Bank of England PRA

Solvency II: The PRA's approach to the permissible recovery period for insurers to restore full cover for their SCR

Statement of policy

November 2024

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

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1: Introduction

1.1 This statement of policy (SoP) relates to the Undertakings in Difficulty and Group Supervision Parts of the PRA Rulebook. Those Parts and the framework outlined in this SoP apply to UK Solvency II firms, the Society, and relevant insurance group undertakings hereafter called insurers. This SoP sets out the circumstances that could lead to the PRA declaring an exceptional adverse situation for the purpose of those rules, and the factors that the PRA will consider in determining whether an insurer should be permitted to have an extension of the permissible recovery period during which it should take the necessary measures to restore full cover for its Solvency Capital Requirement (SCR) including where an exceptional adverse situation has been declared.

1.2 This SoP should be read in conjunction with the statutory Threshold Conditions, and the PRA's Solvent exit planning for insurers policy, as set out in the supervisory statement proposed in consultation paper (CP) 2/24 — Solvent exit planning for insurers.[1]

1.3 Chapter 2 sets out the nature of the circumstances and other factors that the PRA would expect to consider before declaring the existence of an exceptional adverse situation affecting insurers representing a significant share of the market or affected lines of business.

1.4 Chapter 3 sets out the factors and criteria that the PRA will take into account before deciding on an extension of the permissible recovery period for a given insurer, during which the insurer must take the necessary measures to restore full cover for its SCR. The PRA may decide to extend the period of six months in which an insurer must take the measures necessary to achieve the re-establishment of its SCR in the event of a declaration of an 'exceptional adverse situation' and after considering all relevant factors, by up to seven years. In the absence of a declaration of an exceptional adverse situation it may decide to extend the permissible recovery period by up to three months, to make at most nine months from the date when the non compliance was observed.

1 www.bankofengland.co.uk/prudential-regulation/publication/2024/january/solvent-exit-planning-for-insurers-consultation-paper.

2: Declaration of an exceptional adverse situation

2.1 An ‘exceptional adverse situation’ means situations where the financial situation of insurers representing a significant share of the market or the affected lines of business is seriously or adversely affected by one or more of the following conditions:

(a) a fall in financial markets which is unforeseen, sharp and steep;

(b) a persistent low interest rate environment; and

(c) a high impact catastrophic event.

2.2 The PRA would expect to take into account the following factors and criteria before it declares the existence of an ‘exceptional adverse situation’:

(a) The impact of possible subsequent decisions by the PRA to extend the recovery period; (i) on financial markets; (ii) on the availability of insurance and reinsurance products; and (iii) on policyholders and beneficiaries;

(b) the number, size and market share of the insurers affected by the exceptional adverse situation and whether the size and nature of those insurers could, when taken together, have a negative effect on the financial markets, or on insurance and reinsurance markets;

(c) possible pro cyclical effects of re establishing compliance with the SCR, including distressed sales of assets on financial markets;

(d) the possibility for insurers to raise additional own funds in financial markets;

(e) the availability of an active market for assets held by insurers and the liquidity of that market;

(f) the capacity of the reinsurance market to provide reinsurance or retrocession cover;

(g) the availability in financial markets of adequate risk mitigation techniques, including financial instruments; and

(h) the availability in financial markets of other means to reduce the risk-exposure of insurers.

2.3 However, the PRA cannot be certain in advance of all the circumstances that could lead to, or appertain to, such a declaration and would take a decision at the relevant time in line with all the then relevant factors, its statutory objectives, and the legislative framework.

2.4 Following a declaration of an ‘exceptional adverse situation’, the PRA will assess on a regular basis whether the conditions in paragraph 2.2 above still apply and will declare when the exceptional adverse situation has ceased to exist.

3: Extension of the permissible recovery period for an insurer

3.1 An insurer may apply to the PRA for a rule modification, so as to enable an extension of the permissible recovery period during which it must take the necessary measures to re-establish the level of eligible own funds covering its SCR or reduce its risk profile to ensure compliance with its SCR requirement.

3.2 In the absence of an exceptional adverse situation, the PRA will apply the criteria in section 138A of the Financial Services and Markets Act 2000 (FSMA) when considering an application for an extension of the permissible recovery period, and will take into account in particular the impact of an extension on those who are or may become policyholders and beneficiaries of the insurer. The PRA will not extend the permissible recovery period by more than three months in the absence of an exceptional adverse situation.

3.3 If the PRA has declared an exceptional adverse situation in accordance with Chapter 2 above, then an insurer may apply under section 138BA of FSMA for an extension of the recovery period. The PRA will take into account the following factors before deciding on an extension in such a situation, and then determining the length of the extension (by up to a maximum of 7 years) for the permissible recovery period (beyond the normal six months) for a given insurer:

(a) the impact of an extension on those who are or may become policyholders and beneficiaries of the insurer;

(b) the extent to which the insurer is affected by the ‘exceptional adverse situation’;

(c) the means available to the insurer to re-establish compliance with the SCR and the existence of a realistic recovery plan;

(d) the causes and the degree of non-compliance with the SCR;

(e) the composition of own funds held by the insurer;

(f) the composition of the assets held by the insurer;

(g) the nature and duration of technical provisions and other liabilities of the insurer;

(h) when applicable, the availability of financial support from other undertakings of the group to which the insurer belongs;

(i) any measures taken by the insurer to limit the outflow of capital and the deterioration of its solvency position;

(j) the criteria set out at paragraph 2.2 (c)-(h) above; and

(k) the level of cover for the insurer's Minimum Capital Requirement (MCR).

3.4 Where the insurer submits to the PRA a progress report, then the PRA will consider whether this shows that there has been any significant progress in achieving the re-establishment of the level of eligible own funds covering the SCR, or the reduction of the risk profile to ensure compliance with the SCR. If this report shows that there has been no significant progress made between the date of the observation of non-compliance of the SCR and the date of the submission of the progress report, then the PRA would expect to withdraw any extension of the permissible recovery period that it has granted an insurer, but will determine this in the light of the particular circumstances at the time.

3.5 If the insurer has been:

(a) unable to restore full compliance with its SCR within the permissible recovery period (including any extension of this period that the PRA had granted and not withdrawn); or

(b) unable to restore full cover for its MCR within a period of three months (for which an extension will not be permitted) of an observation of non-compliance with the MCR,

then the PRA will withdraw any permission for the insurer to effect new contracts of insurance, and the insurer would be expected to execute a solvent exit.[2]

2 'Solvent exit' means the process through which a firm ceases its insurance business while remaining solvent.