

# Supervisory Statement | SS15/15

## Solvency II: approvals

Appendix 2.15

March 2015



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
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## 1 Introduction

1.1 This supervisory statement is of primary interest to all UK Solvency II firms and to the Society of Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) expectations of firms regarding the following Solvency II approvals:

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

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

1.3 This statement has been subject to public consultation<sup>(2)</sup> and reflects the feedback that was received by the PRA.

## 2 Applications for Solvency II approvals

2.1 Firms can formally submit applications to the PRA for Solvency II approvals from 1 April 2015. Prior to submitting an application the PRA encourages firms to discuss the approvals they intend to apply for with their usual supervisory contact.

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

2.3 Where the PRA is the group supervisor, the PRA will consult the relevant members of the college of supervisors and take into account their views as part of reviewing group applications. The PRA also expects to have input into the

group application processes where the PRA is part of a college of supervisors led by a group supervisor from another Member State.

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

### Dependencies between approvals

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

- firms applying to use the MA may consider another measure as an alternative;
- where firms apply for any of the transitional measures at the same time as applying for the MA and/or volatility adjustment (VA), the PRA expects firms to provide sensitivity tests showing the impact on the transitional measure(s) if their applications for the other adjustments are approved or rejected; and
- where a group submitting an internal model application is intending to use the deduction and aggregation method (method 2) for the group solvency calculation, or intending to apply to exclude an entity from the scope of group supervision, consideration should be given to the impact on the group internal model application if these applications are rejected.

### Internal model approval and matching adjustment

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

### Equivalence

2.7 Where approvals are related to an equivalence decision, if firms wish to submit an application before the equivalence decision is finalised, they may submit an application, stating

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

(2) *PRA Consultation Paper CP24/14, 'Solvency II approvals'*, October 2014; [www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp2314.pdf](http://www.bankofengland.co.uk/pradocuments/publications/cp/2014/cp2314.pdf).

the assumptions made with regard to equivalence. Where appropriate, the PRA may refrain from making a decision until the equivalence decision has been finalised.

### 3 Internal models

3.1 Firms intending to submit an application for internal model approval should refer to the Solvency II Regulations regarding the internal model approval processes for information on how to submit a formal internal model application. The European Insurance and Occupational Pensions Authority (EIOPA) has published an internal model application template which firms should use for their formal internal model applications. Firms in the pre-application process can continue to use the existing PRA self-assessment template (SAT),<sup>(1)</sup> and will be expected to transpose data onto the new EIOPA template when they make their formal application. The PRA will not be updating the SAT to align with EIOPA's application template.

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

### 4 Matching adjustment, ancillary own funds and undertaking specific parameters

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

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

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

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

#### Matching adjustment

4.5 Under Article 77(b) of the Solvency II Directive, firms may apply for approval to use a MA. The PRA's detailed expectations on the MA have been set out in a series of industry communications, including letters from the Executive Director for Insurance, that are available on the Bank's website.<sup>(2)</sup>

4.6 Firms wishing to apply to use the MA can submit a formal application after 1 April 2015. Those firms that participate in the MA pre-application process are also expected to provide the PRA with a detailed breakdown of any changes that have occurred since pre-application.

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

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

#### Ancillary Own Funds

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

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

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

Since the AOF must be callable on demand, firms will also need to demonstrate that there is no trigger event or restrictions affecting when the AOF item can be called.

(1) Dated February 2012, available at [www.bankofengland.co.uk/pradocuments/solvency2/soliiselfassesstemp.xls](http://www.bankofengland.co.uk/pradocuments/solvency2/soliiselfassesstemp.xls).

(2) Available at [www.bankofengland.co.uk/pradocuments/solvency2/updates.aspx](http://www.bankofengland.co.uk/pradocuments/solvency2/updates.aspx).



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

### Undertaking Specific Parameters

4.12 Under Article 104(7) of the Solvency II Directive, firms may apply to the PRA to use USPs when calculating their SCR using the standard formula. Firms are encouraged to submit the application checklist as this will help to ensure firms meet the requirements of the Solvency II Directive.

