risk is not necessary, the firm will need to provide evidence that this is the case. Such evidence might include:

- evidence that the risk to the authorised firm would be addressed by the capital required to support the pension scheme being held elsewhere in the group and not in the authorised firm;
- evidence that the capital held at group level is sufficient to support the pension scheme and that this capital is unencumbered; and
- evidence that this capital may be freely transferred to the authorised firm, including at times of stress, should the firm be required to support the pension scheme in the future.

2.9 A firm is required to assess the significance of the extent to which its risk profile deviates from the assumptions underlying the standard formula.<sup>(1)</sup> As part of this assessment, the PRA expects firms to consider the risks posed by a pension scheme sponsored by an intra-group service company. Depending on whether the obligations in relation to the pension scheme are recognised on the solo balance sheet and the materiality of the pension scheme risk to the firm, the risk may be dealt with through Pillar 2 measures or the firm may need to consider whether it should use a partial internal model to calculate the SCR, in the event that the standard formula does not reflect the firm's risk profile. The PRA will take a proportionate approach in assessing how the risk should be reflected.

2.10 Notwithstanding paragraph 2.9, the calculation of the group SCR should reflect the risks posed by any defined benefit pension schemes within the group, regardless of whether or not the risks have been reflected in the solo SCR of any authorised entity.

### 3 Consideration of pension scheme obligations in the calibration of internal models with regard to credit spread risk

3.1 Internal models will need to cover the risk of credit spreads widening, where this is a material risk to the firm.<sup>(2)</sup>

3.2 International Accounting Standard 19 requires the pension scheme discount rate to be based on the yield on high-quality corporate bonds.<sup>(3)</sup> When a firm's internal model projects the value of the pension scheme liabilities following a hypothetical shock to credit spreads, this should consider which bonds will remain high quality following this shock, and what their yield would be in these circumstances.

3.3 Given this, the PRA expects that firms will justify any allowance made in an internal model for pension scheme liabilities to change following a shock to credit spreads.

## 4 Consideration of restrictions on the recognition of a pension scheme surplus as part of the calibration of an internal model

4.1 Firms should consider requirements in the relevant International Financial Reporting Standards concerning the circumstances under which a pension scheme surplus may be recognised as an asset of the sponsor.

4.2 These considerations are relevant for determining the impact of the pension scheme on a firm's own funds. If the firm uses an internal model to calculate its SCR then restrictions on the recognition of a pension scheme surplus will also be relevant for determining the SCR.

4.3 The SCR calculated by an internal model should provide policyholders with a level of protection that is equivalent to a calibration corresponding to the value-at-risk of the firm's basic own funds subject to a confidence interval of 99.5% over a one-year period.<sup>(4)</sup> It is important for the firm to consider how basic own funds may change as a result of risk events. Part of this change may be driven by changes in the value of the assets and liabilities of a pension scheme.

4.4 When considering how basic own funds may change owing to risk events, firms should consider whether restrictions on recognition of pension scheme surpluses would apply in those circumstances.

4.5 For example, an internal model may suggest that a pension scheme that is currently in deficit may move in to surplus following a risk event. When a firm considers how its basic own funds would change following this risk event, for the purpose of calculating the SCR, the PRA would expect the firm to take account of any restriction that would apply to recognition of this hypothetical emerging surplus.

## 5 Allowance for diversification between pension scheme risks and a firm's other risks in the calibration of an internal model

5.1 Firms should consider carefully the extent to which correlations exist and can be evidenced between the risks posed by a pension scheme and other risks that the firm faces. Relevant considerations include the extent to which:

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(1) Conditions Governing Business 3.8(2)(c) of the draft PRA Rulebook as consulted in CP16/14.  
 (2) Solvency Capital Requirement — Internal Models 11.6 of the draft PRA Rulebook as consulted in CP16/14.  
 (3) Paragraph 83 of International Accounting Standard 19.  
 (4) Article 101(3) of the Solvency II Directive.

- correlations exist owing to the firm and the pension scheme holding similar assets or assets whose values are expected to be correlated; or
- the pension scheme exposes the firm to demographic risks that are similar to the underwriting risks run by the firm. A particular example of strong correlations would be where a firm's insurance business exposes it to longevity risk.

5.2 Where correlations between risks are not perfect, Solvency II permits this diversification benefit to be reflected in the calibration of an internal model.<sup>(1)</sup> However, the firm will be required to justify robustly any allowance that has been made in an internal model for diversification between the risks associated with a pension scheme and the other risks faced by the firm.

## 6 Cost benefit analysis

6.1 The statement regards the benefits of providing appropriate levels of policyholder protection from exposure to pension risk as proportionate to the capital compliance costs, which are not expected to increase compared to the current approach.

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(1) Solvency Capital Requirement — Internal Model 11.8(1) of the draft PRA Rulebook as consulted in CP16/14.

## Appendix 9

## National specific templates and LOG files

Number	Template name	Template and LOG file link
NS.12	The Society of Lloyd's solvency capital requirement	The Society of Lloyd's solvency capital requirement template: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns12template.xlsx">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns12template.xlsx</a> The Society of Lloyd's solvency capital requirement log file: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns12log.pdf">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns12log.pdf</a>
NS.13	The Society of Lloyd's minimum capital requirement	The Society of Lloyd's minimum capital requirement template: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns13template.xlsx">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns13template.xlsx</a> The Society of Lloyd's minimum capital requirement log file: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns13log.pdf">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/ns13log.pdf</a>

## Regulatory reporting templates and LOG files

Number	Template name	Template and LOG file link
NL.IMS.01– NL.IMS.10	Internal model outputs (non-life)	Non-life internal model outputs template: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/nl0110template.xlsx">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/nl0110template.xlsx</a> Non-life internal model outputs log file: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/nl0110log.pdf">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/nl0110log.pdf</a>
IM.01	Internal model risk outputs (life)	Life internal model risk outputs template: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im01template.xlsx">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im01template.xlsx</a> Life internal model risk outputs log file: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im01log.pdf">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im01log.pdf</a>
IM.02	Internal model counterparty risk	Life internal model counterparty risk template: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im02template.xlsx">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im02template.xlsx</a> Life internal model counterparty risk log file: <a href="http://www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im02log.pdf">www.bankofengland.co.uk/prd/Documents/publications/cp/2014/solvency2/im02log.pdf</a>
NL.MUO.01– NL.MUO.10	Non-life model outputs	See NL.IMS.01–NL.IMS.10