

# Appendix 1: PRA Rulebook

**PRA RULEBOOK: SOLVENCY II FIRMS: GENERAL APPLICATION 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: General Application 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: General Application 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

# GENERAL APPLICATION

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Chapter content

1. APPLICATION AND DEFINITIONS
2. UK SOLVENCY II FIRM
3. LLOYD'S
4. INTERPRETATION

Links

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*;
- (2) the *Society*; and
- (3) *managing agents*.

1.2 In this Part, the following definitions shall apply:

### *ancillary risk*

- (1) subject to (2), means (in relation to an *insurer with Part 4A permission to insure a principal risk belonging to one class of general insurance business*) a risk included in another such *class* which is:
  - (a) connected with the principal risk,
  - (b) concerned with the object which is covered against the principal risk, and
  - (c) the subject of the same contract insuring the principal risk.
- (2) the risks included in *classes 14, 15 and 17* may not be treated as risks ancillary to other *classes*, except that the risk included in *class 17* may be regarded as an ancillary risk of *class 18* where:
  - (a) the conditions laid down in (1)(a) to (1)(c) are fulfilled, and
  - (b) the principal risk relates solely to *assistance* provided for persons who fall into difficulties while travelling, while away from home or while away from their permanent residence or where it concerns disputes or risks arising out of, or in connection with, the use of sea going vessels.

### **[Note: Art. 16 of the *Solvency II Directive*]**

### *assistance*

means the *class of contract of insurance*, specified in paragraph 18 of Part I of Schedule 1 to the *Regulated Activities Order*.

### *non-Solvency I firm*

means a firm that immediately before the *Solvency II implementation date* fell outside the scope of *Solvency I Directive*.

### *requirement*

means a requirement or limitation included in a *firm's Part 4A permission* under section 55F(4) of *FSMA* (Giving permission: the PRA), section 55L(3) of *FSMA* (Imposition of requirements by the FCA), section 55M(3) of *FSMA* (Imposition of

Requirements by the PRA) or section 55O of *FSMA* (Imposition of requirements on acquisition of control).

*Solvency I Directive*

means each of:

- (1) the *Consolidated Life Directive*;
- (2) the *First Non-Life Directive*;
- (3) the *Second Non-Life Directive*;
- (4) the *Third Non-Life Directive*; and
- (5) the *Reinsurance Directive*.

*Solvency I firm*

means a *firm* that immediately before the *Solvency II implementation date* was an *insurer* that fell within the scope of *Solvency I Directive*.

*Solvency II excluded operations*

means:

- (1) a *mutual* whose *insurance business* is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat- rate basis; or
- (2) a *mutual* whose liabilities in respect of *contracts of general insurance* must be fully reinsured with or guaranteed by other *mutuals* (including *friendly societies*) and the *mutuals* providing the *reinsurance* or the guarantees are *Solvency II undertakings*.

*Solvency II implementation date*

means 1 January 2016.

*syndicate liabilities*

means liabilities managed by a *managing agent* in respect of *insurance business* carried on through a *syndicate*.

## **2 UK SOLVENCY II FIRM**

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2.1 A *UK Solvency II firm* means a *firm*:

- (1) that satisfies the conditions set out in 2.2, or
- (2) whose *Part 4A permission* includes a *requirement* that it comply with the Solvency II Firms Sector.

2.2 The conditions referred to in 2.1 are, subject to the exclusions in 2.3 – 2.6:

- (1) the *firm* is an *insurer*;
- (2) the *firm* has its head office is in the *United Kingdom*;

- (3) the *firm's Part 4A permission* does not include a *requirement* that it must only carry on *Solvency II excluded operations*;
- (4) if it is a *Solvency I firm*, the *firm* is not excluded pursuant to 2.6;
- (5) if it is a *non-Solvency I firm*, the *firm* is not excluded pursuant to:
  - (a) 2.3 on the *Solvency II implementation date*; or
  - (b) 2.6;
- (6) if it obtains its *Part 4A permission* to *effect contracts of insurance* and/or *carry out contracts of insurance* on or after *Solvency II implementation date*, the *firm* is not excluded pursuant to:
  - (a) 2.3 on the date it obtains such *Part 4A permission*; or
  - (b) 2.6; and
- (7) the *firm* is not a *pure reinsurer* which ceased to conduct new *reinsurance contracts* before 10 December 2007.

**[Note: Arts. 2(1), 4(1),(3), (4), 5(2), 7, 9(1),(2), 12(1) of the *Solvency II Directive*]**

2.3 A *firm* of the kind mentioned in 2.2(5) or 2.2(6) is excluded if it fulfils all of the following conditions:

- (1) the *firm's* annual gross written premium income does not exceed 5,000,000 euro;
- (2) the total of the *firm's technical provisions*, gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*, as referred to in Technical Provisions 2.1 – 2.3 does not exceed 25,000,000 euro;
- (3) where the *firm* belongs to a *group*, the total of the *technical provisions* of the *group* defined as gross of the amounts recoverable from *reinsurance contracts* and *ISPVs* does not exceed 25,000,000 euro;
- (4) the business of the *firm* does not include insurance or *reinsurance* activities covering liability, credit and suretyship insurance risks, unless they constitute *ancillary risks*;
- (5) the business of the *firm* does not include *reinsurance* operations:
  - (a) exceeding:
    - (i) 500,000 euro of its gross written premium income; or
    - (ii) 2,500,000 euro of its *technical provisions* gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*; or
  - (b) with more than 10% of its gross written premium income or more than 10% of its *technical provisions* gross of the amounts recoverable from *reinsurance contracts* and *ISPVs*.

**[Note: Art. 4(1) of the *Solvency II Directive*]**

2.4 A *firm* excluded under 2.3 shall cease to be excluded under that rule from the fourth year if any of the amounts set out in 2.3(1), (2), (3) or (5) are exceeded in each of the three preceding years.

**[Note: Art. 4(2) of the Solvency II Directive]**

- 2.5 A *firm* of the kind mentioned in 2.2(6) is not excluded under 2.3 if any of the amounts set out in 2.3(1), (2), (3) or (5) are expected to be exceeded within five years of the date the *firm* obtained its *Part 4A permission to effect contracts of insurance and/or carry out contracts of insurance*.

**[Note: Art. 4(3) of the Solvency II Directive]**

- 2.6 Subject to 2.4, a *firm* of the kind mentioned in 2.2(4), (5) or (6) is excluded if:
- (1) the *firm* is not exercising *EEA rights* under the *Solvency II Directive*;
  - (2) none of the thresholds set out in 2.3:
    - (a) have been exceeded for three consecutive years; and
    - (b) are expected to be exceeded during the following five years.

**[Note: Art. 4(4) of the Solvency II Directive]****3 LLOYD'S**

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- 3.1 Where a provision in the Solvency II Firms Sector is expressed to apply to the *Society* "in accordance with" this Chapter, the *Society* must:
- (1) manage each *member's funds at Lloyd's*;
  - (2) carry out any applicable calculations in respect of each *member's funds at Lloyd's*;
  - (3) manage its *central assets and central liabilities*;
  - (4) where the context requires, supervise the *insurance business* carried on by each *member* at Lloyd's; and
  - (5) take such further steps as may be required,

in order to achieve, in relation to those assets and liabilities and that *insurance business*, the same effect as the relevant Solvency II Firms Sector provision would have (that is, conforming with the requirements of any *rule*) when applied to a *firm* or to the *insurance business* of a *firm*.

- 3.2 Where a provision in the Solvency II Firms Sector is expressed to apply to a *managing agent* "in accordance with" this Chapter, the *managing agent* must, in relation to each *syndicate* managed by it and for each *syndicate* year:
- (1) manage the *syndicate assets and syndicate liabilities*;
  - (2) manage the *insurance business* carried on by the *members* of the *syndicate* through that *syndicate*; and
  - (3) take such further steps as may be required,

in order to achieve, in relation to those *syndicate assets and syndicate liabilities* and that *insurance business*, the same effect as the relevant Solvency II Firms Sector provision would have (that is, conforming with the requirements of any *rule*) when applied to a *firm* or to the *insurance business* of a *firm*.

## 4 INTERPRETATION

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- 4.1 Where a provision in the Solvency II Firms Sector makes reference to amounts in euro, the exchange rate from the euro to the pound sterling for each year with effect from 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all of the EU member states were published in the Official Journal of the European Union.

**[Note: Art. 299 of the *Solvency II Directive*]**

- 4.2 Where a provision in the Solvency II Firms Sector makes reference to amounts in euro a *firm* must interpret those amounts as being succeeded by any such amounts published in the Official Journal of the European Union reflecting the percentage change in the Harmonised Indices of Consumer Prices (comprising all EU member states, as published by Eurostat) starting from 31 December 2015 until the date of revision and rounded up to a multiple of 100,000 euro, provided that where the percentage change since the previous revision is less than 5% the amounts will not be revised.

**[Note: Art. 300 of the *Solvency II Directive*]**



**PRA RULEBOOK: SOLVENCY II FIRMS: VALUATION 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: Valuation 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: Valuation 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

# VALUATION

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Chapter content

1. APPLICATION
2. VALUATION OF ASSETS AND LIABILITIES

Links

## 1 APPLICATION

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- 1.1 Unless otherwise stated, this Part applies to:
- (1) a *UK Solvency II firm*;
  - (2) in accordance with General Application 3, the *Society*; and
  - (3) in accordance with General Application 3, *managing agents*.

## 2 VALUATION OF ASSETS AND LIABILITIES

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- 2.1 A *firm* must, except where otherwise provided, value:
- (1) assets at the amount for which they could be exchanged between knowledgeable willing parties in an arms' length transaction; and
  - (2) liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arms' length transaction.

**[Note: Art. 75(1) of the *Solvency II Directive*]**

- 2.2 For the purposes of 2.1(2) when valuing liabilities no adjustment must be made to take account of the own credit standing of the *firm*.

**[Note: Art. 75(1) of the *Solvency II Directive*]**

**PRA RULEBOOK: SOLVENCY II FIRMS: TECHNICAL PROVISIONS 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: Technical Provisions 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: Technical Provisions 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

## **TECHNICAL PROVISIONS**

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### **Chapter content**

- 1. APPLICATION AND DEFINITIONS**
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- 3. BEST ESTIMATE**
- 4. RISK MARGIN**
  - 4A. RISK FREE INTEREST RATE TERM STRUCTURE**
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  - 4C. CALCULATION OF THE MATCHING ADJUSTMENT**
  - 4D. VOLATILITY ADJUSTMENT**
- 5. OTHER ELEMENTS TO BE TAKEN INTO ACCOUNT**
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- 10. APPROPRIATENESS OF THE LEVEL OF TECHNICAL PROVISIONS**
- 11. COMMUNITY CO-OPERATION OPERATIONS**
- 12. LLOYD'S**

Links

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*;
- (2) in accordance with General Application 3, the *Society*, as modified by 12; and
- (3) in accordance with General Application 3, *managing agents*, as modified by 12.

1.2 In this Part, the following definition shall apply:

*basic relevant risk-free interest rate term structure*

means the *relevant risk-free interest rate term structure* without:

- (1) a *matching adjustment*;
- (2) a *volatility adjustment*; or
- (3) a *risk-free interest rate transitional measure*.

*Community co-insurance operation*

means a co-insurance operation which relates to one or more risks classified under *general insurance business classes 3 to 16* and which fulfils the conditions set out in Article 190(1) (a) to (f) of the *Solvency II Directive*.

*cost-of-capital rate*

means the rate (above the relevant risk-free interest rate) that must be used in the determination of the cost that a *Solvency II undertaking* would incur in order to hold an amount of *eligible own funds* equal to the *SCR* necessary to support the insurance and *reinsurance* obligations over their lifetime, as specified in the *Solvency II Regulations* adopted under Article 86 of the *Solvency II Directive*.

*leading insurer*

means (in relation to a *Community co-insurance operation*) a *co-insurer* that assumes the leader's role in co-insurance practice and in particular determines the terms and conditions of insurance and rating.

*relevant insurer*

means (in relation to a *Community co-insurance operation*), an *insurer* which is concerned in the operation but is not the *leading insurer*.

*relevant portfolio of assets*

means the assigned portfolio of assets, consisting of bonds and other assets with similar cash-flow characteristics, to cover the *best estimate* of the *relevant portfolio of insurance and reinsurance obligations*, referred to in [the statutory instrument made to implement the *Solvency II Directive*].

*risk-free interest rate transitional measure*

[means the approval granted to a *firm* by the *PRA* referred to in Transitional Measures 10].

*volatility adjustment approval*

means the approval granted to a *firm* by the *PRA* to permit it to apply a *volatility adjustment* for the purposes of calculating the *best estimate*.

## 2 CALCULATION OF TECHNICAL PROVISIONS

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2.1 *Firms* must establish adequate *technical provisions* with respect to all of their insurance and *reinsurance* obligations towards *policyholders*.

**[Note: Art. 76(1) of the Solvency II Directive]**

2.2 The value of *technical provisions* must correspond to the current amount that the *firm* would have to pay if it were to transfer its insurance and *reinsurance* obligations immediately to another *Solvency II undertaking*.

**[Note: Art. 76(2) of the Solvency II Directive]**

2.3 *Firms* must calculate their *technical provisions*:

- (1) such that the calculation makes use of and is consistent with information provided by the financial markets and generally available data on *underwriting risks* (market consistency);
- (2) in a prudent, reliable and objective manner;
- (3) taking into account the principles set out in Valuation 2; and
- (4) in accordance with 2.4 – 8.2.

**[Note: Art. 76(3)–(5) of the Solvency II Directive]**

2.4 The value of *technical provisions* must be equal to the sum of a *best estimate* and a *risk margin* which must be calculated in accordance with 2.5, 3 and 4.

**[Note: Art. 77(1) of the Solvency II Directive]**

2.5 (1) *Firms* must value the *best estimate* and the *risk margin* separately, except where (2) applies.

- (2) Where:
  - (a) future cash-flows associated with insurance or *reinsurance* obligations can be replicated reliably; and
  - (b) that replication is provided using financial instruments; and
  - (c) those financial instruments have a reliable market value which is observable;
 then the value of *technical provisions* associated with those future cash-flows must be determined on the basis of the market value of those financial instruments.

**[Note: Art. 77(4) of the Solvency II Directive]**

### 3 BEST ESTIMATE

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3.1 The *best estimate* must:

- (1) correspond to the probability-weighted average of future cash-flows, taking into account the time value of money (expected present value of future cash-flows) using the *relevant risk-free interest rate term structure*; and
- (2) be calculated:
  - (a) based upon up-to-date and credible information and realistic assumptions;
  - (b) using adequate, applicable and relevant actuarial and statistical methods; and
  - (c) gross, without deduction of the amounts recoverable from *reinsurance* contracts and *ISPVs*, which *firms* must calculate separately in accordance with 7.

**[Note: Art. 77(2) of the *Solvency II Directive*]**

3.2 The cash-flow projection used in the calculation of the *best estimate* (whether valued separately or determined on the basis of financial instruments in accordance with 2.5) must take into account all the cash in- and out-flows required to settle the insurance and *reinsurance* obligations over their lifetime.

**[Note: Art. 77(2) of the *Solvency II Directive*]**

### 4 RISK MARGIN

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4.1 Where *firms* value the *best estimate* and *risk margin* separately, the *risk margin* must be an amount equal to the cost that a *Solvency II undertaking* would incur in order to hold *eligible own funds* to cover the *SCR* necessary to support the insurance and *reinsurance* obligations over their lifetime, determined using the *cost-of-capital rate*.

**[Note: Art. 77(5) of the *Solvency II Directive*]**

4.2 The *risk margin* must be such as to ensure that the value of the *technical provisions* is equivalent to the amount that a *Solvency II undertaking* would be expected to require in order to take over and meet the insurance and *reinsurance* obligations over their lifetime.

**[Note: Art. 77(3) of the *Solvency II Directive*]**

#### 4A RISK-FREE INTEREST RATE TERM STRUCTURE

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4A.1 *Firms* must ensure that the *relevant risk-free interest rate term structure*:

- (1) is determined using, and consistent with, information derived from relevant financial instruments;
- (2) takes account of relevant financial instruments of those maturities where the markets for those financial instruments as well as for bonds, are deep, liquid and transparent; and
- (3) is only extrapolated for maturities where the markets for the relevant financial instruments or for bonds are not deep, liquid and transparent.



- 4A.2 For the purpose of 4A.1, the extrapolated part of the *relevant risk-free interest rate term structure* shall be based on forward rates converging smoothly from one set of forward rates in relation to the longest maturities for which the relevant financial instrument and the bonds can be observed in a deep, liquid and transparent market to an ultimate forward rate.

**[Note: Art. 77a of the Solvency II Directive]**

#### **4B MATCHING ADJUSTMENT TO THE RELEVANT RISK FREE INTEREST RATE TERM STRUCTURE**

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- 4B.1 A *firm* must not apply a *matching adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless it has a *matching adjustment approval*.
- 4B.2 *Firms* that apply the *matching adjustment* to a *relevant portfolio of insurance or reinsurance obligations* shall not revert back to the approach that does not include a *matching adjustment*.
- 4B.3 Where a *firm* that applies the *matching adjustment* is no longer able to comply with the conditions set out in [the statutory instrument made to implement the *Solvency II Directive*], it shall immediately:
- (1) inform the *PRA*; and
  - (2) take the necessary measures to restore compliance with these conditions as soon as possible.
- 4B.4 Where a *firm* is not able to restore compliance with the conditions set out in [the statutory instrument made to implement the *Solvency II Directive*] within two *months* of the date of non-compliance, it shall cease to apply the *matching adjustment* to any of its insurance or *reinsurance* obligations
- 4B.5 The *matching adjustment* shall not be applied with respect to insurance or *reinsurance* obligations where the *relevant risk-free interest rate term structure* to calculate the *best estimate* for those obligations includes a *volatility adjustment* or *risk-free interest rate transitional measure*.

**[Note: Art. 77b of the Solvency II Directive]**

#### **4C CALCULATION OF THE MATCHING ADJUSTMENT**

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- 4C.1 This Chapter applies to a *firm* that has been granted a *matching adjustment approval*.
- 4C.2 The *matching adjustment* shall be calculated for each currency in accordance with the following principles:
- (1) the *matching adjustment* shall be equal to the difference of the following:
    - (a) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value (in accordance with the Valuation Part) of the *relevant portfolio of assets*;
    - b) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value of the *best estimate* of the *relevant portfolio of insurance or reinsurance obligations*, where the time

value is taken into account using the *basic relevant risk-free interest rate term structure*;

- (2) the *matching adjustment* shall not include the fundamental spread reflecting the risks retained by the *firm*;
- (3) notwithstanding (1), the fundamental spread shall be increased where necessary to ensure that the *matching adjustment* for assets with sub-investment grade credit quality does not exceed the *matching adjustment* for assets of investment grade quality, of the same duration and asset class;
- (4) the use of external credit assessments in the calculation of the *matching adjustment* shall be in line with the specifications set out in the *Solvency II Regulations* adopted under Article 111(1)(n) of the *Solvency II Directive*.

4C.3 For the purposes of 4C.2(2) and subject to 4C.5, the fundamental spread shall be:

- (1) equal to the sum of the following:
  - (a) the credit spread corresponding to the probability of default of the assets; and
  - (b) the credit spread corresponding to the expected loss resulting from downgrading of the assets;
- (2) for exposures to *EEA States'* central governments and central banks, no lower than 30% of the long term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;
- (3) for assets other than exposures to *EEA States'* central governments and central banks, no lower than 35% of the long-term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;

4C.4 The probability of default referred to in 4C.3(1)(a) shall be based on long-term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class.

4C.5 Where no reliable credit spread can be derived from the default statistics referred to in 4C.3, the fundamental spread shall be equal to the portion of the long term average of the spread over the risk-free interest rate set out in 4C.3(2) and 4C.3(3).

**[Note: Arts. 77c and 77e(3) of the *Solvency II Directive*]**

#### **4D VOLATILITY ADJUSTMENT**

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4D.1 A *firm* must not apply a *volatility adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless:

- (1) it has been granted a *volatility adjustment approval*; and
- (2) the *volatility adjustment* has been set out in *Solvency II Regulations* adopted under Article 77e of the *Solvency II Directive*.
- (3) the *volatility adjustment* has been set out in *Solvency II Regulations* adopted under Article 77e of the *Solvency II Directive*.

4D.2 The *volatility adjustment* must not be applied to the risk-free interest rates of the *relevant risk-free interest rate term structure* that are derived by means of extrapolation in accordance with 4A.

4D.3 Where a firm applies a *volatility adjustment* in accordance with 4D, the extrapolation of the *relevant risk-free interest rate term structure* referred to in 4A shall be based on the risk-free interest rates adjusted with the *volatility adjustment*.

**[Note: Arts. 77d and 77e(3) of the Solvency II Directive]**

## 5 OTHER ELEMENTS TO BE TAKEN INTO ACCOUNT

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5.1 When calculating *technical provisions*, firms must take into account:

- (a) all expenses that will be incurred in servicing insurance and *reinsurance* obligations;
- (b) inflation, including expenses and claims inflation and
- (c) all payments to *policyholders*, including future discretionary bonuses, which firms expect to make, whether or not those payments are contractually guaranteed, unless those payments fall within Surplus Funds 2.1.

**[Note: Art. 78 of the Solvency II Directive]**

- 5.2 (1) When calculating *technical provisions*, firms must take account of the value of financial guarantees and any contractual options included in *contracts of insurance* and *reinsurance contracts*.
- (2) Any assumptions used by a firm to determine the likelihood that *policyholders* will exercise contractual options, including lapses and surrenders, must:
- (a) be realistic and based on current and credible information; and
  - (b) take into account, either explicitly or implicitly, the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

**[Note: Art. 79 of the Solvency II Directive]**

## 6 SEGMENTATION

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6.1 When calculating *technical provisions*, firms must segment their insurance and *reinsurance* obligations into homogenous risk groups and, as a minimum, by lines of business as contemplated by the *Solvency II Regulations*.

**[Note: Art. 80 of the Solvency II Directive]**

## 7 RECOVERABLES FROM REINSURANCE CONTRACTS AND ISPVs

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- 7.1 (1) Firms must calculate amounts recoverable from *reinsurance contracts* and *ISPVs* in accordance with 2 – 6.
- (2) For the purposes of (1), firms must take into account the time difference between amounts becoming recoverable and the actual receipt of those amounts.

- (3) *Firms* must adjust the calculation referred to in (1) to take into account expected losses due to the default of the counterparty. That adjustment must be based on an assessment of the probability of default of the counterparty and the average loss that would result from that default (loss-given- default).

**[Note: Art. 81 of the Solvency II Directive]**

## **8 DATA QUALITY AND APPLICATION OF APPROXIMATIONS**

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- 8.1 *Firms* must ensure that the data used in the calculation of their *technical provisions* is appropriate, complete and accurate.
- 8.2 Where *firms* have insufficient data of appropriate quality to apply a reliable actuarial method to a set or subset of their insurance and *reinsurance* obligations, or amounts recoverable from their *reinsurance* contracts and *ISPVs*, *firms* may use appropriate approximations, including case-by-case approaches, in the calculation of the *best estimate*.

**[Note: Art. 82 of the Solvency II Directive]**

## **9 COMPARISON AGAINST EXPERIENCE**

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- 9.1 (1) *Firms* must ensure that the *best estimate*, and the assumptions underlying the calculation of the *best estimate*, are regularly compared against experience.
- (2) Where the comparison in (1) identifies systematic deviation exists between the *firm's best estimate* calculations and experience, the *firm* must make appropriate adjustments to the actuarial methods being used and/or the assumptions being made to ensure that the *best estimate* is calculated in accordance with 2 – 8.

**[Note: Art. 83 of the Solvency II Directive]**

## **10 APPROPRIATENESS OF THE LEVEL OF TECHNICAL PROVISIONS**

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- 10.1 Upon request by the *PRA*, the *firm* must demonstrate to the *PRA*:
- (1) the appropriateness of the level of the *firm's technical provisions*;
- (2) the applicability and relevance of the methods applied; and
- (3) the adequacy of the underlying statistical data used.

**[Note: Art. 84 of the Solvency II Directive]**

## **11 COMMUNITY CO-INSURANCE OPERATIONS**

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- 11.1 In relation to *Community co-insurance operations*, where a *firm* is a *leading insurer* or a *relevant insurer*, the amount of *technical provisions* shall be determined according to 2 – 9.
- 11.2 The *technical provisions* calculated by a *firm* which is a *relevant insurer* shall be at least equal to those determined by the *leading insurer*.

**[Note: Art. 192 of the Solvency II Directive]**

## **12 LLOYD'S**

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- 12.1 This Chapter applies to the *Society* and *managing agents*.

- 12.2 For the purposes of complying with 4.1, *managing agents* must construe the reference to “SCR” in 4.1 as a reference to the notional *syndicate SCR* required to be calculated pursuant to Solvency Capital Requirement – General Provisions 8.2.
- 12.3 For the purpose of complying with 1.1(2) the *Society* must calculate *technical provisions* in respect of the *insurance business* of each *member*.
- 12.4 For the purpose of complying with 1.1(3), a *managing agent* must calculate *technical provisions* in respect of each *syndicate* it manages
- 12.5 In respect of business that has been subject to an *approved reinsurance to close*, *managing agents* must calculate *technical provisions* (before and after deduction of *reinsurance cessions*) for the reinsuring and not for the reinsured *member*.
- 12.6 For the purposes of 6.1 in relation to *managing agents*, a *managing agent* must carry out the segmentation referred to in that *rule* in respect of each *syndicate* managed by the *managing agent*.

**PRA RULEBOOK: SOLVENCY II FIRMS: OWN FUNDS 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: Own Funds 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: Own Funds 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

# OWN FUNDS

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Chapter content

1. APPLICATION
2. DETERMINATION OF OWN FUNDS
3. CLASSIFICATION OF OWN FUNDS INTO TIERS
4. ELIGIBILITY AND LIMITS APPLICABLE TO TIERS
5. NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS
6. LLOYD'S

Links

## 1 APPLICATION

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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*.

## 2 DETERMINATION OF OWN FUNDS

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2.1 A *firm's own funds* comprise the sum of its *basic own funds* and *ancillary own funds*.

**[Note: Art. 87 of the *Solvency II Directive*]**

2.2 The *firm's basic own funds* consist of the following items:

- (1) the excess of assets over liabilities, less the amount of own *shares* held by the *firm*; and
- (2) subordinated liabilities.

**[Note: Art. 88 of the *Solvency II Directive*]**

2.3 Subject to 2.5, the *firm's ancillary own funds* consist of items (other than items of *basic own funds*) which can be called up to absorb losses, including the following (to the extent that they are not items of *basic own funds*):

- (1) unpaid share capital or initial fund that has not been called up;
- (2) letters of credit and guarantees;
- (3) any other legally binding commitments received by the *firm*; and
- (4) for a *mutual*, any future claims which it may have against its members by way of a call for supplementary contribution within the next 12 *months*.

**[Note: Art. 89(1) of the *Solvency II Directive*]**

2.4 Where an item of *ancillary own funds* becomes paid in or called up, the proceeds paid in or the amount due in respect of the call must be treated as an asset and the item must cease to be treated as an item of *ancillary own funds*.

**[Note: Art. 89(2) of the *Solvency II Directive*]**

2.5 When determining its *own funds*, a *firm* must not take into account any item of *ancillary own funds* unless, subject to 2.6, it has received the *PRA's* approval of either:

- (1) a monetary amount for the relevant item of *ancillary own funds*; or
- (2) the method by which to determine the amount of the relevant item of *ancillary own funds*, together with the amount determined in accordance with that method for a specified time period.

**[Note: Art. 90(1) and (3) of the *Solvency II Directive*]**



2.6 Where a *firm* has received approval:

- (1) under 2.5(1), it may only include in its *own funds* the item of *ancillary own funds* for an amount up to the amount approved; or
- (2) under 2.5(2), it may only include in its *own funds* the item of *ancillary own funds* up to the amount determined using the method approved, and only for the time period for which approval is granted.

**[Note: Art. 90(3) of the *Solvency II Directive*]**

2.7 A *firm* may only attribute an amount to an item of *ancillary own funds* to the extent that it:

- (1) reflects the loss-absorbency of the item; and
- (2) is based upon prudent and realistic assumptions.

**[Note: Art. 90(2) of the *Solvency II Directive*]**

### **3 CLASSIFICATION OF OWN FUNDS INTO TIERS**

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3.1 A *firm* may only include an *own funds* item in its *Tier 1 own funds* if:

- (1) it is an item of *basic own funds*; and
- (2) it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

**[Note: Art. 94(1) of the *Solvency II Directive*]**

3.2 A *firm* may only include an *own funds* item in its *Tier 2 own funds* if:

- (1) where it is an item of *basic own funds*, it substantially possesses the characteristics set out in 3.5(2), taking into consideration the features set out in 3.6; or
- (2) where it is an item of *ancillary own funds*, it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

**[Note: Art. 94(2) of the *Solvency II Directive*]**

3.3 A *firm* may only include in its *Tier 3 own funds* an item of:

- (1) *basic own funds* that does not fall within 3.1 or 3.2(1); and
- (2) *ancillary own funds* that does not fall within 3.2(2).

