

Supervisory Statement | SS9/15

Solvency II: Group supervision

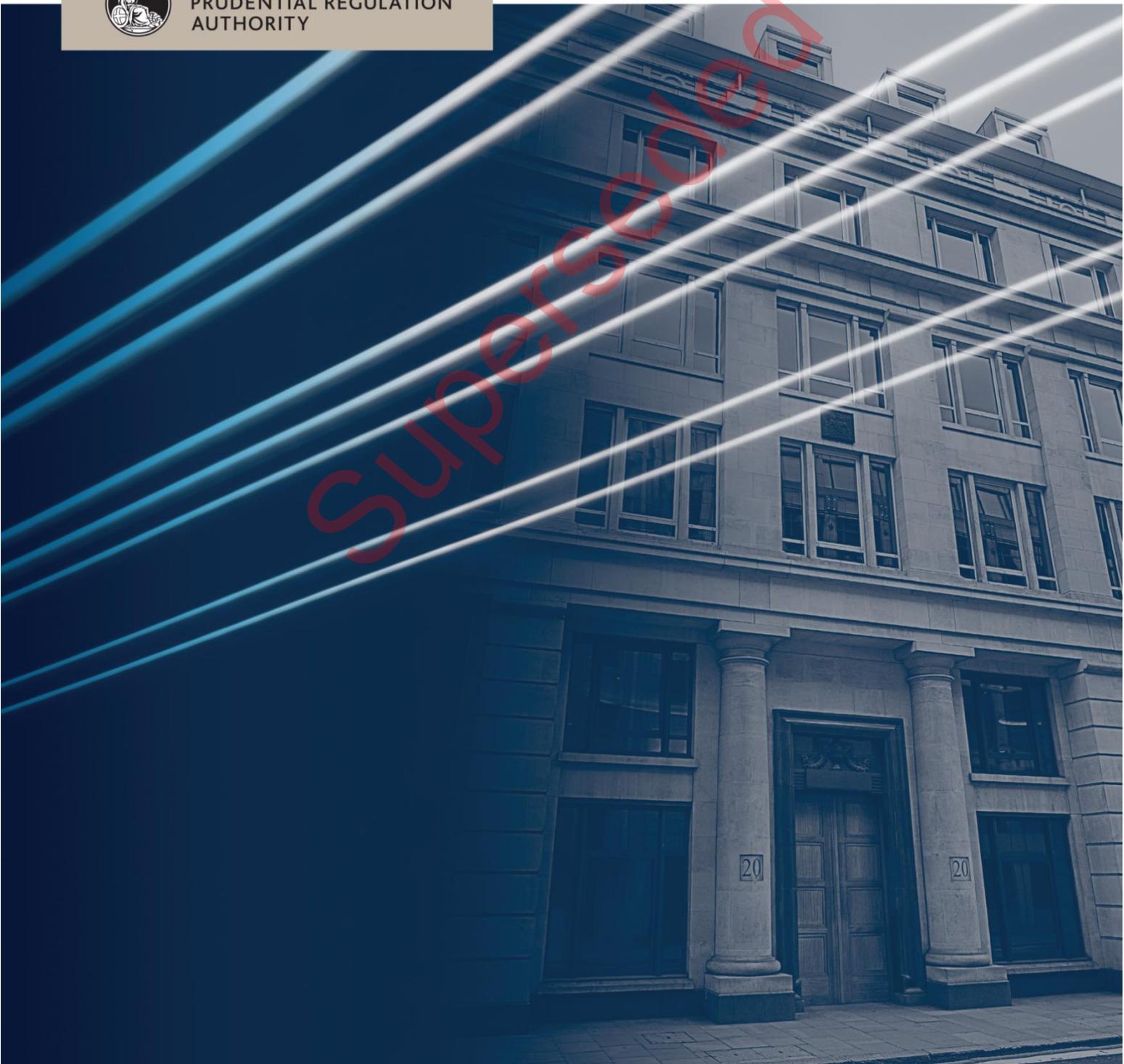
April 2020

(Updating March 2019)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Superseded





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS9/15

Solvency II: Group supervision

April 2020

(Updating March 2019)

