



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP15/18

Solvency II: Group own funds availability

July 2018



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Responses are requested by Monday 12 November 2018

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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out its proposed approach to the determination of the availability of group own funds and its expectations on firms in presenting relevant analysis to the PRA. The PRA sets out amendments to Supervisory Statement (SS) 9/15 'Solvency II: group supervision' to reflect the proposed approach in the Appendix.

1.2 This consultation is relevant to all insurance firms within the scope of the Solvency II Directive and to the Society of Lloyd's.

Background

1.3 In 2016, the PRA published CP38/16 'Solvency II: group supervision'¹ which consulted on number of updates to its supervisory approach for group supervision including the choice of calculation method available to insurance groups; entities excluded from the scope of group supervision; single own risk and solvency assessment reports (ORSAs); single group solvency and condition reports (SFCRs); responsibilities of the relevant insurance group undertaking; and group supervision in the absence of third-country equivalence. The PRA's consideration of responses to the CP were set out in Policy Statement 17/18 'Solvency II: group supervision',² and included an updated version of SS9/15.³

1.4 Further to these amendments, proposals in this CP would better align the PRA policy and supervisory expectations with the point of view put forward by the European Insurance and Occupational Pensions Authority (EIOPA) regarding group own funds availability, through its answer to a question posed in late 2017.⁴

1.5 The PRA proposals are informed by some of the feedback the PRA received to CP38/16 as well as by supervisory practice on assessments the PRA has considered since Solvency II came into force.

Responses and next steps

1.6 This consultation closes on Monday 12 November 2018. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP15_18@bankofengland.co.uk.

1.7 The proposals in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect.

2 Proposals

2.1 The PRA bases its assessment of group own funds availability on the criteria as set out in Article 330 of the Commission Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC of the European Parliament and of the Council⁵ on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) which includes the assessment as to whether any legal or regulatory requirements restrict the ability of:

1 November 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-group-supervision (page 2 of 2).

2 www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-group-supervision (page 1 of 2).

3 July 2018: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-group-supervision-ss.

4 Q&A 438, EIOPA Q and A on Regulation-Answers – Delegated Regulation:
[https://eiopa.europa.eu/Publications/Guidelines/Solvency II Delegated Regulation 17-Nov.xlsx](https://eiopa.europa.eu/Publications/Guidelines/Solvency%20II%20Delegated%20Regulation%2017-Nov.xlsx).

5 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0138&from=EN>.

- own funds items held by insurance or reinsurance undertakings, insurance holding companies or mixed financial holding companies to absorb losses of any nature, elsewhere in a group; and
- those entities to transfer assets to other Solvency II firms in the insurance group.

2.2 Where there is a regulatory requirement to maintain a certain level of solo capital, the PRA looks at the effect that this has on the availability of capital. Solvency II also provides that own funds representing the contribution that is made to the group solvency capital requirement (SCR) should be treated as available. The difference between this amount and the amount of own funds representing the solo capital requirement effectively represents the benefit that the group derives from diversification effects between group entities. The calibration of the group SCR is based on the assumption that the group should benefit from such diversification effects where capital meets the standards set in Solvency II. The PRA therefore considers whether the capital is classified in such a way that reflects its ability to absorb losses to the degree expected under Solvency II and whether any solo capital requirement is calibrated on the same basis as under Solvency II.

2.3 In this CP, the PRA proposes that in assessing group own funds availability, the solo SCR should no longer be presumed to be a barrier to availability. The proposal does not address other potential barriers to group own funds availability. The proposed approach has been developed as part of contributing to the view expressed by EIOPA in its response to a question posed in 2017. Accordingly, the PRA does not expect groups to routinely provide evidence of how own funds may be made available in spite of an insurance undertaking being subject to a Solvency II solo SCR.

2.4 However, the PRA would still expect such analysis to be provided where a group insurer is based in a jurisdiction that is not subject to a regime that is similar to, and built on the same principles in relation to capital requirements and quality of capital at solo level as, the UK solvency regime. The reason for this differentiation is that insurers not subject to such a regime may have solo regulatory requirements calculated on a different basis (either requirements set at a different confidence level or capital resources calculated using different local valuation and quality of capital rules).

3 The PRA's statutory obligations

3.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to consult when setting its general policies and practices.¹ In doing so, it is required to comply with several statutory and public law obligations. The PRA meets these obligations by providing the following in its consultations:

- a cost benefit analysis (CBA);²
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective, insurance objective (if applicable), and secondary competition objective;³
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;⁴ and

1 Section 2L of FSMA.

2 Section 138J (2) of FSMA.

3 Section 2B, section 2C and section 2H (1) of FSMA.

4 Section 2H 2 of FSMA.

- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.¹

3.2 The PRA is also required by 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.

3.3 The PRA should have regard to aspects of the Government's economic policy as recommended by HM Treasury.²

Cost benefit analysis

3.4 The proposals contained in this CP relate to the PRA's approach to recognising own funds at the level of a solo insurer subject to a Solvency II SCR requirement as available to meet the insurance group's capital requirement.