**[Note: Art. 94(3) of the *Solvency II Directive*]**

3.4 (1) In classifying its *own funds* items, a *firm* must refer to the lists of *own funds* items set out in the *Solvency II Regulations*.

- (2) A *firm* must not include an *own funds* item in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds* if that *own funds* item is not covered by the lists referred to in (1), unless it has received the *PRA*'s approval.

- (3) When seeking approval to classify an *own funds* item referred to in (2) in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds*, a *firm* must demonstrate that the *own funds* item satisfies the criteria laid down in 3.1 – 3.3 for that classification.

**[Note: Art. 95 of the Solvency II Directive]**

3.5 The characteristics referred to in 3.1(2) and 3.2 are:

- (1) the item is available, or can be called up on demand, to fully absorb losses on a going-concern basis as well as in the case of winding up (permanent availability); and
- (2) in the case of winding up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and *reinsurance* obligations to *policyholders*, have been met (subordination).

**[Note: Art. 93(1) of the Solvency II Directive]**

3.6 When assessing the extent to which *own funds* items possess the characteristics set out in 3.5, currently and in the future, a *firm* must consider:

- (1) the duration of the item, in particular whether the item is dated or not and, where an *own funds* item is dated, the relative duration of the item as compared to the duration of the insurance and *reinsurance* obligations of the *firm* (sufficient duration);
- (2) whether the item is free from requirements or incentives to redeem the nominal sum (absence of incentives to redeem);
- (3) whether the item is free from mandatory fixed charges (absence of mandatory servicing costs); and
- (4) whether the item is clear of encumbrances (absence of encumbrances).

**[Note: Art. 93(2) of the Solvency II Directive]**

3.7 (1) A *firm* must not classify as *Tier 1 own funds*:

- (a) paid-in ordinary share capital and related share premium account; or
- (b) paid-in initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to cancel and withhold dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

(2) A *firm* must not classify as *Tier 2 basic own funds*:

- (a) ordinary share capital and related share premium account; or
- (b) initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to defer dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

**[Note: Arts. 93 and 94 of the *Solvency II Directive*]**

#### **4 ELIGIBILITY AND LIMITS APPLICABLE TO TIERS**

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- 4.1 As far as compliance with its *SCR* is concerned at least the following conditions must be met:
- (1) more than one-third of the total amount of the *firm's eligible own funds* is accounted for by *Tier 1 own funds*; and
  - (2) less than one-third of the *firm's eligible own funds* is accounted for by *Tier 3 own funds*.

**[Note: Art. 98(1) of the *Solvency II Directive*]**

- 4.2 As far as compliance with its *MCR* is concerned, as a minimum more than 50% of the *firm's eligible own funds* must be accounted for by *Tier 1 own funds*.

**[Note: Art. 98(2) of the *Solvency II Directive*]**

#### **5 NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS**

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- 5.1 5.2 – 5.6 do not apply in respect of the following:
- (1) any item which a *firm* intends to include within its *basic own funds* that is not covered by the lists of *own funds* items set out in the *Solvency II Regulations*, but which may be included in its *basic own funds* only if the *firm* has received the *PRA's* approval; and
  - (2) any item which a *firm* intends to include within its *ancillary own funds*.
- 5.2 (1) A *firm* must notify the *PRA* in writing of its intention to issue an item which it intends to include within its *basic own funds* at least one *month* before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the *firm* must give as much notice as is practicable in those circumstances.
- (2) When giving notice, a *firm* must:
- (a) provide details of the amount of *basic own funds* the *firm* is seeking to raise through the intended issue and whether the *own funds* is intended to be issued to external investors or within its *group*;
  - (b) identify the classification of *basic own funds* the item is intended to fall within;
  - (c) include confirmation from the *governing body* of the *firm* that the item complies with the *rules* applicable to items of *basic own funds* included in the classification of the item identified in (b); and
  - (d) provide a copy of the term sheet and details of any features of the item it intends to include within its *basic own funds* which are novel, unusual or different from an item of *basic own funds* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by the *Solvency II Firms Sector* or the *Solvency II Regulations*.
- 5.3 A *firm* must provide a further written notification to the *PRA* including all the information required in 5.2(2) as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other

feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.

5.4 If a *firm* proposes to establish a debt securities program for the issue of an item for inclusion within its *basic own funds*, it must:

- (1) notify the *PRA* of the establishment of the program; and
- (2) provide the information required by 5.2(2)

at least one *month* before the first proposed drawdown. The *PRA* must be notified of any changes in accordance with 5.3.

5.5 The items of *basic own funds* to which 5.2 does not apply are:

- (1) ordinary *shares* which:
  - (a) meet the classification criteria for ordinary share capital in *Tier 1 own funds*; and
  - (b) are the same as ordinary *shares* previously issued by the *firm*;
- (2) debt instruments issued from a debt securities program, provided that program was notified to the *PRA* prior to its first drawdown, in accordance with 5.4; and
- (3) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *firm* and included in *basic own funds*.

5.6 A *firm* must notify the *PRA* in writing, no later than the date of issue, of its intention to issue an item listed in 5.5 which it intends to include within its *basic own funds*. When giving notice, a *firm* must:

- (1) provide the information set out at 5.2(2)(a), (b) and (c) and
- (2) confirm that the terms of the item have not changed since the previous issue by the *firm* of that type of item of *basic own funds*.

## 6 LLOYD'S

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6.1 This Chapter applies to the *Society*.

6.2 For the purposes of complying with the *SCR Rules*, the *Society* must categorise *own funds* at Lloyd's as between:

- (1) *own funds* attributable to the *Society*; and
- (2) *own funds* attributable to *members* which are available to support *members'* *insurance business* at Lloyd's, including *funds at Lloyd's*.

6.3 The *Society* must notify the *PRA* in writing, within 14 days, in the event the *Council* makes a determination pursuant to paragraph 8(1A) or varies a determination pursuant to paragraph 8(1B)(a) of the New Central Fund Byelaw (No 23 of 1996) as amended, that the *Central Fund* or a part of the *Central Fund* is to constitute *own funds* attributable to the *Society* for the purposes of covering the *SCR* for Lloyd's.

6.4 In determining *own funds* at Lloyd's in accordance with 2, the *Society* shall have regard to:

- (1) the *Society's central assets and central liabilities*; and
- (2) the assets and liabilities of *members*, including assets which are available to support *members' insurance business* at Lloyd's, such assets including a *member's funds at Lloyd's*.

**PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT - GENERAL PROVISIONS 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: Solvency Capital Requirement - General Provisions [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: Solvency Capital Requirement - General Provisions 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

# **SOLVENCY CAPITAL REQUIREMENT – GENERAL PROVISIONS**

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Chapter content

1. APPLICATION
2. REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS COVERING THE SCR
3. GENERAL PROVISIONS FOR THE CALCULATION OF THE SCR
4. FREQUENCY OF CALCULATION OF SCR
5. CAPITAL ADD-ON
6. REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS: LLOYDS
7. GENERAL PROVISIONS FOR CALCULATION OF THE SCR: LLOYD'S
8. SYNDICATE NOTIONAL SCR AND MEMBER NOTIONAL SCR: LLOYD'S

Links

## 1 APPLICATION

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*;
- (2) in accordance with General Application 3, the *Society*, as modified by 6 – 8; and
- (3) in accordance with General Application 3, *managing agents*, as modified by 8.

## 2 REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS COVERING THE SCR

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2.1 A *firm* must hold *eligible own funds* covering its *SCR*.

**[Note: Art. 100 of the *Solvency II Directive*]**

## 3 GENERAL PROVISIONS FOR THE CALCULATION OF THE SCR

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3.1 A *firm* must calculate its *SCR* either in accordance with the *standard formula* or using an *internal model* for which *internal model approval* has been granted.

**[Note: Art. 100 of the *Solvency II Directive*]**

3.2 A *firm* must calculate its *SCR* on the presumption that it will pursue its business as a going concern.

**[Note: Art. 101(2) of the *Solvency II Directive*]**

3.3 A *firm's SCR*:

- (1) must be calibrated to ensure that all quantifiable risks to which the *firm* is exposed are taken into account, including at least the non-life *underwriting risk*, life *underwriting risk*, health *underwriting risk*, *market risk*, *credit risk*, and *operational risk*;
- (2) must cover existing business, as well as the new business expected to be written over the following 12 *months*; and
- (3) with respect to existing business, must cover only unexpected losses.

**[Note: Art. 101(3)–(4) of the *Solvency II Directive*]**

3.4 A *firm's SCR* must correspond to the value-at-risk of its *basic own funds* subject to a confidence level of 99.5% over a one-year period.

**[Note: Art. 101(3) of the *Solvency II Directive*]**

3.5 When calculating the *SCR*, *firms* must take account of the effect of *risk-mitigation techniques*, provided that *credit risk* and other risks arising from the use of *risk-mitigation techniques* are properly reflected in the *SCR*.

**[Note: Art. 101(5) of the *Solvency II Directive*]**

3.6 Notwithstanding 3.2 – 3.5, a *firm's SCR* shall not cover the risk of loss of *basic own funds* resulting from changes to the *volatility adjustment*.

**[Note: Art. 77d(6) of the *Solvency II Directive*]**



#### 4 FREQUENCY OF CALCULATION OF THE SCR

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4.1 A *firm* must calculate its *SCR* and report the result of that calculation to the *PRA* at least once a year.

**[Note: Art. 102(1) of the *Solvency II Directive*]**

4.2 For the purposes of 2.1, a *firm* must hold *eligible own funds* which cover its last reported *SCR*.

**[Note: Art. 102(1) of the *Solvency II Directive*]**

4.3 A *firm* must monitor the amount of its *eligible own funds* and its *SCR* on an ongoing basis.

**[Note: Art. 102(1) of the *Solvency II Directive*]**

4.4 If a *firm's* risk profile deviates significantly from the assumptions underlying its last reported *SCR*, the *firm* must recalculate its *SCR* without delay and report it to the *PRA*.

**[Note: Art. 102(1) of the *Solvency II Directive*]**

4.5 Where there is evidence to suggest that the risk profile of a *firm* has altered significantly since the date on which the *SCR* was last reported by it, if so requested by the *PRA*, the *firm* must recalculate its *SCR*.

**[Note: Art. 102(2) of the *Solvency II Directive*]**

#### 5 CAPITAL ADD-ON

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5.1 A *firm* must make every effort to remedy the deficiencies that led to the imposition of a *capital add-on* arising as a result of an *internal model significant risk profile deviation* or a *significant system of governance deviation*.

**[Note: Art. 37(3) of the *Solvency II Directive*]**

5.2 Except as provided in 5.3, the *SCR* prior to the imposition of the *capital add-on*, together with the amount of the *capital add-on* imposed by the *PRA*, will constitute the *firm's SCR*.

**[Note: Art. 37(5) of the *Solvency II Directive*]**

5.3 For the purposes of calculating the *risk margin*, the *SCR* of a *firm* must not include any *capital add-on* imposed as a result of a *significant system of governance deviation*.

**[Note: Art. 37(5) of the *Solvency II Directive*]**

#### 6 REQUIREMENT TO HOLD ELIGIBLE OWN FUNDS: LLOYD'S

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6.1 This Chapter applies to the *Society*.

6.2 The *Society* must ensure that *eligible own funds* are held at Lloyd's covering its *SCR*.

6.3 *Eligible own funds* covering the *central requirement* must be *eligible own funds* attributable to the *Society*.

6.4 Where the *standard formula* is used by the *Society* to calculate the *SCR* for Lloyd's, the *Society* must carry out the following process before it will be taken to have demonstrated that 6.2 is met:

- (1) *own funds* attributable to a *member* are to be compared with the *member's* notional SCR derived pursuant to 8.4;
- (2) where the *own funds* attributable to the *member* are less than or equal to that *member's* notional SCR, such *own funds* (but no additional *own funds* attributable to that *member*, including any *own funds* which are greater than the *member's* notional SCR) are to be taken into account for the purposes of establishing compliance with 6.2; and
- (3) to the extent the *own funds* attributable to the *member* are less than that *member's* notional SCR derived pursuant to 8.4, the *Society* must hold *own funds* in respect of the difference.

6.5 Where the *Society* uses an approved *internal model*, the *Society* must also ensure that *eligible own funds* are held at Lloyd's covering, for at least 99.5% of the scenarios taken into account in the *internal model* for the purposes of meeting Solvency Capital Requirement - Internal Models 12.2, any diminution in *own funds* at Lloyd's arising from the impact of those scenarios.

6.6 Where an approved *internal model* is used by the *Society* to calculate the SCR, for the purpose of meeting the requirement set out in 6.2, the *Society* may take account of *own funds* attributable to a *member* only to the extent of the diminution, if any, to those *own funds* resulting from the application of risk scenarios taken into account in the *internal model*.

## **7 GENERAL PROVISIONS FOR CALCULATION OF THE SCR: LLOYD'S**

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7.1 This Chapter applies to the *Society*.

7.2 In calculating the SCR for Lloyd's, the *Society* must ensure that the SCR is calibrated so as to include:

- (1) all quantifiable risks to which *members* are exposed as a consequence of those *members* carrying on *insurance business* at Lloyd's; and
- (2) all quantifiable risks to which the *Society* is exposed, including risks to the *central assets* and *central liabilities*,

in the manner required by 3 (and, where an *internal model* is used, in accordance with the Solvency Capital Requirement - Internal Models Part and where the *standard formula* is used, in accordance with the Solvency Capital Requirement - Standard Formula Part).

7.3 The *Society* must calculate a *central requirement* for Lloyd's which meets 7.2(2).

7.4 The *central requirement* must take account of the risk that the *central assets* may be used to meet deficiencies (as to amount or quality) in *own funds* attributable to *members*, such *own funds* supporting *members' insurance business* at Lloyd's.

## **8 SYNDICATE NOTIONAL SCR AND MEMBER NOTIONAL SCR: LLOYD'S**

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8.1 This Chapter applies to *managing agents* and, where specified, the *Society*.

8.2 A *managing agent* must calculate a notional SCR for each *syndicate* which it manages.

8.3 The notional SCR for each *syndicate* referred to in 8.2 must be calculated using a methodology which is consistent with the method used by the *Society* to derive the SCR for Lloyd's for the purposes of enabling the *Society* to comply with the relevant provisions of this Chapter.

- 8.4 The *Society* must calculate a notional *SCR* for each *member* using the method of calculation chosen to calculate the *SCR* for Lloyd's for the purpose of 3.1.
- 8.5 Where a *managing agent* manages risks which are included in the Lloyd's *SCR* calculation, the *managing agent* must promptly assist and provide all relevant information to the *Society* for the purposes of the *Society* complying with relevant provisions of *SCR Rules*.

**PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT STANDARD  
FORMULA 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: Solvency Capital Requirement Standard Formula [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: Solvency Capital Requirement Standard Formula 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

# **SOLVENCY CAPITAL REQUIREMENT – STANDARD FORMULA**

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. STRUCTURE OF THE SCR STANDARD FORMULA
3. THE BASIC SCR
4. CALCULATION OF THE EQUITY RISK SUB-MODULE AND APPLICATION OF THE SYMMETRIC ADJUSTMENT MECHANISM
5. CAPITAL REQUIREMENT FOR OPERATIONAL RISK
6. ADJUSTMENT FOR LOSS-ABSORBING CAPACITY OF TECHNICAL PROVISIONS AND DEFERRED TAXES
7. SIMPLIFICATION IN THE STANDARD FORMULA
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## 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*, as modified by 8.
- (3) [Drafting note: placeholder to consider application of this Part to managing agents further in the light of the arrangements the Society makes to review the notional SCR of each syndicate].

1.2 In this Part, the following definitions shall apply:

*standard equity capital charge*

means the standard capital requirement for equity risk calculated in accordance with the *Solvency II Regulations* before any *symmetric adjustment* is applied.

*symmetric adjustment*

means the symmetric adjustment that may be applied to the *standard equity capital charge* in accordance with the *Solvency II Regulations*.

## 2 STRUCTURE OF THE SCR STANDARD FORMULA

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2.1 For a *firm* calculating its SCR on the basis of the *standard formula*, its SCR is the sum of the following items:

- (1) the *basic SCR*;
- (2) the capital requirement for *operational risk*, as set out in 5; and
- (3) the adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes, as set out in 6.

**[Note: Art. 103 of the *Solvency II Directive*]**

## 3 THE BASIC SCR

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3.1 For the purposes of calculating its *basic SCR*, a *firm* must:

- (1) calculate the capital requirements for:
  - (a) the non-life *underwriting risk* module;
  - (b) the life underwriting risk module;
  - (c) the health underwriting risk module;
  - (d) the market risk module; and
  - (e) the counterparty default risk module; and
- (2) aggregate the capital requirements referred to in (1) in accordance with the following formula:

$$\text{basic SCR} = \sqrt{\sum_{i,j} \text{Corr}_{i,j} \times \text{SCR}_i \times \text{SCR}_j}$$

where:

- (a) 'SCR<sub>i</sub>' and 'SCR<sub>j</sub>' denote the non-life *underwriting risk* module, the life *underwriting risk* module, the health *underwriting risk* module, the *market risk* module and the counterparty default risk module;
- (b) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j';
- (b) the factor 'Corr<sub>i,j</sub>' denotes the item set out in row 'i' and column 'j' of the correlation matrix in (d); and

(d)

i \ j	Market	Default	Life	Health	Non-life
Market	1	0,25	0,25	0,25	0,25
Default	0,25	1	0,25	0,25	0,5
Life	0,25	0,25	1	0,25	0
Health	0,25	0,25	0,25	1	0
Non-life	0,25	0,5	0	0	1

**[Note: Art. 104(1) and Annex IV point (1) of the Solvency II Directive]**

3.2 For the purposes of calculating the capital requirements in 3.1(1) for non-life *underwriting risk*, life *underwriting risk* and health *underwriting risk*, a firm must allocate its insurance and *reinsurance* operations to the *underwriting risk* that best reflects the technical nature of the underlying risks.

**[Note: Art. 104(2) of the Solvency II Directive]**

3.3 Each of the risk modules referred to in 3.1(1) must be calibrated using a Value-at-Risk measure, with a 99.5% confidence level over a one-year period.

3.4. Where appropriate, *diversification effects* must be taken into account in the design of each risk module.

**[Note: Art. 104(4) of the Solvency II Directive]**

3.5 For the purposes of the *basic SCR*, a firm must calculate the capital requirement for the non-life *underwriting risk* module so that it:

- (1) reflects the risk arising from its non-life insurance obligations, in relation to the perils covered and the processes used in the conduct of business; and
- (2) takes account of the uncertainty in its results related to existing insurance and *reinsurance* obligations, as well as to new business expected to be written within the following 12 months.

**[Note: Art. 105(2) of the Solvency II Directive]**

3.6 For the purposes of 3.1(1)(a), the capital requirement for the non-life *underwriting risk* module is a combination of the capital requirements for at least the following sub-modules:

- (1) a non-life premium and reserve risk sub-module covering the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of *claim* settlements; and
- (2) a non-life catastrophe risk sub-module covering the risk of loss, or of adverse change in the value of insurance liabilities, resulting from significant uncertainty of pricing and provisioning assumptions related to extreme or exceptional events.

**[Note: Art. 105(2) of the Solvency II Directive]**

3.7 For the purposes of 3.1(1)(b) a *firm* must calculate the capital requirement for the life *underwriting risk* module so as to reflect the risk arising from its life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.

**[Note: Art. 105(3) of the Solvency II Directive]**

3.8 The life *underwriting risk* module must be calculated as:

- (1) a combination of the capital requirements for the following sub-modules:
  - (a) mortality risk;
  - (b) longevity risk;
  - (c) disability-morbidity risk;
  - (d) life expense risk;
  - (e) revision risk;
  - (f) lapse risk; and
  - (g) life catastrophe risk;
- (2) aggregated in accordance with the following formula:

$$SCR_{\text{life}} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where: 'SCR<sub>i</sub>' and 'SCR<sub>j</sub>' denote the mortality risk sub-module, the longevity risk sub-module, the disability-morbidity risk sub-module, the life expense risk sub-module, the revision risk sub-module, the lapse risk sub-module and the life catastrophe risk sub-module; and

'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'.

**[Note: Art. 105(3) and Annex IV point (3) Solvency II Directive]**

3.9 For the purposes of 3.8:

- (1) the mortality risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of



mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities;

- (2) the longevity risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities;
- (3) the disability-morbidity risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of disability, sickness and morbidity rates;
- (4) the life-expense risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of the expenses incurred in servicing *contracts of insurance* or *reinsurance contracts*;
- (5) the revision risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level, trend or volatility of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured;
- (6) the lapse risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from changes in the level or volatility of the rates of *policy* lapses, terminations, renewals and surrenders; and
- (7) the life-catastrophe risk sub-module covers the risk of loss, or of adverse change, in the value of insurance liabilities, resulting from the significant uncertainty of pricing and provisioning assumptions related to extreme or irregular events.

**[Note: Art. 105(3) of the Solvency II Directive]**

3.10 For the purposes of 3.1(1)(c):

- (1) a *firm* must calculate the capital requirement for the health *underwriting risk* module to reflect the risk arising from its underwriting of health insurance obligations, whether it is pursued on a similar technical basis to that of life insurance or not, following from both the perils covered and the processes used in the conduct of business; and
- (2) the health *underwriting risk* module must cover at least the risk of loss, or of adverse change, in the value of insurance liabilities resulting from:
  - (a) changes in the level, trend, or volatility of the expenses incurred in servicing *contracts of insurance* or *reinsurance contracts*;
  - (b) fluctuations in the timing and amount of *claim* settlements at the time of provisioning; and
  - (c) the significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances.

**[Note: Art. 105(4) of the Solvency II Directive]**

3.11 For the purposes of 3.1(1)(d):

- (1) a *firm* must calculate the capital requirement for the *market risk* module so that it:

- (a) reflects the risk arising from the level or volatility of market prices of financial instruments which have an impact upon the value of the assets and liabilities of the *firm*;
  - (b) properly reflects the structural mismatch between assets and liabilities, in particular with respect to the duration of assets and liabilities; and
- (2) the capital requirement for the *market risk* module is a combination of the capital requirements for at least the following sub-modules:
- (a) an interest-rate risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the term structure of interest rates, or in the volatility of interest rates;
  - (b) an equity risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of equities;
  - (c) a property risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of real estate;
  - (d) a spread risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over the risk-free interest-rate term structure;
  - (e) a currency risk sub-module covering the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of currency exchange rates; and
  - (f) a *market risk* concentrations sub-module covering additional risks to a *firm* stemming either from lack of diversification in the asset portfolio or from large exposure to default risk by a single issuer of securities or a *group* of related issuers.

**[Note: Art. 105(5) of the Solvency II Directive]**

3.12 For the purposes of 3.1(1)(e), the counterparty default risk module:

- (1) must reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of the *firm* over the following 12 *months*;
- (2) must cover risk-mitigating contracts, such as *reinsurance* arrangements, securitisations and *derivatives*, and receivables from intermediaries, as well as any other credit exposures which are not covered in the spread risk sub-module;
- (3) must take appropriate account of collateral or other security held by, or for the account of, the *firm* and the associated risks;
- (4) for each counterparty, must take account of the overall counterparty risk exposure of the *firm* to that counterparty, irrespective of the legal form of the counterparty's contractual obligations to the *firm*.

**[Note: Art. 105(6) of the Solvency II Directive]**

#### 4 CALCULATION OF THE EQUITY RISK SUB-MODULE AND APPLICATION OF THE SYMMETRIC ADJUSTMENT MECHANISM

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- 4.1 For the purposes of calculating the equity risk sub-module referred to in 3.11(2)(b), a *firm* must apply a *symmetric adjustment* to the *standard equity capital charge* to cover the risk arising from changes in the level of equity prices.

**[Note: Art. 106(1) of the *Solvency II Directive*]**

#### 5 CAPITAL REQUIREMENT FOR OPERATIONAL RISK

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- 5.1 A *firm's* capital requirement for *operational risk* must:
- (1) reflect its operational risks to the extent that they are not already reflected in the risk modules used to calculate its *basic SCR*; and
  - (2) be calibrated in accordance with Solvency Capital Requirement – General Provisions 3.3 – 3.4.

**[Note: Art. 107(1) of the *Solvency II Directive*]**

- 5.2 With respect to *linked long-term contracts of insurance*, the calculation of the capital requirement for *operational risk* must take into account the amount of annual expenses incurred in respect of those insurance obligations.

**[Note: Art. 107(2) of the *Solvency II Directive*]**

- 5.3 With respect to *insurance business* operations other than those referred to in 5.2, the capital requirement for *operational risk* must:
- (1) take into account the volume of those operations, in terms of earned *premiums* and *technical provisions* which are held in respect of that *insurance business*; and
  - (2) not exceed 30% of the *basic SCR* relating to those operations.

**[Note: Art. 107(3) of the *Solvency II Directive*]**

#### 6 ADJUSTMENT FOR LOSS-ABSORBING CAPACITY OF TECHNICAL PROVISIONS AND DEFERRED TAXES

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- 6.1 The adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes as referred to in 2.1(3):
- (1) must reflect potential compensation of unexpected losses through a simultaneous decrease in *technical provisions* or deferred taxes, or a combination of the two; and
  - (2) must take account of the risk-mitigating effect provided by future discretionary benefits of *contracts of insurance*.

**[Note: Art. 108 of the *Solvency II Directive*]**

- 6.2 For the purposes of 6.1(2):
- (1) a *firm* must take account of the risk-mitigating effect provided by future discretionary benefits to the extent that it can establish that a reduction in future discretionary benefits may be used to cover unexpected losses when they arise;

- (2) the risk-mitigating effect provided by future discretionary benefits must be no higher than the sum of *technical provisions* and deferred taxes relating to those future discretionary benefits; and
- (3) the value of future discretionary benefits under adverse circumstances must be compared to the value of those benefits under the underlying assumptions of the *best estimate* calculation.

**[Note: Art. 108 of the *Solvency II Directive*]**

## **7 SIMPLIFICATION IN THE STANDARD FORMULA**

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- 7.1 (1) A *firm* may use a simplified calculation for a specific sub-module or risk module where the nature, scale and complexity of the risks it faces justifies it.
- (2) A *firm* must calibrate its simplified calculation in accordance with Solvency Capital Requirement – General Provisions 3.3 – 3.4.

**[Note: Art. 109 of the *Solvency II Directive*]**

## **8 LLOYD'S**

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- 8.1 This Chapter applies to the *Society* in relation to the use of the *standard formula* for the purpose of Solvency Capital Requirement – General Provisions 3.1.
- 8.2 The *Society* must aggregate the results of each notional *SCR* referred to in Solvency Capital Requirement – General Provisions 8.4 together with the *central requirement*, in order to obtain the *SCR* for Lloyd's.

**PRA RULEBOOK: SOLVENCY II FIRMS: SOLVENCY CAPITAL REQUIREMENT – INTERNAL MODELS 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: Solvency Capital Requirement - Internal Models [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: Solvency Capital Requirement - Internal Models 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

# **SOLVENCY CAPITAL REQUIREMENT – INTERNAL MODELS**

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. APPROVAL OF FULL AND PARTIAL INTERNAL MODELS
3. APPLICATIONS FOR APPROVAL OF FULL AND PARTIAL INTERNAL MODELS
4. APPLICATIONS FOR APPROVAL OF PARTIAL INTERNAL MODELS
5. TRANSITIONAL PLAN TO EXTEND THE SCOPE OF THE MODEL
6. CHANGES TO AN INTERNAL MODEL OR INTERNAL MODEL CHANGE POLICY
7. RESPONSIBILITIES OF THE FIRM'S GOVERNING BODY
8. REVERSION TO THE STANDARD FORMULA
9. NON-COMPLIANCE OF THE INTERNAL MODEL
10. USE TEST
11. STATISTICAL QUALITY STANDARDS
12. CALIBRATION STANDARDS
13. PROFIT AND LOSS ATTRIBUTION
14. VALIDATION STANDARDS
15. DOCUMENTATION STANDARDS
16. EXTERNAL MODELS AND DATA
17. LLOYD'S

Links

## 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) [Drafting note: placeholder to consider application of this Part to managing agents further in the light of the arrangements the *Society* makes to review the notional SCR of each syndicate]

1.2 In this Part, the following definitions shall apply:

*internal model approval application*

means an application by a *firm* for *internal model approval*.

*internal model change policy*

means a *firm's* policy for making minor and major changes to its *internal model*.

*internal model requirements*

means the requirements set out in Solvency Capital Requirement – Internal Models 10 – 15.