Superseded

Contents

1	Introduction	1
2	Entities excluded from the scope of group supervision	1
3	Choice of calculation method	2
4	Group capital add-on	2
5	Centralised risk management [deleted]	2
5A	Availability of group own funds	2
5B	Regulatory determination on the availability of group own funds	4
6	Single own risk and solvency assessment report	6
7	Single solvency and financial condition report	6
8	Responsibilities of the relevant insurance group undertaking	7
9	Supervision in the absence of third-country equivalence	7
	Annex	9

1 Introduction

1.1 This supervisory statement is addressed to all UK Solvency II firms and to the Society of Lloyd's, which the PRA considers to be a mixed activity insurance holding company. It sets out the Prudential Regulation Authority's (PRA's) expectations in respect of the Solvency II groups provisions.

1.2 Firms should note that if the group supervisor is a supervisory authority other than the PRA, the PRA still expects UK insurers to comply with PRA rules relating to group supervision (if they are part of a group). The PRA expects firms to behave in a way that contributes to effective group supervision irrespective of which supervisory authority is acting as group supervisor.

1.3 This supervisory statement should be read in conjunction with the relevant European legislation, the Group Supervision Part of the PRA Rulebook, The Solvency 2 Regulations 2015¹ ('the Regulations') and the PRA's insurance approach document.²

1.4 This supervisory statement expands on the PRA's general approach as set out in its insurance approach document. 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.

1.5 [Deleted]

2 Entities excluded from the scope of group supervision

2.1 Where a group, for which the PRA is the group supervisor, wishes to exclude entities from the scope of group supervision, it will be expected to make a formal application to the PRA. Where that application is approved, the exclusion will be given effect by the PRA issuing a direction under section 138A of the Financial Services and Markets Act 2000 (FSMA), taking into account the criteria in Article 214(2) of the Solvency II Directive³ ('the Directive'). The PRA expects such applications to articulate the way in which the firm believes that the conditions set out in Article 214(2) of the Directive are met.

2.2 The PRA will assess applications to exclude entities from the scope of group supervision under Article 214(2) of the Directive on a case-by-case basis and will consult with other concerned supervisory authorities in the circumstances required by Regulation 12 of the Regulations.

1 SI 2015/575 available at www.legislation.gov.uk/ukxi/2015/575/contents/made.

2 Available at www.bankofengland.co.uk/prudential-regulation/supervision.

3 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) Text with EEA relevance.

3 Choice of calculation method

3.1 Where the PRA is the group supervisor the PRA may decide, after consulting other concerned supervisory authorities where relevant and the group (as required by Regulation 16 of the Regulations), to apply to the group either method 2 (deduction and aggregation method) or a combination of methods 1 and 2, where the exclusive application of method 1 (accounting consolidation-based method) would not be appropriate,⁴ having considered the provisions of Article 328(1) of the Commission Delegated Regulation.⁵

3.2 Where a group for which the PRA is the group supervisor wishes to use method 2 or a combination of methods 1 and 2, the PRA expects it to make a formal application to the PRA for a direction under section 138A of FSMA.

3.3 The PRA expects this application to articulate the way in which the firm believes that the elements in Article 328(1) of the Commission Delegated Regulation should be considered in the context of the firm's application.

4 Group capital add-on

4.1 Where the PRA is the group supervisor, in considering whether the consolidated group Solvency Capital Requirement (SCR) appropriately reflects the risk profile of the group, it may consider a capital add-on for a group if the circumstances referred to in Article 37(1)(a) to (d) of the Directive arise at the group level.

4.2 In particular, the PRA will consider imposing a capital add-on under Article 232 of the Directive where a:

- (a) specific risk at group level is not sufficiently covered by the standard formula or an internal model; or
- (b) capital add-on is imposed on a Solvency II undertaking in the insurance group because its risk profile deviates significantly from the assumptions underlying the group's internal model.

5 Centralised risk management [deleted]

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

⁴ Group Supervision 7 in the PRA Rulebook.