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

4.14 Under Article 230 of the Solvency II Directive, groups can also apply to the PRA to use group specific parameters (GSP) when calculating the group SCR with the standard formula. Groups seeking to use GSPs should use the same application process as described for USPs, including the submission of the application checklist.

## 5 Other Solvency II approvals

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

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

5.2 For the approvals discussed in this section, the Directive is silent as to any mandated timeframes that the PRA must comply with. The PRA, however, intends to make every effort to communicate, in writing the decision to approve or reject the application, within six months of receiving a completed application.

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

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

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

5.6 All approvals discussed in this section may be effected by use of the statutory waiver power (s.138A of the Financial Services and Markets Act 2000 (FSMA)). Firms should refer to the Bank of England website for further information on the relevant waiver process.

### Exclusion of entity from scope of group supervision

5.7 Article 214(2) of the Solvency II Directive allows the PRA, in consultation with other concerned supervisory authorities, to exclude an entity from the scope of group supervision. This Article is the mechanism to exclude any entity from the scope of group supervision, regardless of its type.

5.8 If the PRA decides that an entity is to be excluded from the scope of group supervision under Article 214(2), then the provisions in the Solvency II Directive will not apply to that entity. However, the group should ensure that any risks which that excluded entity may pose to the rest of the group are adequately identified and managed. Those risks should be reflected in the ORSA and the capital adequacy assessments of group entities that are at risk (including modelled assessments).

### Single group ORSA

5.9 Under Article 246 of the Solvency II Directive, a group can apply to produce a single ORSA report which covers the group and the firm-level ORSA for all the firms in the group.

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

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

5.11 If permission is granted to produce a single ORSA report covering the group and the firm-level ORSA findings, the

group will be required to submit the single ORSA report at the same time to the group supervisor and all the relevant supervisory authorities whose firms report their ORSA findings in the single ORSA report. The exercise of that option shall not exempt the firms concerned from the obligation to ensure that the requirements of Article 45 of the Solvency II Directive are met. For clarity, firms still need to carry out a full ORSA and provide output of this process to the group for inclusion in the single ORSA report, rather than share its full output with their solo supervisor.

5.12 Groups intending to seek approval for a single ORSA report covering the group and the firm-level ORSA findings, should provide a draft single ORSA report as part of their application process based on the forward-looking assessment of own risks (FLAOR) performed by groups during the EIOPA preparatory phase in 2014 and 2015.

### SFCR dispensation

5.13 Under Article 53(1) of the Solvency II Directive a firm can apply to the PRA for reporting exemptions, allowing them to exclude certain information from their SFCR, for example, the public narrative report.

5.14 Under Article 256 of the Solvency II Directive, groups may also apply to the PRA for this exemption. Groups that wish to apply for non-disclosure are also encouraged to submit the application checklist.

### Calculation method for group solvency capital requirement

5.15 Under Article 220 of the Solvency II Directive, the PRA as group supervisor may decide to require groups to calculate their group capital requirements using the deduction and aggregation method ('method 2') instead of the default accounting consolidation-based method ('method 1'), or to use a combination of method 1 and method 2.

5.16 If groups do not think that the exclusive use of method 1 is appropriate and therefore propose to use method 2, or a combination of method 1 and method 2, the PRA expects groups to indicate this by submitting the PRA's application checklist. This form includes the necessary information the PRA needs to make its decision on the choice of calculation method and includes the financial and solvency position of subsidiaries, availability of data, and rationale for using an alternative to method 1.

5.17 The PRA will review the submission from groups and, where applicable, in co-operation with the college of supervisors, decide on whether the exclusive use of method 1 is appropriate and whether to allow groups to use method 2, or a combination of the two. The PRA will make its decision based on the factors outlined in the Solvency II Regulations. As part of this assessment, the PRA will review the impact of the use of method 2 or a combination method on the solvency position of the group, own funds availability, and the interconnectedness of any entity for which method 2 would be used and the rest of the group.