## 2 APPROVAL OF FULL AND PARTIAL INTERNAL MODELS

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2.1 A *firm* may calculate its *SCR* using an *internal model* that is either a full *internal model* or a *partial internal model* only:

- (1) if it has been granted *internal model approval* in respect of its *internal model*; and
- (2) to the extent of its *internal model approval*.

2.2 A *firm* that has been granted *internal model approval* must calculate its *SCR* using the *internal model* for which *internal model approval* has been granted.

**[Note: Arts. 112(1) and 112(2) of the *Solvency II Directive*]**

## 3 APPLICATIONS FOR APPROVAL OF FULL AND PARTIAL INTERNAL MODELS

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3.1 A *firm* making an *internal model approval application* must submit, as a minimum, documentary evidence that demonstrates to the *PRA's* satisfaction that the *internal model* and, if the context requires, the *firm* satisfies the *internal model requirements*.

**[Note: Art. 112(3) of the *Solvency II Directive*]**

3.2 A *firm* making an *internal model approval application* must demonstrate to the *PRA's* satisfaction that its systems for identifying, measuring, monitoring, managing and reporting risk are adequate.

**[Note: Art. 112(5) of the *Solvency II Directive*]**

3.3 When making an *internal model approval application*, a *firm* must submit its *internal model change policy* to the *PRA* for approval.

**[Note: Art. 115 of the Solvency II Directive]**

- 3.4 Upon request by the PRA, a *firm* with an *internal model approval* must provide the PRA with an estimate of the SCR determined in accordance with the *standard formula*.

**[Note: Art. 112(7) of the Solvency II Directive]****4 APPLICATIONS FOR APPROVAL OF PARTIAL INTERNAL MODELS**

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- 4.1 Where an *internal model approval application* relates to the use of a *partial internal model*, the *internal model requirements* apply with any changes that are necessary to take account of the limited scope of the application of the *internal model*.

**[Note: Art. 112(3) of the Solvency II Directive]**

- 4.2 A *firm* making an *internal model approval application* to use a *partial internal model* must:
- (1) explain, and properly justify, the reason for the limited scope of application of the *internal model*;
  - (2) explain how the resulting SCR reflects more appropriately the risk profile of the *firm* and complies with 2.3 and Solvency Capital Requirement - General Provisions 2 – 4; and
  - (3) demonstrate that the design of its *partial internal model* is consistent with the principles in 2.3 and Solvency Capital Requirement - General Provisions 2 – 4 so as to allow the *partial internal model* to be fully integrated into the *standard formula*.

**[Note: Art. 113(1) of the Solvency II Directive]****5 TRANSITIONAL PLAN TO EXTEND THE SCOPE OF THE MODEL**

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- 5.1 Upon request by the PRA, a *firm* which has made an *internal model approval application* in respect of a *partial internal model* that only covers certain sub-modules of a specific risk module, or some of the business units of the *firm* with respect to a specific risk module, or parts of both, must submit a realistic transitional plan to extend the scope of the proposed *partial internal model*.

**[Note: Art. 113(2) of the Solvency II Directive]**

- 5.2 The realistic transitional plan referred to in 5.1 must set out the manner in which the *firm* plans to extend the scope of the proposed *partial internal model* to other sub-modules or business units of the *firm*, in order to ensure that the *internal model* covers a predominant part of the *firm's insurance business* with respect to that specific risk module.

**[Note: Art. 113(2) of the Solvency II Directive]****6 CHANGES TO AN INTERNAL MODEL OR INTERNAL MODEL CHANGE POLICY**

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- 6.1 A *firm* with *internal model approval* must not change its *internal model* otherwise than in accordance with the *firm's internal model change policy* as approved by the PRA.

**[Note: Art. 115 of the Solvency II Directive]**

- 6.2 A *firm's internal model change policy* must include a specification of minor and major changes to the *internal model*.

**[Note: Art. 115 of the Solvency II Directive]**



6.3 A firm with *internal model approval* must not:

- (1) make any major change to its *internal model*; or
- (2) make any change to its *internal model change policy*;

without obtaining the prior approval of the *PRA* in accordance with the procedures set out in 3 – 5 for obtaining *internal model approval*.

**[Note: Art. 115 of the *Solvency II Directive*]**

## **7 RESPONSIBILITIES OF THE FIRM'S GOVERNING BODY**

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7.1 A firm's:

- (1) *internal model approval application*; and
- (2) application to the *PRA* for approval to make a major change to its *internal model* for which it has received *internal model approval*;

must be approved by the firm's governing body.

**[Note: Art. 116 of the *Solvency II Directive*]**

7.2 A firm must have in place systems which ensure that its *internal model* operates properly on a continuous basis.

**[Note: Art. 116 of the *Solvency II Directive*]**

## **8 REVERSION TO THE STANDARD FORMULA**

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8.1 A firm with an *internal model approval* must not, in respect of the *internal model* for which that *internal model approval* has been granted, revert to calculating the whole or any part of the *SCR* in accordance with the *standard formula*.

**[Note: Art. 117 of the *Solvency II Directive*]**

## **9 NON-COMPLIANCE OF THE INTERNAL MODEL**

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9.1 If a firm with *internal model approval* ceases to comply with the *internal model requirements*, the firm must, without delay, either present to the *PRA* a plan to restore compliance within a reasonable period of time, or demonstrate to the *PRA* that the effect of non-compliance is immaterial.

**[Note: Art. 118(1) of the *Solvency II Directive*]**

## **10 USE TEST**

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10.1 A firm must demonstrate to the *PRA* that its *internal model* is widely used, and plays an important role in its system of governance (referred to in Conditions Governing Business 2 – 8) and particularly in its:

- (1) risk-management system, as set out in Conditions Governing Business 3.1 – 3.4, and decision-making processes; and
- (2) economic and solvency capital assessment and allocation processes, including its *ORSA*, as set out in Conditions Governing Business 3.5 – 3.8.

**[Note: Art. 120 of the *Solvency II Directive*]**

10.2 A *firm* must also demonstrate to the *PRA* that the frequency of calculation of its *SCR* using the *internal model* is consistent with the frequency with which it uses its *internal model* for the purposes set out in 10.1.

**[Note: Art. 120 of the Solvency II Directive]**

10.3 A *firm* must ensure the ongoing appropriateness of the design and operations of its *internal model*, and that the *internal model* continues to appropriately reflect the risk profile of the *firm*.

**[Note: Art. 120 of the Solvency II Directive]**

## 11 STATISTICAL QUALITY STANDARDS

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11.1 A *firm* must ensure that its *internal model* and, in particular, the calculation of the *probability distribution forecast* underlying it, complies with 11.2 – 11.8.

**[Note: Art. 121(1) of the Solvency II Directive]**

11.2 The methods used to calculate the *probability distribution forecast* must be:

- (1) based on adequate, applicable and relevant actuarial and statistical techniques;
- (2) based upon current and credible information and realistic assumptions; and
- (3) consistent with the methods used to calculate *technical provisions*.

**[Note: Art. 121(2) of the Solvency II Directive]**

11.3 A *firm* must be able to justify the assumptions underlying its *internal model* to the *PRA*.

**[Note: Art. 121(2) of the Solvency II Directive]**

- 11.4 (1) Data used for the *internal model* must be accurate, complete and appropriate.
- (2) A *firm* must update the data sets used in the calculation of the *probability distribution forecast* at least annually.

**[Note: Art. 121(3) of the Solvency II Directive]**

11.5 Without limiting the operation of 11.2, irrespective of the method chosen to calculate the *probability distribution forecast*, the ability of the *internal model* to rank risk must be sufficient to ensure that it is widely used and plays an important role in the system of governance of the *firm*, in particular in its risk-management system and decision-making processes, and capital allocation in accordance with 10.1.

**[Note: Art. 121(4) of the Solvency II Directive]**

11.6 The *internal model* must cover all of the material risks to which the *firm* is exposed, including at least the risks set out in Solvency Capital Requirement – General Provisions 3.3(1).

**[Note: Art. 121(4) of the Solvency II Directive]**

11.7 In its *internal model*, a *firm* must:

- (1) accurately assess:
  - (a) the particular risks associated with financial guarantees and any contractual options, where material; and

- (b) the risks associated with both *policyholder* options and the *firm's* contractual options,

taking into account the impact that future changes in financial and non-financial conditions may have on the exercise of those options; and

- (2) take account of all payments to *policyholders* which it expects to make, whether or not those payments are contractually guaranteed.

**[Note: Art. 121(7) and (9) of the Solvency II Directive]**

11.8 A *firm's internal model* must only take into account:

- (1) as regards *diversification effects*, dependencies within and across risk categories, if the *PRA* is satisfied, as part of the *internal model approval*, that the *firm's* system for measuring those *diversification effects* is adequate;
- (2) the effect of *risk-mitigation techniques*, if and to the extent that *credit risk* and other risks arising from the use of *risk-mitigation techniques* are properly reflected in the *internal model*; and
- (3) future management actions, if and to the extent that:
  - (a) they are future management actions that the *firm* would reasonably expect to carry out in specific circumstances; and
  - (b) the *firm* makes allowance in its *internal model* for the time necessary to implement those actions.

**[Note: Art. 121(5), (6) and (8) of the Solvency II Directive]**

**12 CALIBRATION STANDARDS**

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12.1 A *firm* may use, for internal modelling purposes, a different time period or *risk measure* than that set out in Solvency Capital Requirement – General Provisions 3.4 only where the outputs of the *internal model* can be used by the *firm* to calculate the *SCR* in a manner that provides *policyholders* with a level of protection equivalent to that set out in Solvency Capital Requirement – General Provisions 3.2 – 3.5.

**[Note: Art. 122(1) of the Solvency II Directive]**

12.2 A *firm* must derive the *SCR* directly from the *probability distribution forecast* generated by its *internal model*, using the Value-at-Risk *risk measure* set out in Solvency Capital Requirement – General Provisions 3.4.

**[Note: Art. 122(2) of the Solvency II Directive]**

12.3 When required to do so by the *PRA*, a *firm* must run its *internal model* on relevant benchmark portfolios, using assumptions based on external rather than internal data in order to verify the calibration of the *internal model* and to check that its specification is in line with generally accepted market practice.

**[Note: Art. 122(4) of the Solvency II Directive]**

### 13 PROFIT AND LOSS ATTRIBUTION

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13.1 A *firm* with *internal model approval* must review, at least annually, the causes and sources of profits and losses for each *major business unit*.

**[Note: Art. 123 of the *Solvency II Directive*]**

13.2 A *firm* must demonstrate how the categorisation of risk chosen in its *internal model* explains the causes and sources of profits and losses.

**[Note: Art. 123 of the *Solvency II Directive*]**

13.3 A *firm* must ensure that its categorisation of risk and attribution of profits and losses reflects its risk profile.

**[Note: Art. 123 of the *Solvency II Directive*]**

### 14 VALIDATION STANDARDS

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- 14.1 (1) A *firm* must have in place a regular cycle of *internal model* validation which includes:
- (a) monitoring the performance of the *internal model*, reviewing the ongoing appropriateness of its specification and testing its results against experience;
  - (b) an effective statistical process for validating the *internal model* which enables the *firm* to demonstrate to the *PRA* that the resulting capital requirements are appropriate;
  - (c) an analysis of the stability of the *internal model* and, in particular, the testing of the sensitivity of the results of the *internal model* to changes in key underlying assumptions; and
  - (d) an assessment of the accuracy, completeness and appropriateness of the data used by the *internal model*.
- (2) The statistical methods applied for the purposes of (1)(b) must test the appropriateness of the *probability distribution forecast* compared to loss experience, all material new data and information relating thereto.

**[Note: Art. 124 of the *Solvency II Directive*]**

### 15 DOCUMENTATION STANDARDS

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15.1 A *firm* must document the design and operational details of its *internal model*.

**[Note: Art. 125 of the *Solvency II Directive*]**

- 15.2 The documentation referred to in 15.1 must:
- (1) demonstrate compliance with 10 – 14;
  - (2) provide a detailed outline of the theory, assumptions, and mathematical and empirical bases underlying the *internal model*;
  - (3) indicate any circumstances under which the *internal model* does not work effectively; and
  - (4) include all major changes to the *internal model*, as referred to in 6.

[Note: Art. 125 of the *Solvency II Directive*]

## 16 EXTERNAL MODELS AND DATA

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16.1 The *internal model requirements* apply regardless whether a *firm* uses, in its *internal model*, a model or data obtained from a third party.

[Note: Art. 126 of the *Solvency II Directive*]

## 17 LLOYD'S

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17.1 This Chapter applies to the *Society* in relation to the use of an *internal model* for the purpose of Solvency Capital Requirement – General Provisions 3.1.

17.2 The *internal model* must:

- (1) separately identify and aggregate any diminution in *basic own funds* arising as a result of the application of risk scenarios taken into account in the *internal model* to:
  - (a) the *insurance business* of *members*; and
  - (b) the *central assets* and *central liabilities*; and
- (2) where the risk scenarios taken into account in the *internal model* result in the *own funds* attributable to a particular *member* being exhausted, identify the consequent impact upon *own funds* attributable to the *Society*.

**PRA RULEBOOK: SOLVENCY II FIRMS: MINIMUM CAPITAL REQUIREMENT 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: Minimum Capital Requirement 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: Minimum Capital Requirement 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

# MINIMUM CAPITAL REQUIREMENT

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Chapter content

1. APPLICATION AND DEFINITIONS
2. GENERAL PROVISIONS
3. CALCULATION OF THE MINIMUM CAPITAL REQUIREMENT
4. FREQUENCY AND REPORTING IN RELATION TO THE MINIMUM CAPITAL REQUIREMENT
5. LLOYD'S

Links

## 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*, as modified by 5.

1.2 In this Part, the following definitions shall apply;

*captive insurer*

means a *Solvency II undertaking* owned by:

- (1) a financial *undertaking* other than a *Solvency II undertaking*; or
- (2) a *group* of *Solvency II undertakings*; or
- (3) a non-financial *undertaking*;

the purpose of which is to provide insurance cover exclusively for the risks of the *undertaking* or *undertakings* to which it belongs, or of an *undertaking*, or *undertakings*, of the *group* of which that *Solvency II undertaking* is a member.

**[Note: Art. 13(2) of the *Solvency II Directive*]**

*captive reinsurer*

means a *Solvency II undertaking* that is a *pure reinsurer* owned by:

- (1) a financial *undertaking* other than a *Solvency II undertaking*; or
- (2) a *group* of *Solvency II undertakings*; or
- (3) a non-financial *undertaking*;

the purpose of which is to provide *reinsurance* cover exclusively for the risks of the *undertaking* or *undertakings* to which it belongs or of an *undertaking* or *undertakings* of the *group* of which that *pure reinsurer* is a member.

**[Note: Art.13(5) of the *Solvency II Directive*]**

## 2 GENERAL PROVISIONS

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2.1 A *firm* must hold *eligible own funds* covering the *MCR*.

**[Note: Art. 128 of the *Solvency II Directive*]**

## 3 CALCULATION OF THE MINIMUM CAPITAL REQUIREMENT

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3.1 The function used to calculate the *firm's MCR* must be calibrated to the value-at-risk of its *basic own funds* subject to a confidence level of 85% over a one-year period.

**[Note: Art. 129(1)(c) of the *Solvency II Directive*]**

3.2 The *MCR* must have an absolute floor of:



- (1) 2,500,000 euro for *firms*, including *captive insurers*, which have *Part 4A permission to effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of general insurance*, except in the case where all or some of the *general insurance business classes 10 to 15* are covered, in which case it must be no less than 3,700,000 euro;
- (2) 3,700,000 euro for *firms*, including *captive insurers*, which have *Part 4A permission to effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of long term insurance*;
- (3) 3,600,000 euro for *pure reinsurers*, except in the case of *captive reinsurers* that are *pure reinsurers*, in which case the *MCR* must be no less than 1,200,000 euro;
- (4) the sum of the amounts set out in (1) and (2) for *firms* other than *pure reinsurers* which as of 15 March 1979 carried on both *long-term insurance business* and *general insurance business*.

**[Note: Art. 129(1)(d) of the Solvency II Directive]**

- 3.3 Without prejudice to the requirements on the absolute floor in 3.2, the *MCR* must neither fall below 25% nor exceed 45% of the *firm's SCR*, calculated in accordance with *SCR Rules*, and including any *capital add-on* which has been imposed.

**[Note: Art. 129(3) of the Solvency II Directive]**

#### **4 FREQUENCY AND REPORTING IN RELATION TO THE MINIMUM CAPITAL REQUIREMENT**

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- 4.1 A *firm* must calculate the *MCR* and report the results of that calculation to the *PRA* at least quarterly.

**[Note: Art. 129(4) of the Solvency II Directive]**

- 4.2 Where either of the limits referred to in 3.3 determines a *firm's MCR* the *firm* must provide the *PRA* information allowing a proper understanding of the reasons therefor.

**[Note: Art. 129(4) of the Solvency II Directive]**

#### **5 LLOYD'S**

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- 5.1 This Chapter applies to the *Society*.
- 5.2 In calculating the *MCR* for Lloyd's, in the manner required by 3, the *Society* must ensure that the *MCR* is calibrated so as to include all quantifiable risks to which:
- (1) *members* are exposed as a consequence of those *members* carrying on *insurance business* at Lloyd's; and
  - (2) the *Society* is exposed, including risks to the *central assets* and *central liabilities*.
- 5.3 The *Society* must determine, at least quarterly, the ratio of the Lloyd's *MCR* to the Lloyd's *SCR* and notify the *PRA* of the result at the same time it reports the quarterly *MCR* calculation required by 4.1.
- 5.4 The *Society* must calculate a reporting point for each *underwriting member*, in accordance with 5.5.

- 5.5 The reporting point for each *underwriting member* must be calculated using the ratio referred to in 5.3, expressed as a percentage of the *member's* notional SCR referred to in Solvency Capital Requirement – General Provisions 8.4.
- 5.6 The *Society* must notify the *PRA* if *own funds* attributable to a *member* fall below the reporting point determined in accordance with 5.5 as soon as it is observed by the *Society*.

**PRA RULEBOOK: SOLVENCY II FIRMS: UNDERTAKINGS IN DIFFICULTY 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: Undertakings in Difficulty 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: Undertakings in Difficulty 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

# UNDERTAKINGS IN DIFFICULTY

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Chapter content

1. APPLICATION
2. IDENTIFICATION AND NOTIFICATION OF DETERIORATING FINANCIAL CONDITIONS
3. NON-COMPLIANCE WITH THE SCR
4. NON-COMPLIANCE WITH THE MCR
5. RECOVERY PLAN AND FINANCE SCHEME
6. LLOYD'S

Links

## 1 APPLICATION

---

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*, as modified by 6.

## 2 IDENTIFICATION AND NOTIFICATION OF DETERIORATING FINANCIAL CONDITIONS

---

2.1 A *firm* must have procedures in place to identify deteriorating financial conditions and must immediately notify the *PRA* when such deterioration occurs.

**[Note: Art. 136 of the *Solvency II Directive*]**

## 3 NON-COMPLIANCE WITH THE SCR

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3.1 A *firm* must:

- (1) immediately inform the *PRA* as soon as it observes that the *SCR* is no longer complied with, or where there is a risk of non-compliance within the next three *months*;
- (2) within two *months* from the observation of non-compliance with the *SCR*, submit a realistic *recovery plan* for approval by the *PRA*; and
- (3) take the measures necessary to achieve, within six *months* (or such longer period as the *PRA* may determine) from the observation of non-compliance with the *SCR*, the re-establishment of the level of *eligible own funds* covering the *SCR* or the reduction of its risk profile to ensure compliance with the *SCR*.

**[Note: Art. 138(1)–(3) of the *Solvency II Directive*]**

3.2 If the *PRA* has extended the period referred to in 3.1(3), by reason of the declaration by *EIOPA* of *exceptional adverse situations* affecting the *firm*, the *firm* must submit a progress report to the *PRA* every three *months* setting out the measures taken and the progress made to re-establish the level of *eligible own funds* covering the *SCR* or to reduce its risk profile to ensure compliance with the *SCR*.

**[Note: Art. 138(4) of the *Solvency II Directive*]**

## 4 NON-COMPLIANCE WITH THE MCR

---

4.1 A *firm* must:

- (1) inform the *PRA* immediately where it observes that the *MCR* is no longer complied with or where there is a risk of non-compliance within the next three *months*; and
- (2) within one *month* from the observation of non-compliance with the *MCR*, submit, for approval by the *PRA*, a short-term realistic *finance scheme* to restore, within three *months* of that observation, the reestablishment of *eligible own funds* at least to the level of the *MCR* or to reduce its risk profile to ensure compliance with the *MCR*.

## 5 RECOVERY PLAN AND FINANCE SCHEME

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- 5.1 Any *recovery plan* or *finance scheme* must at least include particulars or evidence concerning the following:
- (1) estimates of management expenses, in particular current general expenses and commissions;
  - (2) estimates of income and expenditure in respect of direct business, *reinsurance* acceptances and *reinsurance* cessions;
  - (3) a forecast balance sheet;
  - (4) estimates of the financial resources intended to cover the *technical provisions* and the *SCR* and the *MCR*; and
  - (5) the *firm's* overall *reinsurance* policy.

**[Note: Art. 142(1) of the Solvency II Directive]**

## 6 LLOYD'S

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- 6.1 For the purposes of this Part, 3 and 5 shall apply to the *Society* such that a breach of the *central requirement* shall be treated as a breach of the *SCR*.

**PRA RULEBOOK: SOLVENCY II FIRMS: INVESTMENTS 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: Investments 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: Investments 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

# INVESTMENTS

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Chapter content

1. APPLICATION AND DEFINITIONS
2. PRUDENT PERSON PRINCIPLE: GENERAL PRINCIPLES
3. PRUDENT PERSON PRINCIPLE: ASSETS COVERING TECHNICAL PROVISIONS
4. PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS FOR ASSETS COVERING LINKED LONG-TERM LIABILITIES
5. PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS WHERE THE INVESTMENT RISK IS NOT BORNE BY THE POLICYHOLDER
6. REPACKAGED LOANS

Links



## 1 APPLICATION AND DEFINITIONS

---

1.1 Unless otherwise stated, this Part applies to:

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

1.2 In this Part, the following definitions shall apply:

*alternative investment fund*

means (in accordance with Article 4(1)(a) of Directive 2011/61/EU) a collective investment undertaking, including investment compartments thereof, which:

- (1) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- (2) does not require authorisation pursuant to Article 5 of the Directive 2009/65/EC.

*authorised contractual scheme*

means a *co-ownership scheme* or a *partnership scheme*.

*collective investment scheme*

means a collective investment scheme, as defined in section 235 of *FSMA*.

*ICVC*

means a body incorporated under the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

*linked benefit*

means a benefit payable under a *linked long-term contract of insurance* or a *regulated collective investment scheme* the amount of which is determined by reference to:

- (1) the value of the property of any description (whether specified or not); or
- (2) fluctuations in the value of any such property; or
- (3) income from such property; or
- (4) fluctuations in an index of the value of such property.

*linked long-term liabilities*

means the insurance obligations in respect of *linked benefits* under a *linked long-term contract of insurance*.

*recognised scheme*

means a scheme recognised under:

- (1) section 264 of *FSMA* (Schemes constituted in other EEA States); or
- (2) section 270 of *FSMA* (Schemes authorised in designated countries or territories); or
- (3) section 272 of *FSMA* (Individually recognised overseas schemes).

*regulated collective investment scheme*

means:

- (1) an *ICVC*; or
- (2) an *authorised unit trust scheme*; or
- (3) an *authorised contractual scheme*; or
- (4) a *recognised scheme*;

*regulated market*

means:

- (1) a regulated market as defined in point (14) of Article 4 of Directive 2004/39/EC; or
- (2) a market situated outside the *EEA States* which is characterised by the fact that:
  - (a) it meets comparable requirements to those set out in (1); and
  - (b) the financial instruments dealt in are of a quality comparable to those in a regulated market in the *United Kingdom*.

*unit*

means:

- (1) (in relation to a *collective investment scheme*) the investment, specified in article 81 of the *Regulated Activities Order* (Units in a collective investment scheme) and defined in section 237(2) of *FSMA* (Other definitions); and
- (2) (in relation to an *alternative investment fund*) the right or interest (however described) of an investor in an *alternative investment fund*.

## **2 PRUDENT PERSON PRINCIPLE: GENERAL PRINCIPLES**

---

2.1 A *firm* must invest its assets in accordance with the following requirements:

- (1) the *firm* must only invest in assets and instruments the risks of which it can properly identify, measure, monitor, manage, control and report and appropriately take into account in the assessment of its overall solvency needs in accordance with Conditions Governing Business 3.5(2)(a);

- (2) all the assets of the *firm* must be:
  - (a) invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio of assets of the *firm* as a whole; and
  - (b) localised such as to ensure their availability; and
- (3) in the case of a conflict of interest, the *firm* must, or must procure that any third party which manages its assets will ensure that the investment of assets is made in the best interest of *policyholders*.

**[Note: Art. 132(1) – (2) of the Solvency II Directive]**

### **3 PRUDENT PERSON PRINCIPLE: ASSETS COVERING TECHNICAL PROVISIONS**

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- 3.1 In addition to meeting the requirements set out in 2.1, a *firm* must ensure that assets held to cover its *technical provisions* are invested in a manner appropriate to the nature and duration of the *firm's* insurance and *reinsurance* liabilities and in the best interests of all *policyholders*, taking into account any disclosed *policy* objectives.

**[Note: Art. 132(2) of the Solvency II Directive]**

### **4 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS FOR ASSETS COVERING LINKED LONG-TERM LIABILITIES**

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- 4.1 This Chapter does not apply to a *pure reinsurer*.
- 4.2 In addition to the requirements set out in 2.1 and 3.1, where a *firm* carries out *linked long-term contracts of insurance*, it must also satisfy the requirements in 4.3.
- 4.3 Where 4.2 applies, the *firm* must cover its *technical provisions* in respect of its *linked long-term liabilities* as closely as possible with:
- (1) where the *linked benefits* are linked to the value of *units*, those *units*;
  - (2) where the *linked benefits* are linked to the value of assets contained in an internal fund of the *firm*:
    - (a) in a case where the internal fund is divided into notional units, the assets represented by those notional units; or
    - (b) in a case where notional units are not established, those assets; and
  - (3) where the *linked benefits* are linked to a *share* index or other reference value not mentioned in (1) or (2), assets of appropriate security and marketability which correspond as closely as possible to the assets on which the reference value is based.

**[Note: Art. 132(3) of the Solvency II Directive]**

### **5 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS WHERE THE INVESTMENT RISK IS NOT BORNE BY THE POLICYHOLDER**

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- 5.1 This Chapter does not apply in respect of assets covering *technical provisions* for *linked long-term contracts of insurance* unless, and to the extent that, the assets are held to cover the

*technical provisions* in respect of any guarantee of investment performance or other guaranteed benefit provided under those *linked long-term contracts of insurance*.

**[Note: Art. 132(3) – (4) of the Solvency II Directive]**

- 5.2 Subject to 5.1, and without prejudice to 2, 3 and 4, a *firm* must invest its assets in accordance with the following requirements
- (1) the *firm* must not invest in a *derivative* or *quasi-derivative* unless, and to the extent that, it contributes to a reduction of risks or facilitates efficient portfolio management;
  - (2) investments and assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;
  - (3) assets must be properly diversified in such a way as to avoid:
    - (a) excessive reliance on any particular asset, issuer, *group* of *undertakings* or geographical area; and
    - (b) excessive accumulation of risk in the portfolio as a whole;
  - (4) investments in assets issued by the same issuer, or issuers belonging to the same *group*, must not expose the *firm* to excessive risk concentration.

**[Note: Art. 132(4) of the Solvency II Directive]**

## **6 REPACKAGED LOANS**

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- 6.1 A *firm* must ensure that the requirements set out in the *Solvency II Regulations*, that need to be met by *undertakings* that repackage loans into tradable securities and other financial instruments in order for a *firm* to be allowed to invest in such securities or instruments, are met in respect of securities or instruments held by the *firm* that were:
- (1) issued after 1 January 2011; or
  - (2) issued before 1 January 2011 where new underlying exposures were added or substituted after 31 December 2014.

**[Note: Arts. 135(2)(a) and 308b (11) of the Solvency II Directive]**

**PRA RULEBOOK: SOLVENCY II FIRMS: COMPOSITES 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: Composites 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: Composites 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

# COMPOSITES

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Chapter content

1. APPLICATION
2. LONG-TERM AND GENERAL INSURANCE ACTIVITIES TO BE SEPARATELY MANAGED
3. MINIMUM FINANCIAL OBLIGATIONS: GENERAL PROVISIONS
4. MINIMUM FINANCIAL OBLIGATIONS: CALCULATION OF NOTIONAL MINIMUM CAPITAL REQUIREMENT
5. LINKS BETWEEN GENERAL INSURERS AND LONG-TERM INSURERS
6. LLOYDS

Links

## 1 APPLICATION

---

- 1.1 Unless otherwise stated, this Part applies to:
- (1) a *UK Solvency II firm*;
  - (2) in accordance with General Application 3, the *Society*; and
  - (3) in accordance with General Application 3, *managing agents*.