⁵ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 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.

specifically referenced under Article 222 of the Directive and Article 330 of the Delegated Regulation.⁶ 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 13⁷ when making its own assessment of availability of own funds at group level of related undertakings that are not subsidiaries.

5A.2A The PRA assesses availability of own funds to cover the group solvency capital requirement (SCR) on the same basis for different types of groups. In particular, the PRA notes that the scope of the assessment, elements of availability and assumptions as to the availability of different types of own funds under Article 330 of the Delegated Regulation do not differ depending on structure of the group or the type of entity at its head. Furthermore, where a firm faces legal or other restrictions from issuing other types of own funds as a result of being a mutual or company limited by guarantee, it may place greater reliance on own funds issued by other group undertakings. The PRA considers that it is important that such groups demonstrate that these own funds are not restricted in meeting all types of losses arising anywhere in the group.

5A.2AA 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 not 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.2B 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.2C 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.

5A.2D Firms should note that solo regulatory requirements applied under regimes which are not built on the same principles as, or not 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.

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

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

5A.2E 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.2F 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 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. 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.⁸

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, 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.

5B Regulatory determination on the availability of group own funds

5B.1 Article 330 in the Delegated Regulation sets out how own fund items of: a related insurance or reinsurance undertaking; insurance holding company; or mixed financial holding company should be

⁸ 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.

assessed when considering their availability at the group level. The Article identifies and describes the treatment of specific own fund items where those own fund items are either:

- (i) presumed to be unavailable unless the firm can demonstrate to the group supervisor that this assumption is inappropriate; or
- (ii) not considered to be available in any case.

5B.1A Subordinated liabilities and preference shares are among own fund items treated as in 5B.1

(i). These instruments create legal obligations on the issuing entity to their holders. At the same time, the issuing entity would not ordinarily have legal obligations in relation to losses arising in another group undertaking. This restricts the ability of these instruments to absorb losses in other group undertakings.

5B.1B Where the PRA is the group supervisor, for a firm to satisfy the PRA that the own fund items are available to cover the group SCR, the firm needs to demonstrate that these own fund items are available to absorb losses anywhere in the group. The PRA considers that a firm may demonstrate this as follows:

- Each insurance and reinsurance undertaking in the Solvency II group has the right to claim against the issuing entity if that insurance or reinsurance undertaking is wound up and there is a shortfall for its policyholders and beneficiaries. This includes any insurance and reinsurance undertakings acquired by the group after the issuance of the subordinated liabilities or preference shares. Furthermore, the right of the group insurance and reinsurance undertakings to claim on the issuing entity does not significantly increase group risks, including the level of complexity when winding up and contagion risk for issuing entities that are insurance or reinsurance undertakings.
- The legal obligations of the issuing entity to the holders of the instruments, including coupon payments, are subordinated to any claims made by group insurance and reinsurance undertakings that are being wound up.

5B.1C The PRA considers that intra-group guarantees used for this purpose increase certain risks in a group. The PRA would assess the level and volume of risks and the possible risks of contagion in the group due to the intra-group guarantees. The PRA would expect a firm to demonstrate that the intra-group guarantees do not significantly increase the level of complexity when winding up the group. The PRA would also expect a firm to demonstrate that the intra-group guarantees do not significantly increase contagion risk for issuing entities that are insurance or reinsurance undertakings by exposing the solvency of the issuing entity to losses in the other insurance and reinsurance undertakings in the group.

5B.1D The PRA considers that features that increase the impact of intra-group guarantees on these risks include, but are not limited to, the following:

- (i) the issuing entity is an insurance or reinsurance undertaking;
- (ii) there are multiple insurance and reinsurance undertakings in the group;
- (iii) the issuing entity is a subsidiary of an entity that either has related insurance or reinsurance undertakings, or is an insurance or reinsurance undertaking; and
- (iv) there are significant intra-group transactions, both in terms of volume and value.

5B.1E As these features are present in most groups, the PRA expects that for most groups it will not be appropriate to use intra-group guarantees to make subordinated liabilities and preference shares effectively available to absorb losses anywhere in the group. Furthermore, the PRA would expect a firm to consider any other relevant group-specific factors that increase group complexity. The PRA is receptive to other approaches that firms may wish to propose when seeking to demonstrate availability of subordinated liabilities and preference shares but these must address the legal restrictions associated with such instruments. The PRA will assess such proposals on a case-by-case basis.