3.5 There should be no additional costs for firms implementing the proposed amendment to the PRA supervisory approach for group supervision. The proposed approach should only lead to an incremental benefit for those firms which would no longer be required to undertake and submit to PRA an availability assessment for the group own-funds from EEA entities in the group. The costs related to assessing other potential barriers to group own funds availability are unaffected by this proposal.

3.6 The PRA's secondary objective is to facilitate effective competition between providers of PRA regulated activities, and competition is effective when it is fair and prudent. The PRA expects no impact on competition in the United Kingdom from its proposals.

Compatibility with the PRA's objectives

3.7 The PRA believes that the proposals in this CP are compatible with the PRA's statutory objectives to promote the safety and soundness of PRA-authorized firms; and in the context of insurance, to contribute to policyholder protection. The proposals in this CP further specify PRA's expectation for firms undertaking availability of own funds assessments and relieves firms from having to routinely provide evidence of how own funds may be made available in spite of an insurance undertaking being subject to a Solvency II solo SCR. The PRA will continue to expect such assessments to be provided on a regular basis for own funds from third country subsidiaries that are not subject to a solvency regime (and quality of capital requirements) that provides similar outcomes to that applied to UK firms.

3.8 By providing guidance to firms on how the PRA expects firms to implement the Solvency II Directive (2009/138/EC), the PRA is also helping ensure that the main objective of the Directive, described in Article 27 of the Directive as the protection of policyholders and beneficiaries, is met.

Regulatory principles

3.9 In making its rules and establishing its policy, practices and procedures, the PRA must have regard to the regulatory principles as set out in FSMA.

3.10 Two of the principles are of particular relevance to this consultation:

1 Section 138K (2) of FSMA.

2 www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-spring-budget-2017.

- (a) That a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.

Through the proposed supervisory approach, the PRA is reducing the firm's burden of proof for group own fund availability assessments. The PRA follows this principle by further ensuring that the burden it imposes on firms is proportionate to the benefits expected. The PRA proposed approach also provides for further alignment with the current EIOPA expectations for assessing group own funds as set in its Q&A publication.

- (b) That the regulators should exercise their functions as transparently as possible.

The PRA has followed this principle by issuing a consultation on its current supervisory expectations, and when the policy is finalised by including it in an updated version of SS9/15.

HM Treasury recommendation letter

3.11 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.¹

3.12 The aspect of the Government's economic policy most relevant to the proposals in this CP is competitiveness. Through the proposed policy, the PRA seeks to reduce the administrative costs for insurance groups in demonstrating that own funds of insurers in the group are available to the group where those insurers are subject to requirements which are similar in outcome to those applicable under the UK group solvency regime. This should enhance the competitiveness of insurance groups regulated by the PRA.

Impact on mutuals

3.13 In the PRA's opinion, the impact of the proposed supervisory statement on mutuals is expected to be no different from the impact on other firms.

Equality and diversity

3.14 The PRA considers that the proposals do not give rise to equality and diversity implications.

¹ Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Appendix: Draft amendments to Supervisory Statement 9/15 ‘Solvency II: group supervision’

This appendix outlines proposed amendments to SS9/15 ‘Solvency II: group supervision’.

Underlining indicates new text and striking through indicates deleted text.

5A Availability of group own funds

5A.1 Group Supervision 9.4 and Article 330 of the Commission Delegated Regulation place limits on the own funds which can be included in the group solvency calculation, depending on their availability to absorb losses anywhere in the group.

5A.2 Groups are required to set out their own assessment of any items which might be deducted from own funds due to any significant restriction affecting the availability, fungibility or transferability of own funds within the undertaking. Unless a formal determination is made by the PRA in respect of a particular own funds item, firms should report own funds items as available (notwithstanding their own assessment) except where the treatment of that own fund item is specifically referenced under Article 222 of the Directive and Article 330 of the Delegated Regulation.¹ The PRA expects firms to provide the appropriate level of detail in these assessments, either in the solvency and financial condition report (SFCR) or in the regular supervisory report (RSR) depending on the confidentiality of the information. These assessments would subsequently be updated by the firm if there are material changes in the group or as agreed with the supervisor. Firms are expected to comply with the EIOPA Group Solvency Guideline 13² when making its own assessment of availability of own funds at group level of related undertakings that are not subsidiaries.