## 2 LONG-TERM AND GENERAL INSURANCE ACTIVITIES TO BE SEPARATELY MANAGED

---

- 2.1 This Chapter:
- (1) applies to a *composite firm* other than a *pure reinsurer*; and
  - (2) does not apply to a *managing agent* which manages one or more *syndicates*, all of which carry on *reinsurance* exclusively.
- 2.2 A *composite firm* must separately manage the activities relating to its *general insurance business* and the activities relating to its *long-term insurance business* in such a way that:
- (1) its *long-term insurance business* and its *general insurance business* are distinct from one another;
  - (2) the interests of *policyholders of contracts of long-term insurance* are not prejudiced by activities relating to the *firm's general insurance business* and the interests of *policyholders of contracts of general insurance* are not prejudiced by activities relating to the *firm's long-term insurance business*; and
  - (3) profits from the activities relating to the *composite firm's long-term insurance business* benefit *policyholders of contracts of long-term insurance* as if the *composite firm* was engaged only in *long-term insurance business*.

**[Note: Art. 74(1) of the *Solvency II Directive*]**

## 3 MINIMUM FINANCIAL OBLIGATIONS: GENERAL PROVISIONS

---

- 3.1 This Chapter:
- (1) applies to a *composite firm*, other than a *pure reinsurer*; and
  - (2) does not apply to a *managing agent* which manages one or more *syndicates*, all of which carry on *reinsurance* exclusively.
- 3.2 A *composite firm* must maintain separate accounts for each of its *long-term insurance business* and its *general insurance business* to show the sources of the results for each activity separately.
- 3.3 For the purposes of 3.2, the *firm* must:
- (1) break down, according to origin, all income (including *premiums*, recoverables from *reinsurance contracts* and investment income) and all expenditure (including insurance settlements, additions to *technical provisions*, *reinsurance premiums* and

operating expenses) in respect of its *general insurance business* and its *long-term insurance business*, respectively; and

- (2) if items are shared between the *firm's long-term insurance business* and its *general insurance business*, apportion those items appropriately between the two activities and enter them into the accounts on the basis of that apportionment.

**[Note: Art. 74(6) of the Solvency II Directive]**

- 3.4 The *firm* must record the methods on the basis of which the apportionment referred to in 3.3(2) has been made and be able to demonstrate to the *PRA* the appropriateness of those methods of apportionment.

#### **4 MINIMUM FINANCIAL OBLIGATIONS: CALCULATION OF NOTIONAL MINIMUM CAPITAL REQUIREMENT**

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4.1 This Chapter:

- (1) applies to a *composite firm*, other than a *pure reinsurer*; and
- (2) does not apply to *managing agents*.

4.2 Without prejudice to the *SCR rules* and the Minimum Capital Requirement Part, the *firm* must calculate a notional minimum capital requirement on the basis of the accounts referred to in 3.2:

- (1) with respect to its *long-term insurance business*, calculated as if the *firm* carried on *long-term insurance business* only; and
- (2) with respect to its *general insurance business*, calculated as if the *firm* carried on *general insurance business* only.

**[Note: Art. 74(2) of the Solvency II Directive]**

4.3 The *firm* must cover:

- (1) its *notional life MCR* with *eligible own funds* attributable to its *long-term insurance business*, as identified on the basis of the accounts referred to in 3.2; and
- (2) its *notional non-life MCR* with *eligible own funds* attributable to its *general insurance business*, as identified on the basis of the accounts referred to in 3.2.

**[Note: Art. 74(3) of the Solvency II Directive]**

4.4 For the purposes of 4.3, the *firm* must not cover:

- (1) its *notional life MCR* with *eligible own funds* attributable to its *general insurance business*; and
- (2) its *notional non-life MCR* with *eligible own funds* attributable to its *long-term insurance business*.

**[Note: Art. 74(3) of the Solvency II Directive]**

4.5 The *firm* must prepare a statement on the basis of the accounts referred to in 3.2 identifying the *eligible own funds* covering the *notional life MCR* and the *notional non-life MCR*, respectively.



**[Note: Art. 74(6) of the Solvency II Directive]**

4.6 Provided the *firm* satisfies the requirements in 4.3 and 4.4, and subject to the requirement in 4.7, a *firm* may use:

- (1) *eligible own funds* attributable to its *general insurance business* that are in excess of its *notional non-life MCR*; and
- (2) *eligible own funds* attributable to its *long-term insurance business* that are in excess of its *notional life MCR*;

to cover part or all of the difference between the *firm's SCR* and the sum of its *notional non-life MCR* and *notional life MCR*.

**[Note: Art. 74(4) of the Solvency II Directive]**

4.7 For the purposes of 4.6, a *firm* must notify the *PRA* before using:

- (1) *eligible own funds* referred to in 4.6(1) to cover the portion of the difference referred to in 4.6 that relates to the difference between the *notional life SCR* and the *notional life MCR*; or
- (2) *eligible own funds* referred to in 4.6(2) to cover the portion of the difference referred to in 4.6 that relates to the difference between the *notional non-life SCR* and the *notional non-life MCR*.

**[Note: Art. 74(4) of the Solvency II Directive]**

4.8 If a *composite firm* is in breach of either 4.3(1) or 4.3(2), the provisions of Minimum Capital Requirement 4.1 apply to the activity in respect of which the breach has occurred, as if the words "*MCR*" in Minimum Capital Requirement 4.1 were substituted with the words "*notional life MCR*" or "*notional non-life MCR*", as applicable, regardless of whether any breach has occurred in respect of the other activity.

**[Note: Art. 74(7) of the Solvency II Directive]**

## **5 LINKS BETWEEN GENERAL INSURERS AND LONG-TERM INSURERS**

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5.1 If a *general insurer* and a *long-term insurer* have financial, commercial or administrative links with each other, each of those *firms* must ensure that its accounts are not distorted by an agreement between them or by any arrangement which could affect the apportionment of expenses and income.

**[Note: Art. 73(4) of the Solvency II Directive]**

## **6 LLOYD'S**

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6.1 This Chapter applies to *managing agents*.

6.2 A *managing agent* must not permit both *general insurance business* and *long-term insurance business* to be carried on together through any *syndicate* managed by it, except where:

- (1) the *long-term insurance business* to be carried on by that *syndicate* is or is to be restricted to *reinsurance*; or

- (2) the *general insurance business* to be carried on by that *syndicate* is or is to be restricted to *effect contracts of insurance* or *carry out contracts of insurance* in *general insurance business class 1* (accident) or *class 2* (sickness).

**[Note: Art. 73(2) of the Solvency II Directive]**

**PRA RULEBOOK: SOLVENCY II FIRMS: CONDITIONS GOVERNING BUSINESS 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: Conditions Governing Business 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: Conditions Governing Business 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

# CONDITIONS GOVERNING BUSINESS

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. GENERAL GOVERNANCE REQUIREMENTS
3. RISK MANAGEMENT
4. INTERNAL CONTROL
5. INTERNAL AUDIT
6. ACTUARIAL FUNCTION
7. OUTSOURCING
8. FIT AND PROPER REQUIREMENTS FOR PERSONS WHO EFFECTIVELY RUN THE UNDERTAKING OR HAVE OTHER KEY FUNCTIONS
9. FINITE REINSURANCE
10. RESTRICTION OF BUSINESS
11. PREMIUMS FOR NEW BUSINESS
12. LLOYD'S

Links

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*;
- (2) in accordance with General Application 3, the *Society*, as modified by 12; and
- (3) in accordance with General Application 3, *managing agents*, as modified by 12.

1.2 In this Part, the following definitions shall apply:

*closed year*

means a *syndicate year* closed by *reinsurance to close*, either into another *syndicate year* or into an *insurer* approved by the *Council* for that purpose.

*concentration risk*

means all risk exposures with a loss potential which is large enough to threaten the solvency or the financial position of a *Solvency II undertaking*.

**[Note: Art. 13(35) of the *Solvency II Directive*]**

*corporate member*

means a *member* that is a *body corporate* or a Scottish Limited partnership.

*explicit maximum loss potential*

means the maximum economic risk transferred by the ceding undertaking to the *reinsurer* under a contract of *reinsurance*.

*external credit assessment institution*

means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009.

**[Note: Art. 13(40) of the *Solvency II Directive*]**

*finite reinsurance*

means *reinsurance*:

- (1) under which the *explicit maximum loss potential* arising from a significant transfer of both *underwriting risk* and timing risk exceeds the premium payable by the ceding *undertaking* over the duration of the contract by a limited but significant amount; and
- (2) which possesses at least one of the following characteristics:
  - (a) explicit and material consideration of the time value of money; and

- (b) contractual provisions to moderate the balance of economic experience between the parties to the *reinsurance* over time to achieve the target risk transfer.

**[Note: Art. 210(3) of the Solvency II Directive]**

*former member*

means a *person* who has ceased to be a *member*, whether by resignation or otherwise, in accordance with the Lloyd's Act 1982 and any *byelaw* made under it.

*individual member*

means a *member*, or *former member*, who is a natural *person*.

*liquidity risk*

means the risk that a *firm* is unable to realise investments and other assets in order to settle its financial obligations when they fall due.

**[Note: Art. 13(34) of the Solvency II Directive]**

*quasi-derivative*

means a contract or asset having the effect of a *derivative* contract.

*reinsurer*

means an *insurance undertaking* whose business includes effecting or carrying out contracts of *reinsurance*; includes a retrocessionaire.

*technical provisions transitional measure*

[means the approval granted to a *firm* by the *PRA* referred to in Transitional Measures 11].

## 2 GENERAL GOVERNANCE REQUIREMENTS

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- 2.1 A *firm* must ensure its *governing body* is ultimately responsible for the *firm's* compliance with the *rules* and all applicable laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*.

**[Note: Art. 40 of the Solvency II Directive]**

- 2.2 (1) A *firm* must have in place an effective system of governance which provides for sound and prudent management of its business.
- (2) The system of governance must include at least:
- (a) an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities; and
- (b) an effective system for ensuring the transmission of information.
- (3) The system of governance must include compliance with the requirements laid down in 2.5 and 3 – 8.
- (4) The system of governance must be subject to regular internal review.

**[Note: Art. 41(1) of the Solvency II Directive]**

2.3 A *firm's* system of governance must be proportionate to the nature, scale and complexity of its operations.

**[Note: Art. 41(2) of the Solvency II Directive]**

2.4 A *firm* must:

- (1) have written policies in relation to at least risk management, internal control, internal audit and, where relevant, *outsourcing*;
- (2) make those policies subject to prior approval of its *governing body*;
- (3) ensure those policies are implemented;
- (4) review those policies at least annually; and
- (5) adapt those policies in view of any significant change in the system or area concerned.

**[Note: Art. 41(3) of the Solvency II Directive]**

2.5 The written policy on risk management referred to in 2.4(1) must comprise:

- (1) policies relating to points (i) – (vi) in 3.1(2)(c); and
- (2) where the *volatility adjustment* is applied, a policy on the criteria for the application of the *volatility adjustment*.

**[Note: Art. 44(2) and (2a) of the Solvency II Directive]**

2.6 A *firm* must take reasonable steps to ensure continuity and regularity in the performance of its activities, including the development of contingency plans. To that end, the *firm* must employ appropriate and proportionate systems, resources and procedures.

**[Note: Art. 41(4) of the Solvency II Directive]****3 RISK MANAGEMENT**

- 
- 3.1 (1) A *firm* must have in place an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies.
- (2) That risk management system must:
- (a) be effective and well integrated into the organisational structure and decision-making processes of the *firm* with proper consideration of the *persons* who effectively run the *firm* or have other key *functions*;
  - (b) cover the risks to be included in the calculation of the *SCR* as set out in Solvency Capital Requirement - General Provisions 3.3(1), as well as the risks which are not, or not fully, included in the calculation thereof;
  - (c) cover at least the following areas:

- (i) underwriting and reserving;
  - (ii) asset–liability management;
  - (iii) investment, in particular *derivatives*, *quasi-derivatives* and similar commitments;
  - (iv) *liquidity risk* and *concentration risk* management;
  - (v) *operational risk* management;
  - (vi) *reinsurance* and other *risk-mitigation techniques*.
- (3) Where a *firm* applies the *matching adjustment* or the *volatility adjustment* it must set up a liquidity plan projecting the incoming and outgoing cash-flows in relation to the assets and liabilities subject to those adjustments.

**[Note: Art. 44(1)–(2) of the Solvency II Directive]**

3.2 As regards asset-liability management, a *firm* must:

- (1) regularly assess the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the extrapolation of the *relevant risk-free interest rate term structure* referred to in Technical Provisions 4A;
- (2) where the *matching adjustment* is applied, regularly assess:
  - (a) the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the calculation of the *matching adjustment*, including the calculation of the fundamental spread referred to in Technical Provisions 4C.2(2), and the possible effect of a forced sale of assets on its *eligible own funds*;
  - (b) the sensitivity of its *technical provisions* and *eligible own funds* to changes in the composition of the assigned portfolio of assets;
  - (c) the impact of a reduction of the *matching adjustment* to zero;
- (3) where the *volatility adjustment* is applied, regularly assess:
  - (a) the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the calculation of the *volatility adjustment* and the possible effect of a forced sale of assets on its *eligible own funds*;
  - (b) the impact of a reduction of the volatility to zero.

**[Note: Art. 44(2a) of the Solvency II Directive]**

3.3 A *firm* must submit the assessments referred to in 3.2 as part of the information reported annually in accordance with Reporting 2. Where the reduction of the *matching adjustment* or the *volatility adjustment* to zero would result in non-compliance with the *SCR*, the *firm* must also submit an analysis of the measures it could apply in such a situation to re-establish the level of the *eligible own funds* covering the *SCR* or to reduce its risk profile to restore compliance with the *SCR*.

**[Note: Art. 44(2a) of the Solvency II Directive]**



3.4 As regards investment risk, a *firm* must demonstrate that it complies with the Investments Part.

**[Note: Art. 44(3) of the Solvency II Directive]**

3.5 A *firm* must provide for a risk management *function* that is structured in such a way as to facilitate the implementation of the risk management system.

**[Note: Art. 44(4) of the Solvency II Directive]**

3.6 In order to avoid overreliance on *external credit assessment institutions* when it uses external credit rating assessments in the calculation of *technical provisions* and the *SCR*, a *firm* must assess the appropriateness of those external credit rating assessments as part of its risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments.

**[Note: Art. 44(4a) of the Solvency II Directive]**

3.7 A *firm* that has received *internal model approval* must ensure that its risk management *function* covers the following additional tasks:

- (1) to design and implement the *internal model*;
- (2) to test and validate the *internal model*;
- (3) to document the *internal model* and any subsequent changes made to it;
- (4) to analyse the performance of the *internal model* and to produce summary reports thereof; and
- (5) to inform the *governing body* about the performance of the *internal model*, suggesting areas needing improvement, and updating that body on the status of efforts to improve previously identified weaknesses.

**[Note: Art. 44(5) of the Solvency II Directive]**

- 3.8
- (1) A *firm* must conduct an *ORSA* as part of its risk management system.
  - (2) The *ORSA* must include at least the following:
    - (a) the *firm's* overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the *firm*;
    - (b) the compliance, on a continuous basis, with:
      - (i) the *SCR* and *MCR*; and
      - (ii) the requirements regarding *technical provisions*, as set out in Technical Provisions; and
    - (c) the significance with which the risk profile of the *firm* deviates from the assumptions underlying the *SCR*.
  - (3) For the purposes of 3.8(2)(a), the *firm* must:
    - (a) have in place processes which are proportionate to the nature, scale and complexity of the risks inherent in its business and which enable it to properly

identify and assess the risks it faces in the short and long term and to which it is, or could be, exposed; and

- (b) demonstrate the methods used in that assessment.
- (4) Where a *firm* applies the *matching adjustment*, the *volatility adjustment*, the *risk-free interest rate transitional measure* or the *technical provisions transitional measure*, it must perform the assessment of compliance with the capital requirements referred to in 3.8(2)(b) with and without taking into account those adjustments and transitional measures.
- (5) In the case referred to in 3.8(2)(c), when an *internal model* is used, the assessment must be performed together with the recalibration that transforms the internal risk numbers into the *SCR risk measure* and calibration.

**[Note: Arts. 45(1), (2), (2a), (3) of the Solvency II Directive]**

3.9 A *firm* must make the *ORSA* an integral part of its business strategy and take the *ORSA* into account on an ongoing basis in its strategic decisions.

**[Note: Art. 45(4) of the Solvency II Directive]**

3.10 A *firm* must perform the *ORSA* regularly and without delay following any significant change in its risk profile.

**[Note: Art. 45(5) of the Solvency II Directive]**

3.11 A *firm* must inform the *PRA* of the results of each *ORSA* as part of the information reported under Reporting 2.

**[Note: Art. 45(6) of the Solvency II Directive]**

## 4 INTERNAL CONTROL

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- 4.1 (1) A *firm* must have in place an effective internal control system.
- (2) That system must include administrative and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels of the *firm* and a compliance *function*.

**[Note: Art. 46(1) of the Solvency II Directive]**

- 4.2 The compliance *function* referred to in 4.1(2) must include:
  - (1) advising the *governing body* on compliance with the *rules* and other laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*; and
  - (2) an assessment of the possible impact of any changes in the legal environment on the operations of the *firm* concerned and the identification and assessment of compliance risk.

**[Note: Art. 46(2) of the Solvency II Directive]**

4.3 A *firm* must have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of its *technical provisions*.

**[Note: Art. 82 of the Solvency II Directive]**

- 4.4 A *firm* must have processes and procedures in place to ensure that the *best estimate*, and the assumptions underlying the calculation of the *best estimate*, are regularly compared against experience.

**[Note: Art. 83 of the Solvency II Directive]****5 INTERNAL AUDIT**

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- 5.1 (1) A *firm* must provide for an effective internal audit *function*.
- (2) The internal audit *function* must:
- (a) include an evaluation of the adequacy and effectiveness of the internal control system and other elements of the system of governance; and
  - (b) be objective and independent from the operational *functions*.
- (3) A *firm* must ensure that any findings and recommendations of the internal audit *function* are reported to the *firm's governing body* which must:
- (a) determine what actions are to be taken with respect to each of the internal audit findings and recommendations; and
  - (b) ensure that those actions are carried out.

**[Note: Art. 47 of the Solvency II Directive]****6 ACTUARIAL FUNCTION**

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- 6.1 (1) A *firm* must provide for an effective actuarial *function* to:
- (a) coordinate the calculation of *technical provisions*;
  - (b) ensure the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of *technical provisions*;
  - (c) assess the sufficiency and quality of the data used in the calculation of *technical provisions*;
  - (d) compare *best estimates* against experience;
  - (e) inform the *governing body* of the reliability and adequacy of the calculation of *technical provisions*;
  - (f) oversee the calculation of *technical provisions* in the cases set out in Technical Provisions 8;
  - (g) express an opinion on the overall underwriting policy;
  - (h) express an opinion on the adequacy of *reinsurance* arrangements; and
  - (i) contribute to the effective implementation of the risk management system referred to in 3, in particular with respect to the risk modelling underlying the calculation of the *SCR* and *MCR* and to the *firm's ORSA*.

- (2) The actuarial *function* must be carried out by *persons* who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the *firm's* business, and who are able to demonstrate their relevant experience with applicable professional and other standards.

**[Note: Art. 48 of the Solvency II Directive]**

## 7 OUTSOURCING

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- 7.1 If a *firm outsources* a *function* or any insurance or *reinsurance* activity, it remains fully responsible for discharging all of its obligations under the *rules* and other laws, regulations and administrative provisions adopted in accordance with the *Solvency II Directive*.

**[Note: Art. 49(1) of the Solvency II Directive]**

- 7.2 A *firm* must not *outsource* a critical or important operational *function* or activity in such a way as to lead to any of the following:
- (1) materially impairing the quality of the *firm's* system of governance;
  - (2) unduly increasing the *operational risk*;
  - (3) impairing the ability of the *supervisory authorities* to monitor the *firm's* compliance with its obligations;
  - (4) undermining continuous and satisfactory service to *policyholders*.

**[Note: Art. 49(2) of the Solvency II Directive]**

- 7.3 A *firm* must, in a timely manner, notify the *PRA* prior to the *outsourcing* of critical or important *functions* or activities as well as of any subsequent material developments with respect to those *functions* or activities.

**[Note: Art. 49(3) of the Solvency II Directive]**

- 7.4 Without prejudice to 7.1 – 7.3, a *firm outsourcing* a *function* or an insurance or *reinsurance* activity must take the necessary steps to ensure that the following conditions are satisfied:
- (1) the service provider must co-operate with the *PRA* and, where relevant, any other *supervisory authority* of the *firm* in connection with the *function* or activity that is the subject of the *outsourcing*;
  - (2) the *firm*, its auditors, the *PRA* and, where relevant, any other *supervisory authority* of the *firm* must have effective access to data related to the *functions* or activities that are the subject of the *outsourcing*; and
  - (3) the *PRA* and, where relevant, any other *supervisory authority* of the *firm* must have effective access to the business premises of the service provider and must be able to exercise those rights of access.

**[Note: Art. 38(1) of the Solvency II Directive]**

## 8 FIT AND PROPER REQUIREMENTS FOR PERSONS WHO EFFECTIVELY RUN THE UNDERTAKING OR HAVE OTHER KEY FUNCTIONS

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[Drafting Note: Placeholder for rules in relation to Article 42 of the Solvency II Directive]

## 9 FINITE REINSURANCE

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- 9.1 A *firm* must not enter into a contract of *finite reinsurance* (either as a cedant or a *reinsurer*) or pursue *finite reinsurance* activities unless it is able to properly identify, measure, monitor, manage, control and report the risks arising from that contract or those activities.

**[Note: Art. 210 of the *Solvency II Directive*]**

## 10 RESTRICTION OF BUSINESS

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- 10.1 (1) A *firm*, other than a *pure reinsurer*, must not carry on any commercial business other than *insurance business* and activities directly arising from that business.
- (2) (1) does not prevent a *friendly society* that was on 15 March 1979 carrying on *long-term insurance business* and savings business from continuing to carry on savings business.

**[Note: Articles 18(1)(a) and 305(3) of the *Solvency II Directive*]**

- 10.2 A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

**[Note: Art. 18(1)(b) of the *Solvency II Directive*]**

## 11 PREMIUMS FOR NEW BUSINESS

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- 11.1 A *firm* must not enter into a *contract of long-term insurance* unless it is satisfied, on reasonable actuarial assumptions, that the *premiums* receivable shall be sufficient:
- (1) to enable the *firm* to meet all of its commitments; and
- (2) in particular, to establish adequate *technical provisions* as required in the Technical Provisions Part.

**[Note: Art. 209 of the *Solvency II Directive*]**

- 11.2 For the purposes of 11.1, all aspects of the financial situation of the *firm* may be taken into account, provided that input from resources other than *premiums* and investment income expected to be earned from *premiums* is not systematic and permanent in a way that may jeopardise the long-term solvency of the *firm*.

**[Note: Art. 209 of the *Solvency II Directive*]**

## 12 LLOYD'S

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- 12.1 This Chapter applies to the *Society* and *managing agents*.
- 12.2 For the purpose of;
- (1) 3.1(2)(b), 3.8(2)(c) and 6.1(1)(i), as applied to *managing agents*, the reference to “*SCR*” is to be interpreted as a reference to the notional *syndicate SCR* calculated by *managing agents* as required by Solvency Capital Requirement - General Provisions 8.2.
- (2) 3.7 and 3.8(5), as applied to *managing agents*, the reference to “internal model” is to be interpreted as a reference to any *internal model* used by a *managing agent* to

calculate the notional *syndicate SCR* as required by Solvency Capital Requirement – General Provisions 8.2; and

- (3) 3.10, as applied to *managing agents*, the reference to “risk profile” is to be interpreted as a reference to the risk profile of any *syndicate* managed by the *managing agent*.
- 12.3 For the purpose of 3.8 – 3.11, as applied to *managing agents*, *managing agents* must conduct an *ORSA* for each *syndicate* which they manage.
- 12.4 Where a provision of this Part requires that a *function* be established, the *Society* and *managing agents* must each separately establish that *function*.
- 12.5 The actuarial *function* of a *managing agent* must, in respect of each *syndicate* managed by the *managing agent*, carrying out *general insurance business*;
- (1) review the *technical provisions* of each *syndicate year* (other than a *closed year*); and
  - (2) provide an opinion to the *managing agent* and the *Society* confirming that the *technical provisions* (before addition of the *risk margin*) for each *syndicate year* are no less prudent than the *best estimate* of the amounts required to be held (before addition of the *risk margin*) in accordance with Technical Provisions 2 – 8.
- 12.6 The *PRA* must be informed by the *managing agent* promptly if the *managing agent* becomes aware that the actuarial *function* of the *managing agent* will or may be unable to produce an unqualified opinion under 12.5(2).
- 12.7 8 applies separately to *managing agents* and the *Society*.
- 12.8 For the purpose of 10.1, the *Society* and *managing agents* must take all reasonable steps to ensure that:
- (1) a *corporate member* does not carry on any commercial business other than *insurance business* and activities arising directly from that business; and
  - (2) *individual members* do not, in their capacity as *underwriting members*, carry on any commercial business other than *insurance business* and activities arising directly from that business.

**PRA RULEBOOK: SOLVENCY II FIRMS: INSURANCE SPECIAL PURPOSE VEHICLES  
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: Insurance Special Purpose Vehicles 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: Insurance Special Purpose Vehicles 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

# INSURANCE SPECIAL PURPOSE VEHICLES

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Chapter content

1. APPLICATION
2. GENERAL PROVISIONS
3. UK ISPVS WITH PART 4A PERMISSION

Links



**1 APPLICATION**

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1.1 Unless otherwise stated, this Part applies to a *UK ISPV*.

**2 GENERAL PROVISIONS**

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2.1 A *UK ISPV* must ensure that at all times it is fully funded.

**3 UK ISPVs WITH PART 4A PERMISSION**

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3.1 Where a *UK ISPV* has a *Part 4A permission* in force prior to 1 January 2016, that *Part 4A permission* shall continue to have effect thereafter provided that the *UK ISPV* satisfies the requirements of the *Solvency II Regulations* on that date.

**PRA RULEBOOK: SOLVENCY II FIRMS: GROUP SUPERVISION 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); and
  - (3) section 192J (rules requiring provision of information by parent undertakings).
- 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: Group Supervision 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: Group Supervision 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**

# **GROUP SUPERVISION**

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## **Chapter content**

- 1. APPLICATION AND DEFINITIONS**
- 2. CASES OF APPLICATION AND SCOPE OF GROUP SUPERVISION**
- 3. LEVELS**
- 4. GROUP SOLVENCY: GENERAL PROVISIONS**
- 5. GROUP SOLVENCY: FREQUENCY OF CALCULATIONS**
- 6. GROUP SOLVENCY: NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS BY GROUP MEMBER**
- 7. GROUP SOLVENCY: BASIC PRINCIPLES**
- 8. GROUP SOLVENCY: PROPORTIONAL SHARES**
- 9. GROUP SOLVENCY: ELIMINATION OF DOUBLE USE OF ELIGIBLE OWN FUNDS AND INTRA-GROUP CREATION OF CAPITAL AND VALUATION**
- 10. GROUP SOLVENCY: APPLICATION OF THE CALCULATION METHODS**
- 11. CALCULATION METHODS: METHOD 1**
- 12. CALCULATION METHODS: METHOD 2**
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- 14. SUPERVISIONS OF GROUP SOLVENCY FOR SOLVENCY II FIRMS THAT ARE SUBSIDIARIES OF AN INSURANCE HOLDING COMPANY OR A MIXED FINANCIAL HOLDING COMPANY**
- 15. GROUPS WITH CENTRALISED RISK MANAGEMENT**
- 16. RISK CONCENTRATION AND INTRA-GROUP TRANSACTIONS**
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- 18. GROUP SFCR**
- 19. GROUP STRUCTURE**
- 20. THIRD COUNTRIES**
- 21. MIXED-ACTIVITY INSURANCE HOLDING COMPANIES**

**Links**

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) every *UK Solvency II firm*:
  - (a) that is a member of a *group* for which the *PRA* is the *group supervisor*;
  - (b) that is a member of a *group* for which a *supervisory authority* (other than the *PRA*) is the *group supervisor*, subject to (c) and to the extent this Part gives effect to the *Solvency II EEA implementing measures* in the *EEA State* of its *group supervisor*; and
  - (c) where the *group supervisor* of a *group* of which a *firm* is a member is a *supervisory authority* in an *EEA State* other than the *United Kingdom*, the requirements of the *Solvency II EEA implementing measures* in that *EEA State* apply to the *firm* in relation to its capacity as a member of that *group*;
- (2) in accordance with General Application 3, the *Society* as a *mixed activity insurance holding company*, as modified by 21; and;
- (3) a *UK holding company*

1.2 In this Part, the following definitions shall apply:

*close links*

means a situation in which two or more *persons* are linked by *control* or *participation*, or a situation in which two or more *persons* are permanently linked to one and the same person by a *control* relationship.