5B.1F Where own fund items are not specifically identified in Article 330 of the Delegated Regulation, the firm should assume that these own fund items are available to cover the group SCR. The PRA may require the firm to provide an assessment of availability of the own fund items which the PRA will consider to determine whether the PRA agrees with the analysis.

5B.2 The PRA will communicate clearly to the firm the PRA's determination as to whether an own fund item should be considered available or unavailable. This communication may be considered to be a determination in the context of Supervisory Statement 11/16⁹ and as set out in the Financial Reporting Council's (FRC) guidance, Practice Note 20.¹⁰

5B.3 Where the firm has not appropriately assessed any own fund items as being not available to meet the group SCR, and the PRA has not assessed any items as not available, then the PRA considers that no determination has been made.

5B.4 If the PRA has not provided a determination on the availability of an own fund item where one is required by the Directive and a firm has nevertheless assessed an item as unavailable, the PRA recommends that the firm discusses this with the PRA, in order to obtain a formal determination of the PRA's position.

6 Single own risk and solvency assessment report

6.1 A group, for which the PRA is the group supervisor, may apply to produce a single document covering its own risk and solvency assessments (ORSAs) at the level of the group and at the level of any subsidiary in the group at the same time (Group Supervision 17.2(3)). The PRA will assess applications to produce a single ORSA document in consultation with the college of supervisors.

6.2 In addition to the ORSA conducted at group level, the PRA expects the group ORSA document to include sufficient details on the solo firms included within the scope of the group ORSA such that Conditions Governing Business 3.8 (solo ORSA) is satisfied in respect of each of those firms.

7 Single solvency and financial condition report (SFCR)

7.1 A group, for which the PRA is the group supervisor, may apply to produce a single report on its SFCR at the level of the group, and at the level of any subsidiary in the group which must be individually identifiable (Group Supervision 18.1(2)). The PRA will assess applications to produce a single SFCR in consultation with the college of supervisors.

9 PRA Supervisory Statement 11/16 'Solvency II: external audit of the public disclosure requirement', September 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-external-audit-of-the-public-disclosure-requirement-ss.

10 FRC Practice Note 20 (Revised). The audit of Insurers in the United Kingdom: www.frc.org.uk/news/february-2017/frc-publishes-revised-practice-note-20.

7.2 The PRA expects the single document produced to cover the same level of detail on the solo subsidiary firms as is required in the solo SFCR.

8 Responsibilities of the relevant insurance group undertaking¹¹

8.1 [Deleted]

8.2 For a group, for which the PRA is the group supervisor, it is sufficient for one relevant insurance group undertaking within an insurance group to undertake the following activities on behalf of the group to:

- (a) submit the relevant data for and the results of the group eligible own funds and the group SCR to the PRA, as referred to in Group Supervision 5.2;
- (b) ensure ongoing compliance with the conditions for the prudent management of subsidiaries, where the PRA has agreed to the use of a single document, the production of the single document covering all relevant ORSAs and the production of the single SFCR, as referred to in Group Supervision 15.4(2);
- (c) inform the PRA in an event of non-compliance with the group SCR within the appropriate timeframes, as referred to in Group Supervision 4.4; and
- (d) submit a realistic recovery plan and take measures to ensure compliance with the group SCR in an event of non-compliance with the group SCR within the appropriate timeframes, as referred to in Group Supervision 4.4.
- (e) [Deleted]
- (f) [Deleted]

9 Supervision in the absence of third-country equivalence

9.1 In the absence of equivalent group supervision, in accordance with Group Supervision 20, the relevant Solvency II requirements will apply to the worldwide group, unless the PRA has specified 'other methods' to achieve the objectives of group supervision. In the absence of a decision by the PRA to specify 'other methods' for the group, then firms in that group are required to apply the relevant Solvency II requirements to the worldwide group.