5A.2.1 Since the current UK group solvency regime indicates that the group SCR is intended to represent a diversified risk standard, the PRA makes the assumption that diversification benefits are intended to be preserved when the valuation basis and quality of capital used to meet that standard correspond with UK group solvency principles. The consequence of this is that where standards that are not built on the same principles as, and are similar in outcome to, those applicable under the UK group solvency regime are applied to the valuation basis and quality of capital, then the PRA will not assume that diversification benefits are intended to be preserved.

5A.2.2 Therefore, in principle, firms should not consider the solo SCR as restricting the availability of own fund items or assets at the level of the group, in the meaning of Article 330 of Commission Delegated Regulation (EU) 2015/35. However this does not prevent the PRA from challenging the availability and transferability of own funds as assessed by groups. In the case where the PRA deems that own fund items are unavailable, under Article 330 of the Commission Delegated Regulation the PRA may require the group to make a deduction from group own funds. Groups should engage from an early stage with their group supervisor should there be any doubt as to the availability and transferability of group own fund items.

5A.2.3 The assumption made concerning the solo SCR as a restriction for the purposes of calculating the group SCR does not alter the operation of the solo SCR as a requirement for solo own funds.

1 https://eur-lex.europa.eu/eli/reg_del/2015/35/oj.

2 EIOPA Guidelines on Group Solvency: <https://eiopa.europa.eu/publications/eiopa-guidelines/guidelines-on-group-solvency>.

5A.2.4 Firms should note that solo regulatory requirements applied under regimes which are not built on the same principles as, or similar in outcome to, the UK solvency regime do not necessarily apply the same basis for valuing assets and liabilities, and therefore the availability of capital contributed to the group solvency position and the transferability of assets from those regimes may be different. In these cases the PRA will presume that solo regulatory requirements do restrict the availability of capital or assets at the level of the group and so the PRA expects firms to provide details how such own funds would be made available considering the elements set out at Article 330 of the Commission Delegated Regulation.

5A.2.5 Not only could the different valuation bases and quality of capital permitted for the purpose of local regulatory requirements affect the availability of capital which represents the difference between the contribution to the group SCR and the solo SCR, but also the availability of any surplus capital in excess of the local solo regulatory requirement. The PRA expects firms to take this into account when providing it with information on which the PRA will base its judgements as to the point at which other regulators would intervene to restrict flows of capital out of their jurisdiction.

5A.2.6 Firms will also need to classify separately own funds at group level in accordance with Articles 331 to 334 of the Solvency II Delegated Regulation including those own funds contributed by third country insurance or reinsurance undertakings. The quality of capital will be one of the factors taken into account by the PRA when determining when and at which level supervisors from jurisdictions that do not have a solvency framework similar to that applicable in UK may raise regulatory barriers to reduce own funds availability at group level.

5A.3 When firms are providing details of how own funds could be made available to the group, the PRA notes that these may include actions ~~At the group level, firms can take a number of potential actions~~ to transfer own funds around the group, for instance through paying dividends, or selling the assets of an undertaking or insurance holding company to recapitalise group companies in difficulty. The PRA will consider these actions when reviewing a group's assessment of transferability. ~~However~~ In respect of parts of the group subject to requirements which are not similar in outcome to those applicable under the UK group solvency regime, the PRA expects groups to provide robust and credible evidence that the apparent availability of own funds at the group level is not compromised or effectively undermined by any legal or regulatory restrictions on transferability, and that the suggested action resulting in the transfer of the own funds does not jeopardise an orderly resolution of the group. In particular, the PRA expects the evidence to cover, as a minimum, the likely scenarios under which the actions could be taken, and the time that would be required to execute the actions. For the own funds considered available at group level, the PRA expects groups to evidence that these own funds can be made available to the group within a maximum of nine months.¹

5A.4 Under the current group solvency framework, the PRA may decide to apply to a group the deduction and aggregation method (method 2) for calculation of its solvency requirements, which would allow a firm to use local solvency rules when determining the requirements placed on (equivalent) third-country related undertakings. However, the assessment of the availability at a group level of an own funds item of such a related undertaking needs to be carried out by reference to the UK groups provisions, not only local rules.

5A.5 To illustrate this point further, the assessment of availability should demonstrate that both the solo undertaking third-country rules and the UK group rules have been considered. For example,

1 Article 330 of the Commission Delegated Regulation (EU) 2015/35 of 10 October supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) Text with EEA relevance.

this might mean that for an own funds item to be considered available at the level of the group, the firm should be able to defer coupon payments both in the event of non-compliance with the solo undertaking's third-country capital requirement and the UK group SCR.