**[Note: Art. 13(17) of the *Solvency II Directive*]**

*financial institution*

has the meaning given in point (26) of Article 4(1) of the *CRR*.

*group supervisor*

means (in relation to a *group*) the authority designated as group supervisor in relation to that *group*, in accordance with Article 247 of the *Solvency II Directive*.

*intermediate holding company*

means an *insurance holding company* or a *mixed financial holding company* through which a *Solvency II undertaking* in a *group* holds a *participation* in a *related Solvency II undertaking*, a *third country insurance undertaking* or a *third country reinsurance undertaking*.

*method 1*

means the method for calculating group solvency described in 11.1.

*method 2*

means the method for calculating group solvency described in 12.1.

*mixed activity insurance holding company*

means a *parent undertaking*, other than a *Solvency II undertaking*, a *third-country insurance undertaking*, a *third-country reinsurance undertaking*, an *insurance holding company* or a *mixed financial holding company*, the *subsidiary undertakings* of which include at least one *Solvency II undertaking*.

**[Note: Art. 212(1)(g) of the Solvency II Directive]**

*own funds eligible for the group SCR*

means:

- (1) in relation to *method 1*, the *own funds eligible for the group SCR* in accordance with 11.1(3); and
- (2) in relation to *method 2*, the aggregate *eligible own funds* of the *group* referred to in 12.2.

*own funds eligible for the SCR*

means the aggregate of the *firm's*:

- (a) *Tier 1 own funds*; and
- (b) *eligible Tier 2 own funds*; and
- (c) *eligible Tier 3 own funds*.

*related Solvency II undertaking*

means a *Solvency II undertaking* that is a *related undertaking* of another *undertaking*.

*related undertaking*

means, in relation to an *undertaking* ("U"):

- (1) any *subsidiary undertaking* of U; or
- (2) any *undertaking* in which U or any of U's *subsidiary undertakings* holds a *participation*; or
- (3) any *undertaking* linked to U by an *Article 12(1) relationship*; or
- (4) any *undertaking* linked by an *Article 12(1) relationship* to an *undertaking* in (1), (2) or (3).

*solvency deficit*

means the amount (if any) by which the *related undertaking's eligible own funds* fall short of its solvency capital requirement under the *SCR Rules* or the relevant *Solvency II implementing measures* as appropriate.

*UK holding company*

means an *insurance holding company* or *mixed financial holding company* that:

- (1) is incorporated in the *United Kingdom*; or

- (2) has a place of business in the *United Kingdom*.

## 2 CASES OF APPLICATION AND SCOPE OF GROUP SUPERVISION

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2.1 This Part applies at the level of the *group* to types of *groups* where:

- (1) either:
- (a) a *UK Solvency II firm* is a *participating undertaking* in at least one other *Solvency II undertaking*, *third country insurance undertaking* or *third country reinsurance undertaking*; or
  - (b) a *Solvency II undertaking* (other than a *UK Solvency II firm*) is a *participating undertaking* in a *UK Solvency II firm*; or
- (2) the *parent undertaking* of a *UK Solvency II firm* is an *insurance holding company* or a *mixed financial holding company* which has its head office in an *EEA State*; or
- (3) the *parent undertaking* of a *UK Solvency II firm* is an *insurance holding company* or a *mixed financial holding company* which does not have its head office in an *EEA State* or is a *third country insurance undertaking* or a *third country reinsurance undertaking*; or
- (4) the *parent undertaking* of a *UK Solvency II firm* is a *mixed activity insurance holding company*.

### [Note: Art. 213(2) of the *Solvency II Directive*]

2.2 Where, in accordance with 2.1, this Part applies at the level of a *group*, that *group* consists of all *undertakings* within the relevant *group*, subject to 2.3 and 3 and provided that:

- (1) where 2.1(1) applies, the definition of a *group* must be applied to the *participating Solvency II undertaking*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*;
- (2) where 2.1(2) applies, the definition of a *group* must be applied to the *insurance holding company* or *mixed financial holding company*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*;
- (3) where 2.1(3) applies, the definition of a *group* must be applied to the *insurance holding company* or *mixed financial holding company*, *third country insurance undertaking* or *third country reinsurance undertaking* (as applicable), its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*; and
- (4) where 2.1(4) applies, the definition of a *group* must be applied to the *mixed activity insurance holding company*, its *subsidiary undertakings*, the *undertakings* in which it holds a *participation* and *undertakings* to which it is linked by an *Article 12(1) relationship* or, where applicable, to the *undertakings* in a *mutual-type group*.

### [Note: Art. 213(2) of the *Solvency II Directive*]

2.3 Where the *PRA* as *group supervisor* has granted a *waiver* or where a *supervisory authority* which is the *group supervisor* has decided, in accordance with Article 214 of the *Solvency II Directive*, not to include an *undertaking* in the group supervision referred to in 2.1:

- (1) that *undertaking* must be excluded from the *group* for the purposes of 2.1; and
- (2) if that *undertaking* is a *firm* and is excluded because:
  - (a) it is of negligible interest with respect to the objectives of group supervision; or
  - (b) its inclusion would be inappropriate or misleading with respect to the objectives of group supervision,

the *firm* which is at the head of the *group* of which that *firm* would otherwise be a part, or any other *firm* which is a member of the *group* must provide any information in relation to the excluded *firm* that the *PRA* may require to facilitate the supervision of the excluded *firm*.

**[Note: Art. 214(2) of the *Solvency II Directive*]**

2.4 The provisions of the *Solvency II Firms Sector* concerning the supervision of *firms* (or the *Solvency II EEA implementing measures* in relation to *Solvency II undertakings* which are members of a *group* for which the *PRA* is the *group supervisor*) taken individually continue to apply to those *undertakings*, except where otherwise provided under this Part.

**[Note: Art. 213(1) of the *Solvency II Directive*]**

### 3 LEVELS

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3.1 If the *participating Solvency II undertaking* or the *insurance holding company* or *mixed financial holding company* referred to in 2.1(1) or 2.1(2) is itself a *subsidiary undertaking* of another *Solvency II undertaking* or of another *insurance holding company* or *mixed financial holding company* which has its head office in an *EEA State*, then 4 – 19 apply only at the level of the ultimate *Solvency II undertaking*, *insurance holding company*, or *mixed financial holding company* in the *group* which has its head office in an *EEA State*.

**[Note: Art. 215(1) of the *Solvency II Directive*]**

3.2 If the *PRA* makes the decision referred to in Article 216(1) of the *Solvency II Directive* (group supervision at national level) then 4 – 19 apply with any necessary changes, subject to Articles 216(6) and 217 of the *Solvency II Directive* and the following:

- (1) group supervision of the ultimate *parent undertaking* at national level is restricted to those *rules* of 4 – 19 if the *firm* is granted a *waiver* of such other sections as would otherwise apply to a *group*; and
- (2) no *firm* in the *group* may introduce, in accordance with 15.1(5), an application for permission to subject any *subsidiary undertakings* in the *group* to 15.3.

**[Note: Art. 216(2) and (5) of the *Solvency II Directive*]**

### 4 GROUP SOLVENCY: GENERAL PROVISIONS

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4.1 Where 2.1(1) applies, each *participating Solvency II undertaking* that is a *firm* in the *group* and each *relevant insurance group undertaking* must ensure that *eligible own funds* are

available in the *group* which are always at least equal to the *group SCR* as calculated in accordance with 7 – 12.

**[Note: Art. 218(2) of the Solvency II Directive]**

4.2 Where 2.1(2) applies, each *relevant insurance group undertaking* must ensure that *eligible own funds* are available in the *group* which are always at least equal to the *group SCR* as calculated in accordance with 14.

**[Note: Art. 218(3) of the Solvency II Directive]**

4.3 *Relevant insurance group undertakings* must have procedures in place to identify deteriorating financial conditions within the *groups* of which they are members and must immediately notify the *group supervisor* when that deterioration occurs.

**[Note: Arts. 218(4) and 136 of the Solvency II Directive]**

4.4 *Relevant insurance group undertakings* must:

- (1) immediately inform the *PRA* as soon as they observe that the *group SCR* is no longer complied with, or where there is a risk of non-compliance within the next three *months*;
- (2) within two *months* from the observation of non-compliance with the *group SCR*, submit a realistic *recovery plan* in accordance with Undertakings In Difficulty 5.1 for approval by the *PRA*;
- (3) take the measures necessary to achieve, within six *months* (or such longer period as the *PRA* may determine) from the observation of non-compliance with the *group SCR*, the re-establishment of the level of *eligible own funds* covering the *group SCR* or the reduction of the risk profile to ensure compliance with the *group SCR*; and
- (4) if the *PRA* has extended the period referred to (3) by reason of the declaration by *EIOPA* of an *exceptional adverse situation* affecting the *group*, submit a progress report to the *PRA* every three *months* setting out the measures taken and the progress made to re-establish the level of *own funds* covering the *group SCR* or to reduce the risk profile to ensure compliance with the *group SCR*.

**[Note: Arts. 218(4) and 138(1)–(4) of the Solvency II Directive]**

## **5 GROUP SOLVENCY: FREQUENCY OF CALCULATIONS**

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5.1 The calculations referred to in 4.1 and 4.2 must be carried out at least annually by the *relevant insurance group undertakings*.

**[Note: Art. 219(1) of the Solvency II Directive]**

5.2 The relevant data for, and the results of, the calculations referred to in 4.1 and 4.2 must be submitted to the *group supervisor* by:

- (1) the *participating Solvency II undertakings* referred to in 4.1, or by any one of them, in the case of the calculations referred to in 4.1; or
- (2) *UK holding company* or such other *undertaking* in the *group* as may be determined by the *group supervisor* in accordance with Article 219(1) of the *Solvency II Directive*, in the case of the calculations referred to in 4.2.



**[Note: Art. 219(1) of the Solvency II Directive]**

- 5.3 (1) The *relevant insurance group undertakings* must monitor the *group SCR* on an ongoing basis.
- (2) Where the risk profile of the *group* deviates significantly from the assumptions underlying the last reported *group SCR*, the *group SCR* must be recalculated without delay and reported to the *group supervisor*.
- (3) Upon request by the *group supervisor*, in accordance with Article 219(2) of the *Solvency II Directive*, the *group SCR* must be recalculated without delay and reported to the *group supervisor*.

**[Note: Art. 219(2) of the Solvency II Directive]**

## 6 GROUP SOLVENCY: NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS BY GROUP MEMBER

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- 6.1 This section applies to a *firm* if another member of its *group* intends to issue an item for inclusion within the *basic own funds* forming the *own funds eligible for the group SCR* of the *firm's group*.
- 6.2 A *firm* must notify the *PRA* in writing of the intention of another member of its *group* which is not a *firm* to issue an item which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, as soon as it becomes aware of the intention of the issuing *undertaking*. When giving notice, a *firm* must:
- (1) provide details of the amount of *basic own funds* to be raised through the intended issue and whether the item is intended to be issued to external investors or within its *group*;
  - (2) identify the classification of *basic own funds* the item is intended to fall within;
  - (3) include confirmation from the *governing body* of the *firm* that the item complies with the *rules* applicable to items of *basic own funds* included in the classification of the item identified in (2); and
  - (4) provide a copy of the term sheet and details of any features of the item it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR* which are novel, unusual or different from an item of *own funds* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by the Solvency II Firms Sector or the *Solvency II Regulations*.
- 6.3 A *firm* must provide a further written notification to the *PRA* including all the information required in 6.2 as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.
- 6.4 If an *undertaking* proposes to establish a debt securities program for the issue of an item which the *firm* intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*, the *firm* must:
- (1) notify the *PRA* of the establishment of the program; and
  - (2) provide the information required by 6.2

as soon it becomes aware of the proposed establishment. The *PRA* must be notified of any changes in accordance with 6.3.

6.5 The items of *basic own funds* to which 6.2 does not apply are:

- (1) ordinary *shares* issued by an *undertaking* in the *group* which are:
  - (a) classified as *Tier 1 own funds* or *Tier 2 basic own funds*; and
  - (b) the same as ordinary *shares* previously issued by that *undertaking*;
- (2) debt instruments issued from a debt securities program established by an *undertaking* in the *group*, provided that program was notified to the *PRA* prior to its first drawdown in accordance with 6.4; and
- (3) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *group undertaking* and included in the *basic own funds* forming the *own funds eligible for the group SCR*.

6.6 A *firm* must notify the *PRA* in writing, no later than the date of issue, of the intention of the *undertaking* in the *group* to issue an item listed in 6.5 which it intends to include within the *basic own funds* forming the *own funds eligible for the group SCR*. When giving notice, a *firm* must:

- (1) provide the information set out at 6.2(1) – (3); and
- (2) confirm that the terms of the item have not changed since the previous issue of that type of item of *basic own funds* by that *undertaking*.

## 7 GROUP SOLVENCY: BASIC PRINCIPLES

---

7.1 The calculation of the solvency at the level of the *group* of the *Solvency II undertakings* referred to in 2.1(1) must be carried out:

- (1) in accordance with the technical principles in 8 – 10; and

**[Note: Art. 220(1) of the *Solvency II Directive*]**

- (2) in accordance with *method 1*, unless the *group supervisor* has determined under Article 220(2) of the *Solvency II Directive* that *method 2* or a combination of *method 1* and *method 2* must be applied.

**[Note: Art. 220(2) of the *Solvency II Directive*]**

## 8 GROUP SOLVENCY: PROPORTIONAL SHARES

---

8.1 The calculation of the solvency of a *group* must take account of the proportional share held by the *participating undertaking* in its *related undertakings*.

**[Note: Art. 221(1) of the *Solvency II Directive*]**

8.2 For the purposes of 8.1, the proportional share must comprise either of the following, subject to 8.3:

- (1) where *method 1* is used, the percentages used for the establishment of the consolidated accounts; or

- (2) where *method 2* is used, the proportion of the subscribed capital that is held, directly or indirectly, by the *participating undertaking*.

**[Note: Art. 221(1) of the Solvency II Directive]**

8.3 Notwithstanding 8.2:

- (1) where the *related undertaking* is a *subsidiary undertaking* and does not have sufficient *eligible own funds* to cover its *SCR*, the total *solvency deficit* of the *subsidiary undertaking* must be taken into account (or a proportional share of that *solvency deficit*, if the *group supervisor* so determines under Article 221(1) of the *Solvency II Directive*); and

**[Note: Art. 221(1) of the Solvency II Directive]**

- (2) the proportional share must be as determined by the *group supervisor* if such a determination is made under Article 221(2) of the *Solvency II Directive*.

**[Note: Art. 221(2) of the Solvency II Directive]**

**9 GROUP SOLVENCY: ELIMINATION OF DOUBLE USE OF ELIGIBLE OWN FUNDS AND INTRA-GROUP CREATION OF CAPITAL AND VALUATION**

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9.1 *Own funds eligible for the SCR* must not be taken into account more than once among the different *Solvency II undertakings* taken into account in the calculation of the solvency of a *group*. For that purpose, when calculating the solvency of a *group* and where *method 1* and *method 2* do not provide for it, the following amounts must be excluded:

- (1) the value of any asset of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of one of its *related Solvency II undertakings*;
- (2) the value of any asset of a *related Solvency II undertaking* of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of that *participating Solvency II undertaking*; and
- (3) the value of any asset of a *related Solvency II undertaking* of the *participating Solvency II undertaking* which represents the financing of *own funds eligible for the SCR* of any other *related Solvency II undertaking* of that *participating Solvency II undertaking*.

**[Note: Art. 222(1) of the Solvency II Directive]**

9.2 Without prejudice to 9.1 or 9.3, the following must be excluded in the calculation of the solvency of a *group* unless they are, and only insofar as they are, eligible for covering the *SCR* of the *related undertaking* concerned:

- (1) surplus funds falling under Article 91(2) of the *Solvency II Directive* arising in a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated; and
- (2) any subscribed but not paid-up capital of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated.

**[Note: Art. 222(2) of the Solvency II Directive]**

- 9.3 Without prejudice to 9.1, the following must, in any event, be excluded from the calculation:
- (1) subscribed but not paid-up capital which represents a potential obligation on the part of the *participating undertaking*;
  - (2) subscribed but not paid-up capital of the *participating Solvency II undertaking* which represents a potential obligation on the part of a *related Solvency II undertaking*; and
  - (3) subscribed but not paid-up capital of a *related Solvency II undertaking* which represents a potential obligation on the part of another *related Solvency II undertaking* of the same *participating Solvency II undertaking*.

**[Note: Art. 222(2) of the Solvency II Directive]**

- 9.4 Where the PRA considers that certain *own funds eligible for the SCR* of a *related Solvency II undertaking* (other than those referred to in 9.2 and 9.3) cannot effectively be made available to cover the *SCR* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated, those *own funds* must not be included in the calculation of the group solvency of the *group* unless they are, and only in so far as they are, eligible for covering the *SCR* of the *related undertaking*.

**[Note: Art. 222(3) of the Solvency II Directive]**

- 9.5 The sum of the *own funds* included under 9.2 and 9.4 must not exceed the *SCR* of the *related Solvency II undertaking*.

**[Note: Art. 222(4) of the Solvency II Directive]**

- 9.6 Any *eligible own funds* of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the solvency of a *group* is calculated that are subject to prior authorisation from the *supervisory authority* of the *related Solvency II undertaking*, in accordance with Article 90 of the *Solvency II Directive*, must be included in the calculation of the group solvency only in so far as they have been duly authorised by that *supervisory authority*.

**[Note: Art. 222(5) of the Solvency II Directive]**

- 9.7 When calculating the solvency of a *group*, no account must be taken of any *own funds eligible for the SCR* arising out of reciprocal financing between the *participating Solvency II undertaking* and any of the following:
- (1) a *related undertaking*;
  - (2) a *participating undertaking*; and
  - (3) another *related undertaking* of any of its *participating undertakings*.

**[Note: Art. 223(1) of the Solvency II Directive]**

- 9.8 When calculating the solvency of a *group*, no account must be taken of any *own funds eligible for the SCR* of a *related Solvency II undertaking* of the *participating Solvency II undertaking* for which the group solvency of the *group* is calculated where the *own funds* concerned arise out of reciprocal financing with any other *related undertaking* of that *participating Solvency II undertaking*. Reciprocal financing exists at least where a *Solvency II undertaking*, or any of its *related undertakings*, holds shares in, or makes loans to, another *undertaking* which, directly or indirectly, holds *eligible own funds* of the first *undertaking*.

**[Note: Art. 223(2), (3) of the Solvency II Directive]**

- 9.9 The value of the assets and liabilities of a *group* must be assessed in accordance with Valuation 2.

**[Note: Art. 224 of the Solvency II Directive]****10 GROUP SOLVENCY: APPLICATION OF THE CALCULATION METHODS**

- 10.1 Where a *Solvency II undertaking* has more than one *related Solvency II undertaking*, the group solvency calculation of the *group* must be carried out by including each of those *related Solvency II undertakings*.

**[Note: Art. 225 of the Solvency II Directive]**

- 10.2 In respect of a *related Solvency II undertaking* with its head office in an *EEA State* other than that of the *Solvency II undertaking* for which the group solvency calculation of the *group* is carried out, the group solvency calculation must take account of the *SCR* and the *own funds eligible for the SCR* as laid down in the *Solvency II EEA implementing measures* of that other *EEA State*.

**[Note: Art. 225 of the Solvency II Directive]**

- 10.3 (1) When calculating the group solvency of a *Solvency II undertaking* in a *group*, the situation of each *intermediate holding company* must be taken into account.
- (2) For the sole purpose of that calculation, the *intermediate holding company* must be treated as if it were a *Solvency II undertaking* subject to the *SCR Rules* in respect of the *SCR* and were subject to the same conditions as are laid down in the *Own Funds Part* in respect of *own funds eligible for the SCR*.
- (3) In cases where an *intermediate holding company* holds subordinated debt or other *eligible own funds* subject to limitation in accordance with *Own Funds 5* or any applicable *Solvency II Regulations*, they must be recognised as *eligible own funds* up to the amounts calculated by application of the limits in *Own Funds 5* or any applicable *Solvency II Regulations* to the total *eligible own funds* outstanding at group level of the *group* as compared to the *group SCR*.
- (4) Any *eligible own funds* of an *intermediate holding company*, which would require prior authorisation from a *supervisory authority* in accordance with Article 90 of the *Solvency II Directive*, may be included in the calculation of the group solvency of the *group* only in so far as they have been duly authorised by the *group supervisor*.

**[Note: Art. 226 of the Solvency II Directive]**

- 10.4 (1) Subject to (2), when calculating, in accordance with *method 2*, the group solvency of a *Solvency II undertaking* in a *group* which is a *participating undertaking* in a *third country insurance undertaking* or *third country reinsurance undertaking*, that *third country insurance undertaking* or *third country reinsurance undertaking* must, solely for the purposes of that calculation, be treated as a *related Solvency II undertaking*.
- (2) If the third country in which that *third country insurance undertaking* or *third country reinsurance undertaking* has its head office makes it subject to authorisation and imposes on it a solvency regime that is assessed to be equivalent under Article 227 of the *Solvency II Directive*, the calculation in (1) must take into account, as regards

that *undertaking*, the requirement equivalent to the *SCR* and the capital items eligible to satisfy that requirement as laid down by that third country.

**[Note: Art. 227 of the Solvency II Directive]**

- 10.5 When calculating the group solvency of a *Solvency II undertaking* in a *group* which is a *participating undertaking* in a *credit institution*, *investment firm* or *financial institution*, the *participating Solvency II undertaking* must either:
- (1) apply *method 1* or *method 2* in Annex I to Directive 2002/87/EC with any necessary changes, provided that *method 1* in that Annex must be applied only where the *group supervisor* is satisfied as to the level of integrated management and internal control regarding the *undertakings* which would be included in the scope of consolidation and provided always that the method chosen must be applied in a consistent manner over time; or
  - (2) if the *group supervisor* so determines (either at the request of the *participating undertaking* or on its own initiative), deduct any such *participation* from the *own funds eligible for the group SCR* of the *participating undertaking*.

**[Note: Art. 228 of the Solvency II Directive]**

- 10.6 Where the information necessary for calculating the group solvency of a *Solvency II undertaking* in a *group*, concerning a *related undertaking* with its head office in an *EEA State* or a third country, is not available to the *group supervisor* then:
- (1) the book value of that *related undertaking* in the *participating Solvency II undertaking* must be deducted from the *own funds eligible for the group SCR*; and
  - (2) the unrealised gains connected with that *participation* must not be recognised as *own funds eligible for the group SCR*.

**[Note: Art. 229 of the Solvency II Directive]**

## 11 CALCULATION METHODS: METHOD 1

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- 11.1 (1) The calculation of the group solvency of the *participating Solvency II undertaking* in a *group* must be carried out on the basis of the consolidated accounts.
- (2) The group solvency of the *participating Solvency II undertaking* in a *group* is the difference between the following:
- (a) the *own funds eligible for the group SCR*, calculated on the basis of consolidated data; and
  - (b) the *group SCR* calculated on the basis of consolidated data.
- (3) Own Funds and the *SCR Rules* apply to the calculation of the *own funds eligible for the group SCR* and of the *group SCR* based on consolidated data.

**[Note: Art. 230(1) of the Solvency II Directive]**

- 11.2 The *group SCR* of a *group* based on consolidated data (consolidated *group SCR*) must be calculated on the basis of either the *standard formula* or an approved *internal model*, in a manner consistent with the general principles contained in the *SCR Rules*

**[Note: Art. 230(2) of the Solvency II Directive]**

- 11.3 (1) The consolidated *group SCR* of a *group* must have as a minimum the sum of the following:
- (a) the *MCR* of the *participating Solvency II undertaking*; and
  - (b) the proportional share of the *MCR* of the *related Solvency II undertakings*.
- (2) That minimum must be covered by *eligible own funds* within paragraph 2 of the definition of “*eligible own funds*”.
- (3) For the purposes of determining whether those *eligible own funds* qualify to cover the minimum consolidated *group SCR* of a *group*, the principles in 8 – 10 apply with any necessary changes. Undertakings In Difficulty 3 also applies with any necessary changes.

**[Note: Art. 230(2) of the Solvency II Directive]**

- 11.4 Any application for permission to calculate the consolidated *group SCR*, as well as the *SCR* of *Solvency II undertakings* in the *group*, on the basis of an *internal model*, submitted by a *Solvency II undertaking* and its *related undertakings*, or jointly by the *related Solvency II undertakings* of an *insurance holding company* or a *mixed financial holding company*, must be submitted to the *group supervisor*.

**[Note: Art. 231(1) of the Solvency II Directive]**

## 12 CALCULATION METHODS: METHOD 2

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- 12.1 The group solvency of the *participating Solvency II undertaking* in a *group* is the difference between the following:
- (1) the aggregated group *eligible own funds*, as provided for in 12.2; and
  - (2) the value in the *participating Solvency II undertaking* of the *related Solvency II undertakings* and the aggregated *group SCR*, as provided for in 12.3.

**[Note: Art. 233(1) of the Solvency II Directive]**

- 12.2 The aggregated group *eligible own funds* of a *group* is the sum of the following:
- (1) the *own funds eligible for the SCR* of the *participating Solvency II undertaking*; and
  - (2) the proportional share of the *participating Solvency II undertaking* in the *own funds eligible for the SCR* of the *related Solvency II undertakings*.

**[Note: Art. 233(2) of the Solvency II Directive]**

- 12.3 The aggregated *group SCR* of a *group* is the sum of the following:
- (1) the *SCR* of the *participating Solvency II undertakings*; and
  - (2) the proportional share of the *SCR* of the *related Solvency II undertakings*.

**[Note: Art. 233(3) of the Solvency II Directive]**

- 12.4 Where, in a *group*, the *participation* in the *related Solvency II undertaking* consists, wholly or in part, of an indirect ownership, the value in the *participating Solvency II undertaking* of the *related Solvency II undertaking* must incorporate the value of that indirect ownership. The

value of that indirect ownership must take into account the relevant successive interests, and the items referred to in 12.2(2) and 12.3(2) must include the corresponding proportional shares, respectively, of the *own funds eligible for the SCR* of the *related Solvency II undertaking* and of the *SCR* of the *related Solvency II undertakings*.

**[Note: Art. 233(4) of the Solvency II Directive]**

- 12.5 Any application for permission to calculate the *SCR* of *Solvency II undertakings* in the *group*, on the basis of an *internal model*, submitted by a *Solvency II undertaking* and its *related undertakings*, or jointly by the *related undertakings* of an *insurance holding company* or a *mixed financial holding company*, must be submitted to the *group supervisor*.

**[Note: Art. 233(5) of the Solvency II Directive]**

**13 CALCULATION METHODS: CAPITAL ADD-ONS**

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- 13.1 The *relevant insurance group undertakings* must make every effort to remedy the deficiencies that led to the imposition of a *capital add-on* arising as a result of an *internal model significant risk profile deviation* or a *significant system of governance deviation* at group level.

**[Note: Arts. 232 and 37(3) of the Solvency II Directive]**

- 13.2 The *group SCR* prior to the imposition of the *capital add-on*, together with the amount of the *capital add-on* imposed at group level, will constitute the *group's group SCR*.

**[Note: Arts. 232 and 37(5) of the Solvency II Directive]**

**14 SUPERVISIONS OF GROUP SOLVENCY FOR SOLVENCY II FIRMS THAT ARE SUBSIDIARIES OF AN INSURANCE HOLDING COMPANY OR A MIXED FINANCIAL HOLDING COMPANY**

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- 14.1 (1) Where *Solvency II undertakings* in a *group* are *subsidiary undertakings* of an *insurance holding company* or a *mixed financial holding company*, the calculation of the solvency of the *group* must be carried out at the level of the *insurance holding company* or *mixed financial holding company* applying 7.1(2) – 12.
- (2) For the purpose of that calculation, the *insurance holding company* or *mixed financial holding company* must be treated as if it were a *Solvency II undertaking* subject to the *SCR Rules* as regards the *SCR* and the *Own Funds Part* as regards the *own funds eligible for the SCR*, provided that the *relevant insurance group undertakings* remain responsible for discharging any obligations arising from the application of this subparagraph.