9.2 Firms will be expected to make a formal application to the PRA, where they wish the PRA to specify 'other methods' for the purposes of Group Supervision 20.1(2). Any such specification will be given effect by the PRA issuing a direction under FSMA section 138A. In its application, the PRA expects a firm to propose other methods for the PRA to consider. Firms wishing to apply for a direction may do so using the usual waiver and modification process. The PRA will assess such applications on a case-by-case basis, taking into account the objectives of group supervision as specified by the Directive.

¹¹ Group Supervision 1 in the PRA Rulebook.

9.3 If firms wish to submit an application before a relevant equivalence decision is made, they may do so stating the assumptions made with regard to equivalence. Where appropriate, the PRA may refrain from making a decision until an equivalence decision has been finalised.

Superseded

Annex – SS9/15 updates

This annex details the changes that have been made to this Supervisory Statement (SS) following its initial publication in March 2015.

April 2020

The SS was amended by inserting new paragraphs in 5A.2A and 5B.1A to 5B.1E. Paragraph 5A.2AA was previously paragraph 5A.2A, and 5B.1F was previously without a paragraph number. The changes were made following Policy Statement (PS) 10/20 ‘Solvency II: Group availability of subordinated liabilities and preference shares’ to clarify the PRA’s approach where a firm seeks to demonstrate that the Solvency II assumption that subordinated liabilities and preference shares are not effectively available to cover group SCR is inappropriate in the firm’s specific circumstances. The SS clarifies that the firm would need to satisfy the PRA that these own fund items are available to absorb losses anywhere in the group. It also clarifies that a firm may demonstrate this through intra-group guarantees, but notes that this is not likely to be appropriate for most groups given specific features. The SS also notes that the PRA is receptive to proposals of alternative approaches that address the legal restrictions associated with such instruments.

A number of syntactic amendments were also made to improve the clarity of the SS.

March 2019

The SS was amended in paragraphs 5A.2A to 5A.2F in Chapter 5A following PS9/19 ‘Solvency II – Group own fund availability’¹² to clarify that in assessing group own funds availability, the solo Solvency Capital Requirement should no longer be presumed to be a barrier to availability. The SS clarifies that the PRA expects such availability analysis to be provided only where a group insurer is based in a jurisdiction that is not subject to a regime that is similar to, and not built on the same principles in relation to capital requirements and quality of capital at solo level as, the UK solvency regime.

This SS was also updated to simplify the formatting and aid readability, including sequential numbering of footnotes, the updating of hyperlinks to reflect the location on the Bank of England’s website, and to make hyperlinks more easily identifiable.

July 2018

A number of amendments were made to the SS.

The SS was amended in chapters 2 through to 5A and chapters 6 through 9 following PS17/18 ‘Solvency II: Group supervision’¹³ to clarify for firms which aspects of the PRA’s letter ‘Solvency II: An update on implementation’ published on 25 July 2014 on group supervision are intended to have effect as ongoing supervisory expectations. The SS was also revised to address elements of Solvency II legislation after the publication of the letter and to update it with references to the PRA Rulebook. The chapter on centralised risk management has been deleted.

¹² <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-2-group-own-fund-availability>.

¹³ <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-group-supervision>.

Availability of group own funds

A section has been added to the SS in chapter 5A that sets out the PRA's expectations of firms when they calculate the own funds available to the group. The SS clarifies that unless a formal assessment is made by the PRA, firms are expected to assume that all group own funds are available except where that own fund item is specifically excluded under Article 222 of the Directive and Article 330 of the Delegated Regulation.

Regulatory determination on the availability of group own funds

This SS was updated to include additional guidance to auditors of the group Solvency and Financial Condition Report (SFCR) in Chapter 5B. The guidance describes the process that the PRA expects auditors to follow when assessing whether a regulatory determination has been made in respect of the availability of group own funds. Specifically it outlines:

- what the auditor is expected to consider a regulatory determination;
- what assumption the auditor is expected to make when there has been no regulatory determination made with respect to the availability of group own funds; and
- the process that the auditor is expected to follow where a firm has assessed an own fund item as unavailable; and
- the PRA's expectation that the auditor obtain evidence on the firm's processes for the determination of the availability of own fund items.