**[Note: Art. 235 of the Solvency II Directive]**

**15 GROUPS WITH CENTRALISED RISK MANAGEMENT**

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- 15.1 15.3 applies to any *Solvency II undertaking* in a *group* which is a *subsidiary undertaking* of another *Solvency II undertaking* or of an *insurance holding company* where all of the following conditions are satisfied:
- (1) the *subsidiary undertaking*, in relation to which the *group supervisor* has not made a decision under Article 214(2) of the *Solvency II Directive*, is included in the *group supervision* carried out by the *group supervisor* at the level of the *parent undertaking* in accordance with this Part;



- (2) the risk-management processes and internal control mechanisms of the *parent undertaking* cover the *subsidiary undertaking* and the *parent undertaking* satisfies the *PRA* regarding the prudent management of the *subsidiary undertaking*;
- (3) (a) the *parent undertaking*; or  
 (b) one or more *relevant insurance group undertakings*,  
 is permitted, under 17.2(3), to produce a single document covering all relevant *ORSAs*;
- (4) (a) the *parent undertaking*; or  
 (b) one or more *relevant insurance group undertaking*,  
 is permitted, under 18.1(2), to produce a single *SFCR* covering all relevant *Solvency II undertakings* and *insurance holding companies* and *mixed financial holding companies*; and
- (5) an application for permission to be subject to 15.3 has been submitted by the *parent undertaking* or one or more *relevant insurance group undertakings* and a favourable decision has been made on that application in accordance with the procedure in Article 237 of the *Solvency II Directive*.

**[Note: Art. 236 of the *Solvency II Directive*]**

- 15.2 An application for permission to be subject to 15.3 must be made to the *PRA* if the *subsidiary undertaking* is a *UK Solvency II firm*.

**[Note: Art. 237(1) of the *Solvency II Directive*]**

- 15.3 Without prejudice to 11.4 and subject to 15.4, if the conditions referred to in 15.1 are satisfied, the *SCR* of the *subsidiary undertaking* in the *group* must be calculated in accordance with any decisions taken in accordance with Article 238 of the *Solvency II Directive*.

**[Note: Art. 238 of the *Solvency II Directive*]**

- 15.4 (1) 15.3 ceases to apply where:
- (a) the condition referred to in 15.1(1) is no longer complied with;
- (b) the condition referred to in 15.1(2) is no longer complied with and the *group* does not restore compliance with this condition in an appropriate period of time.
- (2) The *parent undertaking* or *relevant insurance group undertakings* of a *group* to which 15.3 applies must ensure that the conditions referred to in 15.1(2) – (4) are complied with on an ongoing basis and in the event of non-compliance must:
- (a) inform the *group supervisor* and the *supervisory authority* of the *subsidiary undertaking* concerned without delay; and
- (b) present a plan to the *supervisory authorities* to restore compliance within an appropriate period of time.

**[Note: Art. 240 of the *Solvency II Directive*]**

## 16 RISK CONCENTRATION AND INTRA-GROUP TRANSACTIONS

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- 16.1 (1) Where 2.1(1) or 2.1(2) apply, the *relevant insurance group undertakings* or any *UK holding company* must report on a regular basis and at least annually to the *group supervisor* any significant risk concentration at the level of the *group*.
- (2) The necessary information must be submitted to the *group supervisor* by the *relevant insurance group undertaking* which is at the head of the *group* or, where the *group* is not headed by a *relevant insurance group undertaking*, by the *UK holding company* or such other *Solvency II undertaking* in the *group* as the *group supervisor* may specify.

**[Note: Art. 244 of the Solvency II Directive]**

- 16.2 (1) Where 2.1(1) or 2.1(2) applies, the *relevant insurance group undertakings* or any *UK holding company* must report on a regular basis, and at least annually, to the *group supervisor* all significant intra-group transactions by *Solvency II undertakings* within a *group*, including those performed with a natural person with *close links* to an *undertaking* in the *group*.
- (2) Where an intra-group transaction falling within (1) is very significant, it must be reported to the *group supervisor* as soon as practicable.
- (3) The necessary information must be submitted to the *group supervisor* by the *relevant insurance group undertaking* which is at the head of the *group* or, where the *group* is not headed by a *Solvency II undertaking*, by the *UK holding company* or such other *Solvency II undertaking* in the *group* as the *group supervisor* may specify.

**[Note: Art. 245 of the Solvency II Directive]**

## 17 RISK MANAGEMENT AND INTERNAL CONTROL

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- 17.1 (1) Where 2.1(1) or 2.1(2) applies, the following requirements in the Conditions Governing Business Part apply with any necessary changes at the level of the *group*:
- (a) 2.2 – 2.6;
  - (b) 3
  - (c) 4.1 – 4.2
  - (d) 5
  - (e) 6
  - (f) 7.1 – 7.3; and
  - (g) 8
- (2) Without prejudice to (1), the risk management and internal control systems and reporting procedures must be implemented consistently in all the *undertakings* included in the scope of *group supervision* under 2.2(1) and 2.2(2) so that those systems and reporting procedures can be controlled at the level of the *group*.
- (3) Without prejudice to (1), the internal control mechanisms must include at least the following:

- (a) adequate mechanisms as regards group solvency to identify and measure all material risks incurred and to appropriately relate *eligible own funds* to risks; and
  - (b) sound reporting and accounting procedures to monitor and manage the intra-group transactions and the risk concentration.
- 17.2 (1) Where 2.1(1) or 2.1(2) applies, a *participating Solvency II undertaking* that is a *firm*, or if there is none, the *UK holding company* or the *relevant insurance group undertakings*, must undertake at the level of the *group* the assessment required by Conditions Governing Business 3.8 – 3.11.
- (2) Where the calculation of the solvency at the level of the *group* is carried out in accordance with *method 1*, the *participating Solvency II undertaking*, the *UK holding company* or the *relevant insurance group undertakings* (as appropriate) must provide to the *group supervisor* a proper understanding of the difference between the sum of the *SCR* of all the *related Solvency II undertakings* in the *group* and the consolidated *SCR* of the *group*.
- (3) Where the *participating Solvency II undertaking*, the *UK holding company* or the *relevant insurance group undertakings* (as appropriate) so decide, and subject to the agreement of the *group supervisor*, they may undertake any assessments required by Conditions Governing Business 3.8 – 3.11 at the level of the *group* and at the level of any *subsidiary undertaking* in the *group* at the same time, and may produce a single document covering all the assessments.
- (4) Where the *group* exercises the option provided in (3), it must submit the document to all *supervisory authorities* concerned at the same time.
- (5) The exercise of the option provided in (3) does not exempt the *subsidiary undertakings* concerned from the obligation to ensure that the requirements of Conditions Governing Business 3.8 – 3.11 are met.

**[Note: Art. 246(1) to (4) of the Solvency II Directive]**

17.3 Reporting 2.1 – 2.4 apply with any necessary changes.

**[Note: Art. 254(2) of the Solvency II Directive]**

## 18 GROUP SFCR

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- 18.1 (1) When 2.1(1) or 2.1(2) applies, *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* must disclose publicly, on an annual basis, a report on the solvency and financial condition at the level of the *group*. Reporting 3 – 6 apply with any necessary changes.
- (2) Where a *participating Solvency II undertaking* that is a *firm* or the *relevant insurance group undertakings* (as appropriate) so decide, and subject to the agreement of the *group supervisor*, they may provide a single *SFCR* which must comprise the following:
- (a) the information at the level of the *group* which must be disclosed in accordance with (1); and
  - (b) the information for any of the subsidiaries within the *group* which must be individually identifiable and disclosed in accordance with Reporting 3 – 6.

**[Note: Art. 256 of the Solvency II Directive]**

## 19 GROUP STRUCTURE

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- 19.1 When 2.1(1) or 2.1(2) applies, *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* must disclose publicly, at the level of the *group*, on an annual basis, the legal structure and the governance and organisational structure, including a description of all *subsidiaries*, material *related undertakings*, and significant branches belonging to the *group*.

**[Note: Art. 256a of the Solvency II Directive]**

## 20 THIRD COUNTRIES

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- 20.1 When 2.1(3) applies, 4 – 14 and 16 – 19 apply with any necessary changes at the level of the *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State*, *third country insurance undertaking* or *third country reinsurance undertaking* unless:
- (1) subject to 20.2, the third country in which that *undertaking* has its head office is assessed to be equivalent under Article 260 of the *Solvency II Directive*; or
  - (2) in the absence of equivalent group supervision referred to in Article 260 of the *Solvency II Directive*, the *PRA* has specified other methods in accordance with Article 262 of the *Solvency II Directive*.

**[Note: Art. 262 of the Solvency II Directive]**

- 20.2 20.1(1) does not apply where, in the case of temporary equivalence under Article 260(5) of the *Solvency II Directive*, there is a *Solvency II undertaking* in the *group* that has a balance sheet total that exceeds the balance sheet total of the *parent undertaking* situated outside of the *EEA*.

**[Note: Art. 260(7) of the Solvency II Directive]**

- 20.3 When calculating the solvency of a *group* falling within 2.1(3) for the purpose of 20.1, a *relevant insurance group undertaking* must treat the *parent undertaking* (being an *insurance holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*), solely for the purposes of that calculation, as a *UK Solvency II firm* to which 2.1(1)(a) applies.

**[Note: Art. 262 of the Solvency II Directive]**

- 20.4 Where the *parent undertaking* referred to in 2.1(3) is itself a *subsidiary undertaking* of an *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*, 20.1 applies at the level of either:
- (1) the ultimate *parent undertaking* which is an *insurance holding company* or *mixed financial holding company* which does not have its head office in an *EEA State* or a *third country insurance undertaking* or a *third country reinsurance undertaking*; or
  - (2) such other *parent undertaking* as the *PRA* may determine in accordance with Article 263 of the *Solvency II Directive*.

**[Note: Art. 263 of the Solvency II Directive]**

**21 MIXED-ACTIVITY INSURANCE HOLDING COMPANIES**

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21.1 16.2 and 17.3 apply, with any necessary changes, to *groups* falling within 2.1(4).

**[Note: Art. 265 of the *Solvency II Directive*]**

**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 [Date].

**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, the text is all new and is not underlined.

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

## 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*.

*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); and
- (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; or
- (2) risks to the *person* insured incurring liabilities to third parties; or
- (3) risks of loss to the *persons* insured arising from the failure of debtors of theirs to pay their debts when due; or
- (4) risks of loss to the *persons* insured attributable to interruptions of business carried on by them; or
- (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 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*; or
  - (b) *aircraft*; or

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

must submit 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*); or
- (b) *public and products liability* (including as part of a *mixed commercial package*); or
- (c) *professional indemnity;*

must submit 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*]
- 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 template* expressly states otherwise.
- 2.10 A *firm* shall submit the annual *national specific templates* referred to in 2.6, 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* shall submit the quarterly *national specific templates* referred to in 2.8 after the end of the transitional period set out in Transitional Measures 3.3, no later than 5 weeks related to 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;

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.



**PRA RULEBOOK: SOLVENCY II FIRMS: LLOYD'S 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); and
  - (3) section 318 (exercise of powers through Council).
- 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: Lloyd's 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: Lloyd's 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

# LLOYD'S

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. SPECIAL PROVISIONS FOR LLOYD'S
3. APPROVED REINSURANCE TO CLOSE
4. PROVISION OF INFORMATION BY MANAGING AGENTS
5. INSURANCE RECEIVABLES TO BE CARRIED TO TRUST FUNDS
6. AMENDMENTS TO BYELAWS, TRUST DEEDS AND STANDARD FORM LETTERS OF CREDIT AND GUARANTEES
7. THE CENTRAL FUND
8. CAPACITY TRANSFER MARKET
9. FORMER UNDERWRITING MEMBERS

Links

## 1 APPLICATION AND DEFINITIONS

---

1.1 Unless otherwise stated, this Part applies to:

- (1) in accordance with General Application 3, the *Society*, and
- (2) in accordance with General Application 3, *managing agents*, where specified.

1.2 In this Part, the following definitions shall apply:

*capacity transfer market*

means any method of transferring capacity in *syndicates*, including capacity auctions, bilateral arrangements, capacity offers, minority buy-outs and conversion schemes.

*compensation scheme*

means the Financial Services Compensation Scheme established under section 213 of *FSMA*.

*Lloyd's member's contribution*

means assets:

- (1) provided to a *managing agent* in response to a cash call; or
- (2) held by the *Society* as *funds at Lloyds*.

*protected claim*

means a *claim* which is covered by the *compensation scheme*, as defined in rule COMP 5.2.1 R of the *PRA Handbook*.

## 2 SPECIAL PROVISIONS FOR LLOYD'S

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2.1 Neither the *Society* nor *managing agents* may permit a *member* to carry on any *insurance business*, except as a participant on one or more *syndicates*.

2.2 The *Society* must ensure that all participants in the Lloyd's market are made aware of their obligations under the Solvency II Firms Sector.

2.3 The *Society* must establish and maintain effective arrangements to monitor and manage risk arising from:

- (1) conflicts of interest (including in relation to (2) – (4));
- (2) inter-*syndicate* transactions, including *reinsurance to close* and *approved reinsurance to close*;
- (3) related party transactions;
- (4) transactions between *members* and itself.

### 3 APPROVED REINSURANCE TO CLOSE

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- 3.1 Notwithstanding that the liability of a reinsured *member* to a *policyholder* is unaffected by an *approved reinsurance to close* for the purposes of the Solvency II Firms Sector:
- (1) for an *approved reinsurance to close* which is not to a *subsidiary undertaking* of the *Society*:
    - (a) a *contract of insurance* reinsured under an *approved reinsurance to close* must be treated as if the reinsuring *member* and not the reinsured *member* had effected the original *contract of insurance*; and
    - (b) any payment received by a *member* as consideration for or in connection with an *approved reinsurance to close* must be treated as a *Lloyd's member's contribution* and not as *premium* or as a *reinsurance recovery*
  - (2) for an *approved reinsurance to close* to a *subsidiary undertaking* of the *Society*, a *contract of insurance* reinsured under that *approved reinsurance to close* must be treated as if the reinsured *member* had not effected the original *contract of insurance* but:
    - (a) for the purposes of the calculation of the Lloyd's *SCR*, *general insurance business* carried on by *members* and *former underwriting members* which has been reinsured to a *subsidiary undertaking* of the *Society* under an *approved reinsurance to close* must be treated as reinsured to a third party; and
    - (b) for the purposes of calculating the *SCR* of any *subsidiary undertaking* of the *Society* which is a *UK Solvency II firm*, the *approved reinsurance to close* must be treated as a *reinsurance*.

### 4 PROVISION OF INFORMATION BY MANAGING AGENTS

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- 4.1 A *managing agent* must, as soon as possible, give the *Society* any information the *managing agent* has concerning material risks to *funds at Lloyd's* or *central assets*.
- 4.2 A *managing agent* need not comply with 4.1 if the *managing agent* knows that the *Society* already has the relevant information.

### 5 INSURANCE RECEIVABLES TO BE CARRIED TO TRUST FUNDS

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- 5.1 The *Society* must take all reasonable steps to ensure that each *member*:
- (1) executes the appropriate *Lloyd's trust deeds*; and
  - (2) carries to the appropriate *Lloyd's trust fund* all amounts received or receivable by the *member*, or on its behalf, in respect of any *insurance business* carried on by it.
- 5.2 The *Society* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.
- 5.3 A *managing agent* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.
- 5.4 In complying with 5.1 to 5.3, the *Society* and *managing agents* must take all reasonable steps to ensure that amounts received or receivable by a *member* in respect of *general insurance business* and *long-term insurance business* are carried to separate *Lloyd's trust funds*.

## 6 AMENDMENTS TO BYELAWS, TRUST DEEDS AND STANDARD FORM LETTERS OF CREDIT AND GUARANTEES

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- 6.1 The *Society* must, as soon as it is practical to do so, notify the *PRA* of its intention to approve the form of any new *Lloyd's trust deed*.
- 6.2 The *Society* must, as soon as it is practical to do so, notify the *PRA* of its intention to make any amendment which may alter the meaning or effect of any *byelaw*, including:
- (1) any *Lloyd's trust deed*;
  - (2) any standard form letter of credit prescribed by the *Society* from time to time; or
  - (3) any standard form guarantee agreement prescribed by the *Society* from time to time.
- 6.3 The *Society* must provide the *PRA* with full details of:
- (1) the form of any new *Lloyd's trust deed* it intends to approve, as described in 6.1; and
  - (2) any amendments falling within 6.2.
- 6.4 The *Society* must consult interested parties in relation to any new *Lloyd's trust deed* and in relation to any amendment falling within 6.2.
- 6.5 The information provided to the *PRA* by the *Society* under 6.3 must include:
- (1) a statement of the purpose of any proposed amendment or new *Lloyd's trust deed* and the expected impact, if any, on *policyholders*, *managing agents*, *members*, and potential *members*; and
  - (2) a description of the consultation undertaken under 6.4 including a summary of any significant responses to that consultation.

## 7 THE CENTRAL FUND

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- 7.1 The directions in this Chapter are given under section 318 of *FSMA* (Exercise of powers through Council) for the purpose of achieving the objective specified, as required by section 318(2) of *FSMA*.
- 7.2 The directions given in this Chapter are given in relation to the exercise of the powers by the *Society* in respect of the *Central Fund* and are given with a view to achieving the objective of ensuring that the *Society* in making payments, or in providing any other financial assistance from the *Central Fund*, does so on a basis which does not take into account the amounts of compensation which *policyholders* may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.
- 7.3 The *Society* must, in the exercise of its powers to make payments from the *Central Fund* or to provide other forms of financial assistance from the *Central Fund*, ensure that in calculating and determining the amount of any such payment or the amount of any other financial assistance, it does not take into account the amounts of compensation which *policyholders* may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

**8 CAPACITY TRANSFER MARKET**

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- 8.1 The *Society* must make appropriate *byelaws* governing conduct in the *capacity transfer market*.

**9 FORMER UNDERWRITING MEMBERS**

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- 9.1 The *Society* must ensure that sections 320 to 322 of *FSMA* (Former underwriting members, Requirements imposed under section 320, Rules applicable to former underwriting members) are drawn to the attention of any *person* ceasing to be an *underwriting member* on or after 1 December 2001.
- 9.2 The *Society* must require any *person*, other than a *body corporate*, ceasing to be an *underwriting member* on or after 1 December 2001 to:
- (1) notify the *Society* of any change in his address within one *month* of the change; and
  - (2) in the case of a natural *person*, to make arrangements for the *Society* to be notified in the event of his death.

**PRA RULEBOOK: SOLVENCY II FIRMS: THIRD COUNTRY BRANCHES 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: Third Country Branches 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: Third Country Branches 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

# THIRD COUNTRY BRANCHES

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. ACCOUNTING RECORDS IN THE UK
3. LOCALISATION AND DEPOSIT OF ASSETS
4. SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT
5. CONTENTS OF THE BRANCH SCHEME OF OPERATIONS
6. TECHNICAL PROVISIONS AND OWN FUNDS
7. CONDITIONS GOVERNING BUSINESS
8. INVESTMENTS
9. REPORTING
10. THIRD COUNTRY BRANCH UNDERTAKINGS IN DIFFICULTY
11. SEPARATION OF LONG-TERM BUSINESS AND GENERAL BUSINESS
12. RESTRICTION OF BUSINESS
13. WORLDWIDE FINANCIAL RESOURCES
14. TRANSITIONAL MEASURES

Links



## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to *third country branch undertakings*, except *Swiss general insurers*.

1.2 In this Part, the following definitions shall apply:

*authorised UK representative*

means a *person* resident in the *United Kingdom* who is authorised to act generally, and to accept service of any *document*, on behalf of the *firm*.

*branch MCR*

means a capital requirement calculated in accordance with the Minimum Capital Requirement Part but taking account only of the operations effected by the *third country branch*.

*branch scheme of operations*

means a scheme containing the information required in 5.1.

*branch SCR*

means a capital requirement calculated in accordance with the *SCR Rules* but taking account only of the operations effected by the *third country branch*.

*branch technical provisions*

means the technical provisions established in accordance with the Technical Provisions Part to cover the insurance and *reinsurance* obligations assumed by a *third country branch undertaking* in the *United Kingdom*.

*composite third country branch*

means a *third country branch* (except a *third country pure reinsurance branch*) that carries on both *long-term insurance business* and *general insurance business* in the *United Kingdom*.

*EEA MCR*

means a capital requirement calculated in accordance with the Minimum Capital Requirement Part but taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

*EEA SCR*

means a capital requirement calculated in accordance with the *SCR Rules* but taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

*EEA technical provisions*

means the technical provisions established in accordance with the Technical Provisions Part to cover the insurance and *reinsurance* obligations assumed by a *UK-deposit insurer* in the *EEA*.

*EEA-deposit insurer*

means a *third country branch undertaking* that has made a deposit in an *EEA State* (other than the *United Kingdom*) under Article 162(2)(e) of the *Solvency II Directive* in accordance with Article 167 of the *Solvency II Directive*.

*pre-Solvency II branch MCR*

means the minimum capital requirement that applied to the *third country branch undertaking* under *PRA rules* as at 31 December 2015.

*Swiss general insurance company*

has the meaning given in article 1(2) of the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507).

*Swiss general insurer*

means a *Swiss general insurance company* which has *Part 4A permission* to effect contracts of insurance or carry out contracts of insurance of a kind which is subject to the *Swiss Treaty Agreement*.

*Swiss Treaty Agreement*

means the agreement of 10 October 1989 between the European Economic Community and the Swiss Confederation on direct insurance other than life insurance, approved on behalf of the European Economic Community by the Council Decision of 20 June 1991 (No 91/370/EEC).

*third country branch*

means a *third country insurance branch* or a *third country pure reinsurance branch*.

*third country branch undertaking eligible own funds*

(1) as to compliance with the *branch SCR*, means the aggregate of the *third country branch undertaking's*:

(a) *Tier 1 own funds*; and

(b) (i) *Tier 2 own funds*; and

(ii) *Tier 3 own funds*

that satisfy the limits in Own Funds 4.1, as if references to the “*SCR*” in those provisions were references to the *branch SCR*; and the limits in the *Solvency II Regulations*.

(2) as to compliance with the *branch MCR*, means the aggregate of the *third country branch undertaking's*:

(a) *Tier 1 own funds*; and

- (b) *Tier 2 basic own funds* that satisfy the limits in Own Funds 4.2 as if references to the “MCR” in those provisions were references to the *branch MCR*; and the limits in the *Solvency II Regulations*.
- (3) as to compliance with the *EEA SCR*, means the aggregate of the *third country branch undertaking*’s:
- (a) *Tier 1 own funds*; and
  - (b) (i) *Tier 2 own funds*; and
  - (ii) *Tier 3 own funds*
- that satisfy the limits in Own Funds 4.1, as if references to the “SCR” in those provisions were references to the *EEA SCR*; and the limits in *Solvency II Regulations*.
- (4) as to compliance with the *EEA MCR*, means the aggregate of the *third country branch undertaking*’s:
- (a) *Tier 1 own funds*; and
  - (b) *Tier 2 basic own funds* that satisfy the limits in Own Funds 4.2, as if references to the “MCR” in those provisions were references to the *EEA MCR*; and the limits in the *Solvency II Regulations*.

*third country branch undertaking own funds*

means, in relation to a *third country branch undertaking*, the firm’s aggregate *basic own funds* and *ancillary own funds* as determined in accordance with the Own Funds Part as if it were a *UK Solvency II firm*.

*third country branch undertaking SCR*

means

- (1) for a *UK-deposit insurer*, *EEA SCR*;
- (2) for an *EEA-deposit insurer*, its solvency capital requirement calculated according to the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;
- (3) for all other *third country branch undertakings*, the *branch SCR*.

*third country undertaking EEA branch*

means a permanent presence of a *third country branch undertaking* in an *EEA State* except the *United Kingdom*, which has received authorisation in accordance with Article 162 of the *Solvency II Directive*.

**[Note: Art. 162(3) of the *Solvency II Directive*]**

*UK-deposit insurer*

means a *third country branch undertaking* that has made a deposit in the *United Kingdom* under Article 162(2)(e) of the *Solvency II Directive* in accordance with Article 167 of the *Solvency II Directive*.

## 2 ACCOUNTING RECORDS IN THE UK

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- 2.1 A *third country branch undertaking* must maintain at a place of business in the *United Kingdom* all records relating to:
- (1) the activities carried on from its *third country branch*; and
  - (2) if it is a *UK-deposit insurer*, the activities carried out from all the *third country undertaking EEA branches*.

**[Note: Art. 162 (2) of the *Solvency II Directive*]**

## 3 LOCALISATION AND DEPOSIT OF ASSETS

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- 3.1 A *third country branch undertaking* (except a *UK-deposit insurer*, an *EEA-deposit insurer* and a *third country branch undertaking* that has a *third country pure reinsurance branch*) must hold assets required to cover the *branch SCR* as follows:
- (1) in the *United Kingdom*, assets representing the *branch SCR* up to the amount of the *branch MCR*; and
  - (2) in any *EEA State*, assets representing the amount of the *branch SCR* in excess of the amount of the *branch MCR*.
- 3.2 A *UK-deposit insurer* must hold assets required to cover the *EEA SCR* as follows:
- (1) in any of the *EEA States* where the *UK-deposit insurer* pursues its activities, assets representing the *EEA SCR* up to the amount of the *EEA MCR*; and
  - (2) in any *EEA State*, assets representing the amount of the *EEA SCR* in excess of the amount of the *EEA MCR*.
- 3.3 A *third country branch undertaking* (except an *EEA-deposit insurer* and a *third country branch undertaking* that has a *third country pure reinsurance branch*) must hold on deposit as security in the *United Kingdom* with a *CRD credit institution* assets of an amount equal to at least one quarter of the absolute floor of the *MCR* set out in Minimum Capital Requirement 3.2.

**[Note: Art. 162(2) and 166(4) of the *Solvency II Directive*]**

## 4 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT

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- 4.1 A *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must:
- (1) calculate a *branch SCR*; and
  - (2) cover the *branch SCR* with *third country branch undertaking eligible own funds*.
- 4.2 A *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must:
- (1) calculate a *branch MCR*; and

- (2) cover the *branch MCR* with *third country branch undertaking eligible own funds*.
- 4.3 For the purposes of the calculations referred to in 4.1(1) and 4.2(1), the *third country branch undertaking* must take account only of the operations effected by the *third country branch*.
- 4.4 A *UK-deposit insurer* must:
- (1) calculate an *EEA SCR*; and
- (2) cover the *EEA SCR* with *third country branch undertakings' eligible own funds*.
- 4.5 A *UK deposit insurer* must:
- (1) calculate an *EEA MCR*; and
- (2) cover the *EEA MCR* with *third country branch undertaking eligible own funds*.
- 4.6 For the purposes of the calculations referred to in 4.4(1) and 4.5(1), the *UK-deposit insurer* must take account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

**[Note: Art. 166(1), (2) and (3) of the Solvency II Directive]**

## **5 CONTENTS OF THE BRANCH SCHEME OF OPERATIONS**

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- 5.1 The *branch scheme of operations* must set out the following:
- (1) the nature of the risks or commitments which the *third country branch undertaking* proposes to cover;
- (2) the guiding principles as to *reinsurance*;
- (3) estimates of the future *branch SCR* on the basis of a forecast balance sheet, as well as the calculation methods used to derive those estimates;
- (4) estimates of the future *branch MCR*, on the basis of a forecast balance sheet, as well as the calculation method used to derive those estimates;
- (5) the state of the *third country branch undertaking eligible own funds* with respect to the *branch SCR* and *branch MCR*;
- (6) estimates of the cost of setting up the administrative services and the organisation for securing business, the financial resources to meet those costs and, where the risks to be covered are classified under paragraph 18 of Part 1 of Schedule 1 to the *Regulated Activities Order*, the resources available for the provision of assistance;
- (7) information on the structure of the system of governance; and
- (8) For the first three financial years:
- (a) a forecast balance sheet;
- (b) estimates of the financial resources intended to cover *branch technical provisions, branch MCR* and *branch SCR*;
- (c) for *general insurance business*:

- (i) estimates of management expenses other than installation costs, in particular current general expenses and commissions;
- (ii) estimates of *premiums* or contributions and *claims*;
- (d) for *long-term insurance business*:
  - a plan setting out detailed estimates of income and expenditure in respect of direct business, *reinsurance* acceptances and *reinsurance* cessions.

**[Note: Arts. 162(2) and 163(1) and (2) of the Solvency II Directive]**

## **6 TECHNICAL PROVISIONS AND OWN FUNDS**

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- 6.1 A *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must establish adequate *branch technical provisions*.
- 6.2 A *UK-deposit insurer* must establish adequate *EEA technical provisions*.
- 6.3 A *third country branch undertaking* (except an *EEA-deposit insurer*) must value assets and liabilities in accordance with the Valuation Part for the purposes of establishing the *branch technical provisions* (or, in the case of a *UK-deposit insurer*, the *EEA technical provisions*).
- 6.4 A *third country branch undertaking* (except an *EEA-deposit insurer*) must determine and classify its *third country branch undertaking own funds* for the purposes of complying with its *branch SCR* and *branch MCR* (or, in the case of a *UK-deposit insurer*, its *EEA SCR* and *EEA MCR*) in accordance with the Own Funds Part as if it were a *Solvency II Firm*.
- 6.5 A *third country branch undertaking* (except an *EEA-deposit insurer*) must fulfil the requirements in Own Funds 5 for the purposes of complying with its *branch SCR* and *branch MCR* (or, in the case of a *UK-deposit insurer*, its *EEA SCR* and *EEA MCR*) as if it were a *Solvency II Firm*.

**[Note: Art. 165 and 166(1), (2) and (3) of the Solvency II Directive]**

## **7 CONDITIONS GOVERNING BUSINESS**

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- 7.1 A *third country branch undertaking* must fulfil the following requirements laid down in Conditions Governing Business Part, as modified by 7.2, 7.3 and 7.4:
  - (1) Conditions Governing Business 1;
  - (2) Conditions Governing Business 2.2 – 8; and
  - (3) Conditions Governing Business 11.
- 7.2 (1) A reference to “*SCR*” is to be interpreted as a reference to “*third country branch undertaking SCR*”.
- (2) A reference to “*MCR*” is to be interpreted as a reference to:
  - (a) for a *UK-deposit insurer*, the *EEA MCR*;
  - (b) for an *EEA-deposit insurer*, its minimum capital requirement calculated in accordance with the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;

- (c) for all other *third country branch undertakings*, the *branch MCR*.
- (3) A reference to “*technical provisions*” is to be interpreted as a reference to:
- (a) for a *UK-deposit insurer*, the *EEA technical provisions*;
  - (b) for an *EEA-deposit insurer*, its technical provisions calculated in accordance with the relevant *Solvency II EEA implementing measures* in the *EEA State* that supervises the solvency of the entire business of the branches within the *EEA*;
  - (c) for all other *third country branch undertakings*, the *branch technical provisions*.
- (4) A reference to “*persons who effectively run the firm*” is to be interpreted as a reference to *persons* who effectively run the operations effected by the *third country branch*.
- (5) A reference to “*function*” is to be interpreted as a reference to the *functions* performed in relation to the operations effected by the *third country branch* and includes the *function* of *authorised UK representative*.
- (6) A reference to “*internal model*” is to be interpreted as a reference to any *internal model* used by a *third country branch undertaking* to calculate the *third country branch undertaking SCR*.
- (7) A reference to “*standard formula*” is to be interpreted as a reference to any *standard formula* used by a *third country branch undertaking* to calculate the *third country branch undertaking SCR*.
- 7.3 A *third country branch undertaking* (except a *UK-deposit insurer*) must apply the requirements referred to in 7.1 taking account only of matters relevant to the operations effected by the *third country branch*.
- 7.4 A *UK-deposit insurer* must apply the requirements referred to in 7.1 taking account only of matters relevant to the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

**[Note: Art. 162(2) of the Solvency II Directive]**

## **8 INVESTMENTS**

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- 8.1 A *third country branch undertaking* must fulfil the requirements laid down in the Investments Part, as modified by 8.2 – 8.4.
- 8.2 A reference to “*technical provisions*” is to be interpreted as laid down in 7.2(3).
- 8.3 A *third country branch undertaking* (except a *UK-deposit insurer*) must fulfil the requirements in the Investments Part taking account only of the operations effected by the *third country branch*.
- 8.4 A *UK-deposit insurer* must fulfil the requirements in the Investments Part taking account only of the operations effected by the *third country branch* and all the *third country undertaking EEA branches*.

**[Note: Art. 162(2) of the Solvency II Directive]**

## 9 REPORTING

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9.1 A *third country branch undertaking* must fulfil the requirements laid down in Reporting 2 as modified by 9.2.

9.2 [Note: placeholder for rules on branch reporting].

**[Note: Art. 168 of the Solvency II Directive]**

## 10 THIRD COUNTRY BRANCH UNDERTAKINGS IN DIFFICULTY

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10.1 A *third country branch undertaking* (except an *EEA-deposit insurer*) must fulfil the requirements laid down in Undertakings in Difficulty 1 – 5 as modified by 10.2.

10.2 (1) A reference to “SCR” is to be interpreted as a reference to the *branch SCR* or, for a *UK-deposit insurer*, to the *EEA SCR*.

(2) A reference to “*eligible own funds*” is to be interpreted as a reference to *third country branch undertaking eligible own funds*.

(3) A reference to “MCR” is to be interpreted as a reference to the *branch MCR* or, for a *UK-deposit insurer*, to the *EEA MCR*.

(4) A reference to “*technical provisions*” is to be interpreted as a reference to the *branch technical provisions* or, for a *UK-deposit insurer*, to the *EEA technical provisions*.

**[Note: Art. 168 of the Solvency II Directive]**

## 11 SEPARATION OF LONG-TERM BUSINESS AND GENERAL BUSINESS

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11.1 (1) A *third country insurance undertaking* that has a *composite third country branch* must fulfil the requirements laid down in Composites 2 – 4 as modified by 11.2.

(2) Composites 3 and 4 do not apply to *EEA-deposit insurers*.

11.2 (1) The requirements referred to in 11.1 must be fulfilled taking account only of the operations effected by the *third country branch* and, in the case of a *UK-deposit insurer*, the operations effected by all the *third country undertaking EEA branches*.

(2) The reference to “SCR” in Composites 4.6 is to be interpreted as a reference to the *branch SCR* and, for a *UK-deposit insurer*, the *EEA SCR*.

(3) The *notional life MCR*, *notional non-life MCR*, the *notional life SCR* and *notional non-life SCR* referred to in the Composites Part shall be calculated taking account only of the operations effected by the *third country branch* and, in the case of a *UK-deposit insurer*, the operations effected by all the *third country undertaking EEA branches*.

**[Note: Art. 169 of the Solvency II Directive]**

## 12 RESTRICTION OF BUSINESS

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12.1 A *third country branch undertaking* except a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

12.2 A *third country branch undertaking* that is a *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.



## 13 WORLDWIDE FINANCIAL RESOURCES

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- 13.1 A *third country branch undertaking* must maintain adequate worldwide financial resources, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.
- 13.2 For the purposes of 13.1:
- (a) a *UK-deposit insurer* must not rely upon the assets held to cover the *EEA technical provisions* and the *EEA SCR* as available to meet liabilities other than those arising from the operations effected by all the *third country undertaking EEA branches*;
  - (b) a *third country branch undertaking* (except a *UK-deposit insurer* and an *EEA-deposit insurer*) must not rely upon the assets held to cover the *branch technical provisions* and the *branch SCR* as available to meet liabilities other than those arising from the operations effected by the *third country branch*.

## 14 TRANSITIONAL MEASURES

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- 14.1 The following provisions in the Transitional Measures Part apply to *third country branch undertakings* with the modifications set out in 14.2:
- (1) Transitional Measures 1.2 (insofar as relevant);
  - (2) Transitional Measures 3.1;
  - (3) Transitional Measures 3.3;
  - (4) Transitional Measures 4 – 7; and
  - (5) Transitional Measures 10 – 12 [note: this is subject to further consideration once the rules for which there are placeholders in 10 – 12 are drafted].
- 14.2 The modifications referred to in 14.1 are:
- (1) any modification set out in this Part to any Parts referred to in the Transitional Measures Part;
  - (2) [Note: placeholder for any other modifications needed in light of any rules still to be included or consulted upon, for example on reporting] ;
  - (3) any reference to “*pre-Solvency II MCR*” is to be interpreted as a reference to *pre-Solvency II branch MCR*; and
  - (4) any other necessary modification.

**PRA RULEBOOK: SOLVENCY II FIRMS: TRANSITIONAL MEASURES 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: Transitional Measures 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 Firms: Transitional Measures 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

# TRANSITIONAL MEASURES

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. FIRMS IN RUN-OFF
3. REPORTING TO THE PRA AND PUBLIC DISCLOSURE
4. BASIC OWN FUNDS
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Links

## 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) the *Society*, in accordance with General Application 3.

1.2 In this Part, the following definitions shall apply:

*capital resources gearing rules*

has the meaning set out in the out in the *PRA Handbook* Glossary as at 31 December 2015.

*core tier one capital*

means an item of capital that is stated in stage A (Core tier one capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be core tier one capital.

*directive reorganisation measures*

has the same meaning as in the Insurers (Reorganisation & Winding Up) Regulations 2004 (2004/353).

*innovative tier one capital*

means an item of capital that is stated in GENPRU 2.2 of the *PRA Handbook* as at 31 December 2015 to be innovative tier one capital.

*lower tier two capital*

means an item of capital that is stated in stage H (Lower tier two capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be lower tier two capital.

*perpetual non-cumulative preference share*

means an item of capital that is stated in stage B (Perpetual non-cumulative preference shares) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be perpetual non-cumulative preference shares.

*upper tier two capital*

means an item of capital that is stated in stage G (Upper tier two capital) of the capital resources table at GENPRU 2 Annex 1 of the *PRA Handbook* as at 31 December 2015 to be upper tier two capital

## 2 FIRMS IN RUN-OFF

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2.1 Without prejudice to General Application 2.2(7), if a *firm* has on the *Solvency II implementation date* ceased to conduct new *insurance business* and does not have a *Part 4A permission to effect contracts of insurance* it is not a *UK Solvency II firm* until:

- (1) where the *firm* has demonstrated to the *PRA* that it will terminate its activity before 1 January 2019:
  - (a) 1 January 2019; or
  - (b) if earlier, the date upon which the *PRA* notifies the *firm* that the *firm* has not demonstrated to the *PRA* that sufficient progress has been made towards terminating the *firm's* activity; or
- (2) where the *firm* is subject to *directive reorganisation measures* and an administrator has been appointed,:
  - (a) 1 January 2021; or
  - (b) if earlier, the date upon which the *PRA* notifies the *firm* that the *firm* has not demonstrated to the *PRA* that sufficient progress has been made towards terminating the *firm's* activity,

where the conditions in 2.2 are met.

**[Note: Art. 308b (1), (2) of the Solvency II Directive]**

2.2 2.1 only applies:

- (1) if the *firm* is not part of a *group* unless all *undertakings* that are part of the *group* have ceased to conduct new *insurance business*;
- (2) if the *firm* provides the *PRA* with an annual report setting out what progress has been made in terminating its activity; and
- (3) after the *firm* has notified the *PRA* that it satisfies the requirements set out in 2.1.

**[Note: Art. 308b (3) of the Solvency II Directive]**

### 3 REPORTING TO THE PRA AND PUBLIC DISCLOSURE

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3.1 A *firm* must submit under Reporting 2.1 and 2.2 the regular supervisory report and annual quantitative templates required to be submitted in accordance with the *Solvency II Regulations* and the annual *national specific templates* under Reporting 2.6 by no later than:

- (1) 20 weeks after the *firm's* financial year end in relation to its financial year ending on or after 30 June 2016 before 1 January 2017;
- (2) 18 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;
- (3) 16 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;
- (4) 14 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (5) of the Solvency II Directive]**

3.2 A *firm* must disclose its *SFCR* under Reporting 3.1 by no later than:

- (1) 20 weeks after the *firm's* financial year end in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;
- (2) 18 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;
- (3) 16 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;
- (4) 14 weeks after the *firm's* financial year end in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (6) of the Solvency II Directive]**

3.3 A *firm* must submit under Reporting 2.1 and 2.2 the quarterly quantitative templates required to be submitted in accordance with the *Solvency II Regulations* and the quarterly *national specific templates* under Reporting 2.7 by no later than:

- (1) 8 weeks related to any quarter ending on or after 1 January 2016 but before 1 January 2017;
- (2) 7 weeks related to any quarter ending on or after 1 January 2017 but before 1 January 2018;
- (3) 6 weeks related to any quarter ending on or after 1 January 2018 but before 1 January 2019;
- (4) 5 weeks related to any quarter ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (7) of the Solvency II Directive]**

3.4 Where Group Supervision 2.1(1) or (2) applies, the submission under Group Supervision 17.3 of the group regular supervisory report and annual quantitative templates required to be submitted in accordance with the *Solvency II Regulations* must be made by no later than:

- (1) 26 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;
- (2) 24 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;
- (3) 22 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;
- (4) 20 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (8) of the Solvency II Directive]**

3.5 A *participating Solvency II undertaking* that is a *firm* or, if there are none, the *relevant insurance group undertakings* must disclose the solvency and financial condition at the level of the *group* under Group Supervision 18.1 by no later than:

- (1) 26 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 30 June 2016 but before 1 January 2017;
- (2) 24 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2017 but before 1 January 2018;
- (3) 22 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2018 but before 1 January 2019;
- (4) 20 weeks after the financial year end of the *participating Solvency II undertaking*, ultimate *insurance holding company* or ultimate *mixed financial holding company* in relation to its financial year ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (8) of the Solvency II Directive]**

3.6 Where Group Supervision 2.1(1) or (2) applies, the submission under Group Supervision 17.3 of the quarterly quantitative templates required to be submitted in accordance with the *Solvency II Regulations* must be made by no later than:

- (1) 14 weeks related to any quarter ending on or after 1 January 2016 but before 1 January 2017;
- (2) 13 weeks related to any quarter ending on or after 1 January 2017 but before 1 January 2018;
- (3) 12 weeks related to any quarter ending on or after 1 January 2018 but before 1 January 2019;
- (4) 11 weeks related to any quarter ending on or after 1 January 2019 but before 1 January 2020.

**[Note: Art. 308b (8) of the Solvency II Directive]****4 BASIC OWN FUNDS**

4.1 Notwithstanding Own Funds 3.1 – 3.3, a *firm* with a *basic own-fund* item that:

- (1) was issued prior to 1 January 2016 or the date of entry into force of the *Solvency II Regulation* referred to in Article 97 of the *Solvency II Directive*, whichever is earliest;
- (2) could be used as:
  - (a) *core tier one capital*;

- (b) *perpetual non-cumulative preference shares;*
- (c) *innovative tier one capital; or*
- (d) *upper tier two capital,*

on 31 December 2015; and

- (3) would not otherwise be included as *Tier 1 own funds* or *Tier 2 own funds* in accordance with Own Funds 3.1 – 3.2,

must include that item in *Tier 1 own funds* for up to 10 years after 1 January 2016.

**[Note: Art. 308b (9) of the Solvency II Directive]**

4.2 Notwithstanding Own Funds 3.1 – 3.3, a *firm* with a *basic own-fund* item that:

- (1) was issued prior to 1 January 2016 or the date of entry into force of the *Solvency II Regulation* referred to in Article 97 of the *Solvency II Directive*, whichever is earliest;
- (2) could be used as *lower tier two capital* on 31 December 2015,

must include that item in *Tier 2 own funds* for up to 10 years after 1 January 2016.

**[Note: Art. 308b (10) of the Solvency II Directive]**

4.3 For the purposes of 4.1 and 4.2 items listed at 4.1(2)(a) to (d) and 4.2(2) must not include those items that could only be used as the item specified by virtue of *rule* GENPRU TP 4 of the *PRA Handbook*.

## 5 STANDARD FORMULA: THE BASIC SCR

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5.1 Notwithstanding Solvency Capital Requirement – General Provisions 2, 3.1, 3.3, 3.4 and Solvency Capital Requirement – Standard Formula 3.1–3.3, the standard parameters to be used when calculating the *market risk* concentrations sub-module and the spread risk sub-module in accordance with the *standard formula* must be adjusted as follows:

- (1) until 31 December 2017, the standard parameters shall be the same in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any *EEA State* as the ones that would be applied to such exposures denominated and funded in their domestic currency;
- (2) from 1 January 2018 the standard parameters must be reduced by 80% in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*;
- (3) from 1 January 2019 the standard parameters must be reduced by 50% in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*;
- (4) from 1 January 2020 and onwards, the standard parameters must not be reduced in relation to exposures to *EEA States'* central governments or central banks denominated and funded in the domestic currency of any other *EEA State*.

**[Note: Art. 308b (12) of the Solvency II Directive]**



5.2 Notwithstanding Solvency Capital Requirement – General Provisions 2, 3.1, 3.3, 3.4 and Solvency Capital Requirement – Standard Formula 3.1 – 3.3, the standard parameters to be used for equities that a *firm* purchased on or before 1 January 2016, when calculating the equity risk sub-module in accordance with the *standard formula* must be calculated as the weighted averages of:

- (1) the standard parameter to be used when calculating the equity risk sub-module in accordance with 5.4; and
- (2) the standard parameter to be used when calculating the equity risk sub-module in accordance with the *standard formula*.

**[Note: Art. 308b (13) of the Solvency II Directive]**

5.3 The weight for the parameter expressed in 5.2(2) must increase at least linearly at the end of each year from 0% during 2016 to 100% from 1 January 2023.

**[Note: Art. 308b (13) of the Solvency II Directive]**

5.4 The equity risk sub-module for the purpose of 5.2(1) must be calibrated using a Value-at-Risk measure, over a time period, which is consistent with the typical holding period of equity investments for the *firm* concerned, with a confidence level providing the *policyholders* with a level of protection equivalent to that set out in Solvency Capital Requirement – General Provisions 3.2-3.5.

**[Note: Art. 308b (16) of the Solvency II Directive]**

## 6 NON-COMPLIANCE WITH THE SCR

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[Drafting note: Placeholder for any rules required to transpose Article 308b(14) of the Solvency II Directive in relation to compliance with the SCR.]

## 7 NON-COMPLIANCE WITH THE MCR

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7.1 If on 31 December 2015 a *firm* complies with the *pre-Solvency II MCR* but does not hold sufficient *eligible own funds* to cover the *MCR* then:

- (1) the *firm* must comply with Minimum Capital Requirement 2.1 by 31 December 2016; and
- (2) Undertakings in Difficulty 4.1 will apply from 31 December 2016.

**[Note: Art. 131 of the Solvency II Directive]**

7.2 If a *firm* to which 7.1 applies complies with the *pre-Solvency II MCR* but does not hold sufficient *eligible own funds* to cover the *MCR* then, until 31 December 2016 a *firm* must:

- (1) inform the *PRA* immediately where it observes that the *pre-Solvency II MCR* is no longer complied with or where there is a risk of non-compliance within the next three *months*; and
- (2) within one *month* from the observation of non-compliance with the *pre-Solvency II MCR*, submit, for approval by the *PRA*, a short-term realistic *finance scheme* to restore, within three *months* of that observation, its capital resources, at least to the

level of the *pre-Solvency II MCR* or to reduce its risk profile to ensure compliance with the *pre-Solvency II MCR*.

- 7.3 Any *finance scheme* submitted under 7.2(2) must at least include particulars or evidence concerning the following:
- (1) estimates of management expenses, in particular current general expenses and commissions;
  - (2) estimates of income and expenditure in respect of direct business, *reinsurance* acceptances and *reinsurance* cessions;
  - (3) a forecast balance sheet;
  - (4) estimates of the capital resources intended to cover the *pre-Solvency II MCR*; and
  - (5) the *firm's* overall *reinsurance* policy.

## 8 GROUPS – INTERNAL MODELS

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- 8.1 Notwithstanding Group Supervision 11.2, until 31 March 2022, the *group SCR* of a *group* based on consolidated data (consolidated *group SCR*) must be calculated on the basis of either:
- (1) the standard formula;
  - (2) an approved *internal model*, in a manner consistent with the general principles contained in the *SCR Rules*; or
  - (3) approved *internal models*, where each approved *internal model* is applicable to a part of a *group* where both the *Solvency II undertaking* and the ultimate *parent undertaking* are located in the same *EEA State* and that part of the *group* forms a distinct part having a significantly different risk profile from the rest of the *group*.

## 9 GROUPS

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- 9.1 Where Group Supervision 2.1(1) or 2.1(2) applies, the following provisions apply (notwithstanding Group Supervision 4.1 – 4.2) with any necessary changes at the level of the *group*:
- (1) 4.1 – 4.2;
  - (2) 5.1;
  - (3) 8.1; and
  - (3) 11 – 13.

**[Note: Art. 308b (17) of the *Solvency II Directive*]**

- 9.2 [Drafting note: Placeholder for any rules required to transpose Article 308b(17) of the *Solvency II Directive* in relation to compliance with the *group SCR*]

## 10 RISK-FREE INTEREST RATES

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[Drafting note: Placeholder for any rules required to transpose Article 308c of the *Solvency II Directive* in relation to risk-free interest rates]

## 11 TECHNICAL PROVISIONS

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[Drafting note: Placeholder for any rules required to transpose Article 308d of the Solvency II Directive in relation to technical provisions]

## 12 NON-COMPLIANCE WITH THE SCR

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[Drafting note: Placeholder for any rules required to transpose Article 308e of the Solvency II Directive in relation to application of the risk-free interest rate and technical provisions transitional measures.]

## 13 REPORT ON FINANCIAL AND SOLVENCY CONDITIONS

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13.1 This Chapter applies to a disclosure of the *SFCR* by a *firm* or, as may be applicable, the report on solvency and financial condition at the level of the *group by participating Solvency II undertakings* or the *relevant insurance group undertakings* within the *group*, made in relation to the relevant financial years ending on or before 31 December 2017.

13.2 In the disclosure required by Reporting 3.1, a *firm* may, unless required under other legal or regulatory requirements (including any *Solvency II EEA implementing measure*), opt not to disclose the following separately when disclosing the amount of the *MCR* and *SCR* under Reporting 3.7:

- (1) the information referred to in Reporting 3.7(2) on any *capital add-on* imposed on the *firm*; and
- (2) the information referred to in Reporting 3.7(3) on any *undertaking specific parameters*.

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

13.3 In the disclosure required by Reporting 3.1 as applied to a *group* by Group Supervision 18.1, the *participating Solvency II undertakings* that are *firms* or, if there are none, the *relevant insurance group undertakings* may, unless required under other legal or regulatory requirements (including any *Solvency II EEA implementing measure*), opt not to disclose the following separately when disclosing the amount of the *group SCR* under Reporting 3.7:

- (1) the information referred to in Reporting 3.7(2) on any *capital add-on* imposed on the *group*; and
- (2) the information referred to in Reporting 3.7(3) on any parameters specific to the *group*.

**[Note: Art. 256(1) and 51(2) of the Solvency II Directive]**

**PRA RULEBOOK: SOLVENCY II FIRMS: SURPLUS FUNDS 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: Surplus Funds 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: Surplus Funds 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

# **SURPLUS FUNDS**

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Chapter content

1. APPLICATION AND DEFINITIONS
2. SURPLUS FUNDS AND TECHNICAL PROVISIONS
3. CALCULATION OF SURPLUS FUNDS
4. CONSISTENCY OF CALCULATION

Links

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to a *UK Solvency II firm* carrying on *with-profits insurance business*.

1.2 In this Part, the following definitions shall apply:

*FCA Handbook*

means the *FCA's Handbook* of rules and guidance as amended from time to time.

*future policy-related liabilities*

means, in relation to a *with-profits fund*, the aggregate of the following amounts (to the extent each constitutes a liability) less the aggregate of such amounts (to the extent each constitutes an asset):

- (1) planned deductions for the costs of guarantees, options, smoothing and provision of life cover and other benefits from the amount calculated in accordance with 3.3 or, where a *firm* is required under 3.2 to use the calculation method in 3.4, in accordance with 3.4;
- (2) planned deductions for other costs deemed chargeable to the amount calculated in accordance with 3.3 or, where a *firm* is required under 3.2 to use the calculation method in 3.4, in accordance with 3.4;
- (3) future costs of contractual guarantees (other than financial options);
- (4) future costs of financial options, including guaranteed annuity and cash options;
- (5) future costs or proceeds of smoothing;
- (6) future liabilities to repay financing costs of a *with-profits fund* where the *firm* expects to have to meet such liabilities; and
- (7) other future costs related to the provision of the benefits referred to in 3.4(4) (regardless of whether the firm is required to effect the calculation in 3.4);

but only to the extent that they are not already included in the amount calculated in accordance with 3.3 or, if applicable, 3.4.

*surplus funds*

means, in relation to a *with-profits fund*, accumulated profits which have not been made available for distribution to policyholders or other *beneficiaries* and which:

- (1) satisfy the criteria for classification as *Tier 1 own funds* set out in Own Funds 3.1; and
- (2) are represented by the output of the calculations set out in 3.

*with-profits assets*

means the assets in a *with-profits fund* except those meeting liabilities in respect of non-profit insurance.

*with-profits fund*

means [see below<sup>1</sup>].

*with-profits insurance business*

the business of *effecting contracts of insurance* or *carrying out contracts of insurance* that are *with-profits policies*.

*with-profits policy*

means a contract of *long-term insurance* which provides benefits through eligibility to participate in discretionary distributions based on profits arising from the *firm's* business or from a particular part of the *firm's* business.

*with-profits policy liabilities*

means, in relation to a *with-profits fund*, the value of liabilities attributable to *with-profits policies* (excluding any liabilities relating to non-profit insurance associated with such policies) set out in, and calculated on the basis prescribed by, 3.3 or, if applicable, 3.4 and (in either case) having also made adequate provisions for amounts representing *future policy-related liabilities*.

## 2 SURPLUS FUNDS AND TECHNICAL PROVISIONS

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- 2.1 A *firm* shall not treat *surplus funds* as insurance and *reinsurance* obligations when valuing payments to *policyholders* and *beneficiaries* in the calculation of *technical provisions* in accordance with Technical Provisions 2.

**[Note: Arts. 78(3) and 91(2) of the Solvency II Directive]**

- 2.2 In order to comply with 2.1, a *firm* must calculate the amount, if any, of its *surplus funds* in accordance with 3.

## 3 CALCULATION OF SURPLUS FUNDS

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- 3.1 A *firm* must calculate the amount (if any) of its *surplus funds* in relation to each of its *with-profits funds* as follows:
- (1) the value of *with-profits assets*;
  - less
  - (2) the value of *with-profits policy liabilities*;
  - less
  - (3) the amount of any tax or other costs which will arise on the recognition of future shareholder transfers properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*, to the extent that such amounts are not included in (2);

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<sup>1</sup> A definition of *with-profits fund* will be consulted on as part of the PRA's broader proposals for the regulation of with-profits insurance business planned for later this year.

less

- (4) the value of any other liabilities (not being liabilities attributable to *with-profits policies* or any other policies in the *with-profits fund*) properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*; and

less

- (5) the value attributable to any future shareholder transfers (calculated by reference to the benefits referred to in 3.5(3) and in a manner consistent with the method of calculation specified in 3.4) relating to *with-profits policies* in that *with-profits fund* which may properly be made out of that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*.

3.2 A *firm* must value its *with-profits policy liabilities* (other than *future policy-related liabilities*) in accordance with 3.3 unless:

- (1) valuation under 3.3 does not adequately reflect the value of some or all of such liabilities; or
- (2) the *firm* can demonstrate that valuation under 3.3 is impracticable in respect of some or all of such liabilities;

in which case the *firm* must value such liabilities in accordance with 3.4.

3.3 Unless the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) as the aggregate of the retrospective value, in respect of each *with-profits policy*, of the following (treating items that increase the future liability to *policyholders* as positive values and treating items that reduce the future liability to *policyholders* as negative values):

- (1) *premiums* received;
- (2) any investment income on, and any increases (or decreases) in, asset values;
- (3) any amounts representing permanent enhancements which the *firm* will take into account when determining the benefits ultimately payable;
- (4) any past miscellaneous surplus (or deficit) which has been allocated;
- (5) any expenses incurred (or deductions made in respect of expenses);
- (6) any past deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits provided;
- (7) any partial benefits paid or due (other than benefits in respect of which deductions have been made under (6));
- (8) any tax paid or payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook*;
- (9) any amounts received (or paid) under contracts of *reinsurance* or arrangements which have a similar financial effect, which relate to that *with-profits policy* (other than in respect of benefits for which deductions have been made under (6)); and
- (10) any past shareholder transfers which are properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook*,



but deducting from that aggregate value any implicit allowance for the value of future shareholder transfers.

3.4 Where the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) on a prospective basis as the aggregate of the net present values of the following expected future cash-flows in respect of each *with-profits policy*:

- (1) future *premiums*;
- (2) expenses expected to be incurred (or deductions expected to be made in respect of expenses);
- (3) planned deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits;
- (4) any benefits payable of the type (or substantially similar to the type) specified in 3.5;
- (5) any amounts receivable (or payable) under contracts of *reinsurance* or arrangements which have a similar financial effect which relate to that *with-profits policy* but excluding amounts in respect of benefits:
  - (a) which have been allowed for under (3); or
  - (b) for which deductions have previously been made with the result that they do not fall under (3); and
- (6) tax payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook*.

3.5 The benefits referred to in 3.4(4) are:

- (1) all guaranteed benefits, including amounts guaranteed to be payable on death and maturity (or on other events), guaranteed surrender values and paid-up values;
- (2) declared bonuses to which the *policyholder* is contractually entitled; and
- (3) future discretionary additions to guaranteed benefits and discretionary payments, in addition to the guaranteed benefits, which are expected to be made when the benefits under the *with-profits policy* becomes payable but only if and to the extent they are additions to benefits or payments which, if the *firm* had been able to effect the calculation required by 3.3, are consistent with those for which allowance would have been made in accordance with that calculation.

3.6 A *firm* must not attribute any charges to a *with-profits policy* for the purposes of this Part unless permitted to do so by any relevant provisions of the *FCA Handbook*.

#### **4 CONSISTENCY OF CALCULATION**

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4.1 A *firm* must ensure that the valuations included in the calculations required to be carried out in accordance with 3.1 are consistent with the valuation methodologies adopted for the calculation of its *technical provisions* in accordance with Technical Provisions 2.

**PRA RULEBOOK: SOLVENCY II FIRMS: GLOSSARY AMENDMENTS 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 instruments) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA) and section 319 of the Act (Consultation), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and the proposed direction and had regard to representations made.

**PRA Rulebook: Solvency II Firms: Glossary Amendments 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: Glossary Amendments Instrument [Year].

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

[Date]

## Annex A

## Amendments to the Glossary

Insert the following new definitions (in the appropriate alphabetical position) into the Glossary Part of the PRA Rulebook:

*ancillary own funds*

- (1) (in relation to a *UK Solvency II firm* and the *Society*) has the meaning given in Own Funds 2.3 and are determined in accordance with Own Funds 2.3 – 2.7; or
- (2) (in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with the applicable *Solvency II EEA implementing measures*; or
- (3) (in relation to an *insurance holding company*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with (1) as if it were a *UK Solvency II firm*; or
- (4) (in relation to a *third country branch undertaking*) means an *own funds* item referred to in Article 89 of the *Solvency II Directive*, determined in accordance with (1) as if it were a *UK Solvency II firm*.

**[Note: Art. 89 of the *Solvency II Directive*]***approved reinsurance to close*

means;

- (1) a *reinsurance to close* effected before 1 January 2005; or
- (2) an agreement under which *members* of a *syndicate* in one *syndicate year* ("the reinsured *members*") agree with the *members* of that *syndicate* in a later *syndicate year* or the *members* of one other *syndicate* ("the reinsuring *members*") that the reinsuring *members* will discharge, or procure the discharge of, or indemnify the reinsured *members* against, all known and unknown *insurance business* liabilities of the reinsured *members* arising out of the *insurance business* carried on by the reinsured *members* in that *syndicate year* that is:
  - (a) effected after 1 January 2005; and
  - (b) not a balance transfer between two *syndicate years* where the *syndicate* has only one *member* and the *member* is the same in each of those years; or
- (3) an agreement under which *members* of a *syndicate* in one *syndicate year* ("the reinsured *members*") agree with a *subsidiary* of the *Society* that that *subsidiary* will discharge, or procure the discharge of, or indemnify the reinsured *members* against, all known and unknown *insurance business* liabilities of the reinsured *members* arising out of the *insurance business*

carried on by the reinsured *members* in that *syndicate year* ("the reinsured liabilities") and where:

- (a) that *subsidiary* is wholly owned by the *Society* and if from time to time the *subsidiary* has an asset or cash flow deficiency such that the *subsidiary* is unable to meet any of the liabilities which it has reinsured, the *Society* is legally obliged to pay to the *subsidiary* a sum equal to that deficiency; and
- (b) at the effective date of the agreement, the relevant *syndicate year* has been open for at least two years after the date at which it would normally have been closed in accordance with the policies and practices in relation to the *syndicate* concerned.

*Article 12(1) relationship*

means a relationship where *undertakings* are linked by a relationship within the meaning of Article 12(1) of Council Directive of 13 June 1983 on consolidated accounts (No 83/349/EEC).

*basic own funds*

- (1) (in relation to a *UK Solvency II firm* and the *Society*), has the meaning given in Own Funds 2.2; or
- (2) (in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*) means an *own funds* item referred to in Article 88 of the *Solvency II Directive*, determined in accordance with the applicable *Solvency II EEA implementing measures*; or
- (3) (in relation to an *insurance holding company*) means an *own funds* item referred to in Article 88 of the *Solvency II Directive* determined in accordance with (1) as if it were a *UK Solvency II firm*; or
- (4) (in relation to a *third country branch undertaking*) means an *own funds* item referred to in article 88 of the *Solvency II Directive* determined in accordance with (1) as if it were a *UK Solvency II firm*.

**[Note: Art. 88 of the *Solvency II Directive*]**

*basic SCR*

means the minimum basic *SCR*, as set out in Solvency Capital Requirement – Standard Formula 3 and as supplemented by the *Solvency II Regulations*.

*beneficiary*

means any *person* who is entitled to a right under a *contract of insurance*.

**[Note: Recital 16 of the *Solvency II Directive*]**

*best estimate*

means the best estimate of future cash-flows, calculated in accordance with Technical Provisions 3.

*byelaw*

means any Byelaw, direction, regulation, or other instrument made using the powers of the *Council* under section 6 of Lloyd's Act 1982 (including any regulation ratified by the *Council* by special resolution) and any condition or requirement made under any such Byelaw, direction, regulation or other instrument.

*capital add-on*

means the amount by which the *SCR* of a *UK Solvency II firm*, or the *group SCR* of a *group* (as appropriate), is increased by the *PRA* as a result of a *standard formula significant risk profile deviation*, *internal model significant risk profile deviation*, *significant system of governance deviation*, *significant deviation from relevant assumptions* or (if appropriate) a specific risk existing at *group* level.

*central assets*

means the *Society's* own assets that are available at its discretion to meet a *member's* liabilities in respect of *insurance business*.

*Central Fund*

means the Central Fund established under Lloyd's Central Fund Byelaw (No 4 of 1986) and the New Central Fund established under Lloyd's New Central Fund Byelaw (No 23 of 1996).

*central liabilities*

means the liabilities of the *Society*, excluding any liabilities of *members* (unless the *Society* has exercised its discretion to meet such liabilities) or any other participant at Lloyd's other than the *Society*.

*central requirement*

means the calculation made by the *Society* pursuant to the requirements of Solvency Capital Requirement – General Provisions 7.3.

*class*

means (in relation to a *contract of insurance*) any class of *contract of insurance* listed in Schedule 1 to the *Regulated Activities Order* (Contracts of insurance) and references to:

- (1) *general insurance business class* 1, 2, 3, etc. are references to *contracts of insurance* of the kind mentioned in the corresponding numbered paragraph in Part I of Schedule 1 to that Order or, as the context may require, to the *effecting or carrying out of contracts of insurance* of that kind; and
- (2) *long-term insurance business class* I, II, III, etc. are references to *contracts of insurance* of the kind mentioned in the corresponding numbered paragraph in Part II of Schedule 1 to that Order or, as the context may require, to the *effecting or carrying out of contracts of insurance* of that kind.

*composite firm*

means a *firm* that carries on both *long-term insurance business* and *general insurance business*.

*contract for differences*

means the investment, specified in article 85 of the *Regulated Activities Order* (Contracts for differences etc).

*contract of insurance*

has the meaning given in article 3(1) of the *Regulated Activities Order*.

*control*

means the relationship between a *parent undertaking* and a *subsidiary undertaking* where that relationship falls within (a) to (g) of the definition of *parent undertaking*, or a similar relationship between any *person* and an *undertaking*.

**[Note: Art. 13(18) of the Solvency II Directive]**

*credit risk*

means the risk of loss, or of adverse change, in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which a *Solvency II undertaking* is exposed, in the form of counterparty default risk, or *spread risk*, or *market risk* concentrations.

**[Note: Art. 13(32) of the Solvency II Directive]**

*derivative*

means a *contract for differences*, a *future* or an *option*.

*diversification effects*

means the reduction in the risk exposure of *UK Solvency II firms* related to the diversification of their business, resulting from the fact that the adverse outcome from one risk can be offset by a more favourable outcome from another risk, where those risks are not fully correlated.

**[Note: Art. 13(37) of the Solvency II Directive]**

*EEA*

means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being and which consists of the *EEA States*.

*EEA State*

has the meaning given in the Interpretation Act 1978 and, where the context requires, references to an *EEA state* include references to Gibraltar as appropriate.

*EIOPA*

means the European Insurance and Occupational Pensions Authority established in accordance with Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010.

*eligible own funds*

means:

- (1) as to compliance with a *UK Solvency II firm's SCR*, the aggregate of the *firm's*:
  - (a) *Tier 1 own funds*; and
  - (b) *eligible Tier 2 own funds*; and
  - (c) *eligible Tier 3 own funds*; and
- (2) as to compliance with a *UK Solvency II firm's MCR*, the aggregate of the *firm's*:
  - (a) *Tier 1 own funds*; and
  - (b) *eligible Tier 2 own funds*; and
- (3) as to compliance by a *composite firm* with the *notional life MCR*, the aggregate of the *firm's*:
  - (a) *Tier 1 own funds*; and
  - (b) *the firm's Tier 2 basic own funds*
- (4) as to compliance by a *composite firm* with the *notional non-life MCR*, the aggregate of the *firm's*:
  - (a) *Tier 1 own funds*; and
  - (b) *the firm's Tier 2 basic own funds*

that satisfy the limits in Own Funds 4 as if references to the “*MCR*” in those provisions were references to the *notional life MCR*; and the limits in the *Solvency II Regulations*; and

that satisfy the limits in Own Funds 4.2 as if references to the “*MCR*” in those provisions were references to the *notional non-life MCR*; and the limits in the *Solvency II Regulations*.

*employers' liability*

means a *contract of insurance* against risks of the *persons* insured incurring liabilities to their employees.

*exceptional adverse situation*

means situations where the financial situation of a firm representing a significant share of the market or the affected lines of business are seriously or adversely affected by one or more of the following:

- (1) a fall in financial markets which is unforeseen, sharp and steep;
- (2) a persistent low interest rate environment; and
- (3) a high impact catastrophic event.

*finance scheme*

means the finance scheme required to be provided by a *UK Solvency II firm* to the PRA under Undertakings in Difficulty 4.1(2).

*function*

means, within a system of governance, an internal capacity to undertake practical tasks.

**[Note: Art. 13(29) of the Solvency II Directive]**

*funds at Lloyd's*

means the assets (not being *syndicate assets*) provided by or on behalf of a *member* to meet the liabilities arising from the *member's insurance business* at Lloyd's which are held in a *Lloyd's trust fund* and managed by the *Society* as trustee.

*future*

means the investment, specified in article 84 of the *Regulated Activities Order* (Futures).

*group*

means a group of *undertakings* that:

- (1) consists of a *participating undertaking*, its *subsidiary undertakings* and the *undertakings* in which it holds a participation, as well as *undertakings* linked to each other by an *Article 12(1) relationship*; or
- (2) consists of a *mutual-type group*.

**[Note: Art. 212(1)(c) of the Solvency II Directive]**

*group SCR*

means the solvency capital requirement calculated at the level of the *group*, in accordance with Group Supervision 4 – 15.

*incorporated friendly society*

means a society incorporated under the Friendly Societies Act 1992.

*insurance holding company*

means a *parent undertaking*, other than a *Solvency II undertaking* and a *mixed financial holding company*, the main business of which is to acquire and hold *participations* in *subsidiary undertakings* and which fulfils the following conditions:

- (1) its *subsidiary undertakings* are either exclusively or mainly *Solvency II undertakings*, *third country insurance undertakings* or *third country reinsurance undertakings*; and
- (2) at least one of those *subsidiary undertakings* is a *Solvency II undertaking*.

**[Note: Art. 212(1)(f) of the Solvency II Directive]**

*internal model*



means the methodology used by a *firm* to calculate all or part of its *SCR*, or by a *group* to calculate part or all of its *group SCR*, in place of the *standard formula*.

*internal model approval*

means;

- (1) the approval granted to a *firm* by the *PRA* to use an *internal model* to calculate part (*partial internal model*) or all of its *SCR*; and
- (2) in relation to a *UK Solvency II firm* that is a member of a *group* the approval granted to that *firm* by the *PRA* to use an *internal model* to calculate part (*partial internal model*) or all of its *group SCR*.

*internal model significant risk profile deviation*

means the determination by the *PRA* of a significant deviation in the risk profile of a *UK Solvency II firm*, or a *group* (as appropriate), from the assumptions underlying the *SCR* (or *group SCR*, as appropriate) in circumstances where the *firm's SCR* (or the *group's group SCR*, as appropriate) is calculated using an *internal model*.

*ISPV*

means an *undertaking*, whether incorporated or not, other than a *Solvency II undertaking*, which has received authorisation in accordance with Article 211(1) or (3) of the *Solvency II Directive* and:

- (1) which assumes risks from *Solvency II undertakings*; and
- (2) which fully funds its exposures to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the *undertaking's* obligations to the *Solvency II undertaking* in respect of the risks referred to in (1).

**[Note: Art. 13(26) of the *Solvency II Directive*]**

*linked long-term*

means (in relation to a *contract of insurance*) a *contract of long-term insurance* where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

*Lloyd's trust deed*

means a trust deed in the form prescribed by the *Society* and notified to the *PRA*, for execution by a *member* in respect of his *insurance business*.

*Lloyd's trust fund*

means a fund held on the terms of a *Lloyd's trust deed*.

*major business unit*

means a defined segment of an *undertaking* that operates independently from other parts of the *undertaking*, has dedicated governance resources and procedures within the *undertaking* and contains risks which are material in relation to the whole business of the *firm*.

[Drafting note: Expected to be defined the *Solvency II Regulations*]

*matching adjustment*

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of a *relevant portfolio of insurance or reinsurance obligations* in accordance with:

- (1) Technical Provisions 4B and 4C;
- (2) the *Solvency II Regulations* adopted under Article 86(1)(h) - (i) of the *Solvency II Directive*; and
- (3) any technical information made by *EIOPA* under Article 77e(1)(b) of the *Solvency II Directive* and adopted in the *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

*matching adjustment approval*

means the approval granted to a *firm* by the *PRA* to permit it to apply a *matching adjustment* for the purposes of calculating the *best estimate* in relation to a *relevant portfolio of insurance and reinsurance obligations*.

*MCR*

means the minimum capital requirement calculated in accordance with the Minimum Capital Requirement Part.

*mixed financial holding company*

means a mixed financial holding company as defined in Article 2(15) of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

**[Note: Art. 212(1)(h) of the *Solvency II Directive*]**

*mutual*

means an *insurer* which:

- (1) if it is a *body corporate* has no *share* capital (except a wholly owned *subsidiary undertaking* with no *share* capital but limited by guarantee); or
- (2) is a *registered friendly society* or *incorporated friendly society*; or
- (3) is a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies (Northern Ireland) Act 1969.

*mutual-type group*

means a group of *undertakings* that is based on the establishment, contractually or otherwise, of strong and sustainable financial relationships among those *undertakings*, and that may include mutual or mutual-type associations, provided that:

- (1) one of those *undertakings* effectively exercises, through centralised coordination, a dominant influence over the decisions, including financial decisions, of the other *undertakings* that are part of the group of *undertakings*; and
- (2) the establishment and dissolution of such relationships for the purposes of Title III of the *Solvency II Directive* are subject to prior approval by the *group supervisor*,

where the undertaking exercising the centralised coordination shall be considered as the *parent undertaking*, and the other *undertakings* shall be considered as *subsidiary undertakings*.

**[Note: Art. 212(1)(c)(ii) of the *Solvency II Directive*]**

*national specific template*

means a template which a firm is required to complete pursuant to Solvency II – Reporting 2.6 and 2.8.

*notional life MCR*

means the notional minimum capital requirement calculated under Composites 4.2(1).

*notional life SCR*

means the notional solvency capital requirement for *long-term insurance business*, calculated in accordance with the *Solvency II Regulations*.

*notional non-life MCR*

means the notional minimum capital requirement calculated under Composites 4.2(2).

*notional non-life SCR*

means the notional solvency capital requirement for general insurance business, calculated in accordance with the *Solvency II Regulations*.

*operational risk*

means the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events, including legal risks but, for the purposes of Solvency Capital Requirement – General Provisions 3.3(1) it excludes risks arising from strategic decisions and reputational risks.

**[Note: Art. 13(33) and Art. 101(4) of the *Solvency II Directive*]**

*option*

means the investment, specified in article 83 of the *Regulated Activities Order* (Options).

ORSA

means the own risk and solvency assessment carried out from time to time, as detailed in Conditions Governing Business 3.6 – 3.8.

*outsourcing*

means an arrangement of any form between a *Solvency II undertaking* and a service provider, whether a supervised entity or not, by which that service provider performs a process, a service or an activity, whether directly or by sub-outsourcing, which would otherwise be performed by the *Solvency II undertaking* itself.

**[Note: Art. 13(28) of the Solvency II Directive]**

*own funds*

means;

- (1) in relation to a *UK Solvency II firm*, the *firm's* aggregate *basic own funds* and *ancillary own funds* as determined in accordance with Solvency II – Own Funds; or
- (2) in relation to a *Solvency II undertaking* other than a *UK Solvency II firm*, own funds determined in accordance with *Solvency II EEA implementing measures*; or
- (3) in relation to an *insurance holding company*, own funds determined in accordance with (1) as if it were a *UK Solvency II firm*.

**[Note: Art. 87 of the Solvency II Directive]**

*parent undertaking*

means, in accordance with section 420 of *FSMA* (Parent and subsidiary undertaking) and section 1162 of the Companies Act 2006 (Parent and subsidiary undertakings), an *undertaking* which has the following relationship to another *undertaking* ("S"):

- (1) it holds a majority of the voting rights in S; or
- (2) it is a member of S and has the right to appoint or remove a majority of its board of *directors*; or
- (3) it has the right to exercise a dominant influence over S through:
  - (a) provisions contained in S's memorandum or articles; or
  - (b) a control contract; or
- (4) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or
- (5) (a) it has the power to exercise, or actually exercises, dominant influence or control over S; or
  - (b) it and S are managed on a unified basis; or
- (6) it is a *parent undertaking* of a *parent undertaking* of S; or
- (7) (except as the Group Supervision Part applies to *members* of the *Society* or to the *Society* or *managing agents* in respect of *members*) it is incorporated in

or formed under the law of another *EEA State* and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the Council Directive of 13 June 1983 on consolidated accounts (No 83/349/EEC); or

- (8) where, in accordance with Article 212(2) of the *Solvency II Directive*, it effectively exercises a dominant influence over S;

and:

- (9) in relation to (2) and (4), the undertaking will be treated as a member of S if any of its *subsidiary undertakings* is a member of S, or if any shares in S are held by a person acting on behalf of the *undertaking* or any of its *subsidiary undertakings*;
- (10) the provisions of Schedule 7 to the Companies Act 2006 (Parent and subsidiary undertakings: supplementary provisions) explain the expressions used in and supplement paragraphs (1) – (6).

**[Note: Art. 212(2) of the *Solvency II Directive*]**

*partial internal model*

means an *internal model* that is:

- (1) used to calculate one or more of the following:
- (a) one or more risk modules, or sub-modules, of the *basic SCR* ;
  - (b) the capital requirement for *operational risk* set out in Solvency Capital Requirement – Standard Formula 5;
  - (c) the adjustment for the loss-absorbing capacity of *technical provisions* and deferred taxes set out in Solvency Capital Requirement – Standard Formula 6; or
- (2) applied to the whole of a *firm's insurance business*, or only to one or more of its *major business units*.

**[Note: Art. 112(2) of the *Solvency II Directive*]**

*participating Solvency II undertaking*

means a *Solvency II undertaking* that holds a *participation* in another *undertaking*.

*participating undertaking*

means an *undertaking* that holds a *participation* in another *undertaking*, or an *undertaking* linked with another *undertaking* by an *Article 12(1) relationship*.

**[Note: Art. 212(1)(a) of the *Solvency II Directive*]**

*participation*

means:

- (1) the ownership, direct or by way of *control*, of 20% or more of the voting rights or capital of an *undertaking*; or

- (2) where, in accordance with Article 212(2) of the *Solvency II Directive*, an *undertaking* effectively exercises a significant influence over another *undertaking*.

**[Note: Art. 13(20) and 212(2) of the *Solvency II Directive*]**

*policy*

has the meaning given in article 2 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361).

*policyholder*

means, in respect of a *contract of insurance* where the *insurance undertaking* is a *Solvency II undertaking*, a policyholder, which includes a *beneficiary*.

*premium*

means the consideration payable under a *contract of insurance* by the *policyholder* to the *insurer*.

*pre-Solvency II MCR*

means the minimum capital requirement that applied to the *UK Solvency II firm* under *PRA rules* as at 31 December 2012.

*probability distribution forecast*

means a mathematical function that assigns a probability of realisation to an exhaustive set of mutually exclusive future events.

**[Note: Art. 13(38) of the *Solvency II Directive*]**

*pure reinsurer*

means an *insurer* whose *insurance business* is restricted to *reinsurance*.

*recovery plan*

means;

- (1) (except in the Group Supervision Part of the Solvency II Firms Sector), the recovery plan required to be provided by a firm to the *PRA* under *Undertakings in Difficulty* 3.1(2); and
- (2) (in the Group Supervision Part of the Solvency II Firms Sector), the recovery plan required to be provided by a *relevant insurance group undertaking* to the *PRA* under Group Supervision 4.4(2).

*registered friendly society*

means a *friendly society* registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any registered branches.

*reinsurance to close*

means;

- (1) an agreement under which members of a *syndicate* in one *syndicate year* ("the reinsured members") agree with the members of that *syndicate* in a later *syndicate year* or the members of another *syndicate* ("the reinsuring members") that the reinsuring members will discharge, or procure the discharge of, or indemnify the reinsured members against, all known and unknown *insurance business* liabilities of the reinsured members arising out of the *insurance business* carried on by the reinsured members in that *syndicate year*; or
- (2) a similar *reinsurance* agreement or arrangement that has been approved by the *Council* as a reinsurance to close.

*relevant insurance group undertaking*

means, in relation to an *group* falling within Group Supervision 2.1(1)(a) or 2.1(1)(b), each *UK Solvency II undertaking* within that *group*.

*relevant portfolio of insurance or reinsurance obligations*

means a portfolio of insurance or *reinsurance* obligations falling within any *long-term insurance business class*, including annuities stemming from a *contract of general insurance*, in respect of which a *firm* has been granted a *matching adjustment approval*.

*relevant risk-free interest rate term structure*

means the relevant risk-free interest rate term structure, in accordance with:

- (1) Technical Provisions 4A and 4D.3 – 4D.4;
- (2) the *Solvency II Regulations* adopted under Article 86 of the *Solvency II Directive*; and
- (3) any technical information made by *EIOPA* under Article 77e(1)(a) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

*risk margin*

means the portion of *technical provisions* calculated in accordance with Technical Provisions 4.1 – 4.2.

*risk measure*

means a mathematical function which assigns a monetary amount to a given *probability distribution forecast* and increases monotonically with the level of risk exposure underlying that *probability distribution forecast*.

**[Note: Art. 13(39) of the *Solvency II Directive*]**

*risk-mitigation techniques*

means all techniques which enable a *Solvency II undertaking* to transfer part or all of their risks to another party.

**[Note: Art. 13(36) of the *Solvency II Directive*]**

*SCR*

means the solvency capital requirement calculated in accordance with the *SCR Rules*.

**[Note: Art. 100 of the *Solvency II Directive*]**

*SCR Rules*

means the *PRA rules* contained in the Solvency Capital Requirement – General Provisions Part, the Solvency Capital Requirement – Standard Formula Part and the Solvency Capital Requirement – Internal Models Part.

*security*

has the meaning specified in article 3(1) of the *Regulated Activities Order*.

*SFCR*

means the solvency and financial condition report, as detailed in Reporting 3 – 6.

*share*

means the investment, specified in article 76 of the *Regulated Activities Order*.

*significant deviation from relevant assumptions*

means a significant deviation from the assumptions underlying the *matching adjustment* or the *volatility adjustment* or the transitional measures referred to in Articles 308c and 308d of the *Solvency II Directive*.

*significant system of governance deviation*

means the determination by the *PRA* of a significant deviation by a *UK Solvency II firm*, or a *group* (as appropriate), from the system of governance requirements set out in Conditions Governing Business 2.2 – 8 (including pursuant to Group Supervision 17.1(1) where appropriate).

*Solvency II Directive*

means the Directive 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*) (No 2009/138/EC).

*Solvency II EEA implementing measures*

means any measures implementing the *Solvency II Directive* in an *EEA State* other than the *United Kingdom*.

*Solvency II Regulations*

the directly applicable EU Regulations adopted in accordance with the *Solvency II Directive*.

*Solvency II undertaking*

means;



- (1) an *undertaking* authorised in accordance with *Solvency II EEA implementing measures* transposing Article 14 of the *Solvency II Directive*; or
- (2) a *UK Solvency II firm*.

*spread risk*

means the risk that a spread (that is, the difference in price or yield) between two variables will change.

*standard formula*

a methodology used by a *firm* to calculate its *SCR* according to the *rules* in the Solvency Capital Requirement – Standard Formula Part.

*standard formula significant risk profile deviation*

means the determination by the *PRA* of a significant deviation in the risk profile of a *UK Solvency II firm*, or a *group* (as appropriate), from the assumptions underlying the *SCR* (or *group SCR*, as appropriate) in circumstances where the *firm's SCR* (or the *group's group SCR*, as appropriate) is calculated using the *standard formula*.

*subsidiary undertaking*

means an *undertaking* of which another *undertaking* is its *parent undertaking*.

*supervisory authority*

means a national authority or the national authorities empowered by law or regulation of an *EEA State* to supervise *Solvency II undertakings* for the purposes of the *Solvency II Directive*, including the *PRA* and *FCA*.

**[Note: Art. 13(10) of the *Solvency II Directive*]**

*syndicate assets*

means the assets managed by or at the direction of a *managing agent* in respect of *insurance business* carried on through a *syndicate* and overseas business regulatory deposits funded from those assets.

*syndicate year*

means a year of account of a *syndicate*.

*technical provisions*

means the technical provisions established in accordance with Technical Provisions 2.1.

*third country branch undertaking*

means

- (1) a *third country insurance undertaking* that has a *third country insurance branch*; or
- (2) a *third country insurance undertaking* or *third country reinsurance undertaking* that has a *third country pure reinsurance branch*.

*third country insurance branch*

means a permanent presence in the *United Kingdom* of a *third country insurance undertaking* or *third country reinsurance undertaking*, that has a *permission* to effect *contracts of insurance* and *carry out contracts of insurance*.

**[Note: Art. 163(3) of the Solvency II Directive]**

*third country insurance undertaking*

means an *undertaking* that would require authorisation as an insurance undertaking in accordance with Article 14 of the *Solvency II Directive* if its head office was situated in the *EEA*.

**[Note: Article 13(3) of the Solvency II Directive]**

*third country pure reinsurance branch*

means a permanent presence in the *United Kingdom* of a *third country insurance undertaking* or *third country reinsurance undertaking*, that has a *permission* to effect *contracts of insurance* and *carry out contracts of insurance* and which pursues only the business of *reinsurance* in the *United Kingdom*.

**[Note: Art. 162(3) of the Solvency II Directive]**

*third country reinsurance undertaking*

means an *undertaking* that would require authorisation as a *reinsurance undertaking* in accordance with Article 14 of the *Solvency II Directive* if its head office were situated in the *EEA*.

**[Note: Article 13(6) of the Solvency II Directive]**

*Tier 1 own funds*

means an item of *basic own funds* that satisfies the conditions in *Own Funds 3.1*.

*Tier 2 basic own funds*

means an item of *Tier 2 own funds* that is an item of *basic own funds*.

*Tier 2 own funds*

means an item of *own funds* that satisfies the conditions in *Own Funds 3.2*.

*Tier 3 own funds*

means an item of *own funds* referred to in *Own Funds 3.3*.

*UK Solvency II firm*

has the meaning in *General Application 2*.

*undertaking specific parameters*

means, for the purposes of determining the *SCR* using the *standard formula*, the replacement of a subset of parameters used in the life *underwriting risk* module, non-

life *underwriting risk* module or health *underwriting risk* module with parameters specific to a *firm*.

*underwriting member*

means a *person* admitted to the *Society* as an underwriting member.

*underwriting risk*

means the risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.

**[Note: Art. 13(30) of the *Solvency II Directive*]**

*volatility adjustment*

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate* in accordance with:

- (1) the *Solvency II Regulations* adopted under Article 86(1)(j) of the *Solvency II Directive*; and
- (2) any technical information made by *EIOPA* under Article 77e(1)(c) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*.

*waiver*

means a direction waiving or modifying a *rule*, given by the *PRA* under section 138A of *FSMA* (Modification or waiver of rules).

Amend the following definitions as shown:

*insurance undertaking*

means an *undertaking*, ~~whether or not an *insurer*, which carries on *insurance business*.~~ (except for an *ISPV* or a *member*, that carries on *insurance business*, whether or not an *insurer*.

*insurer*

means a *firm* with *permission* to *effect contracts of insurance* or *carry out contracts of insurance* (other than an ~~*UK ISPV*~~ *ISPV*).

*market risk*

- (1) (except in the *Solvency II Firms Sector*) means the risk that arises from fluctuations in values of, or income from assets, or in interest or exchange rates; and
- (2) (in the *Solvency II Firms Sector*) means the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

**[Note: Art. 13(31) of the *Solvency II Directive*]**

*UK ISPV*

means an ~~insurance special purpose vehicle~~ ISPV with a *Part 4A* permission to carry out contracts of insurance or effect contracts of insurance.