

Supervisory Statement | SS22/15

Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorized firms

November 2024

(Updating July 2015)



BANK OF ENGLAND
PRUDENTIAL REGULATION
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1 Introduction

1.1 This supervisory statement is addressed to all UK firms within the scope of Solvency II, and to Lloyd's, in relation to the European Insurance and Occupational Pensions Authority's (EIOPA's) Set 1 Solvency II Guidelines¹ ('the Guidelines') published on 2 February 2015.

1.2 This supervisory statement expands on the Prudential Regulation Authority's (PRA's) general approach set out in the PRA's Approach to Insurance Supervision.² By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders. The PRA has considered matters to which it is required to have regard, and it considers that this statement is compatible with the Regulatory Principles³ and relevant provisions of the Legislative and Regulatory Reform Act 2006.⁴ This statement is not expected to have any direct or indirect discriminatory impact under existing UK law.

1.3 This statement has been subject to public consultation⁵ and reflects the feedback that was received by the PRA. It sets out the PRA's expectation that all firms comply with the EIOPA Set 1 Guidelines. It also provides further commentary on certain Guidelines where additional considerations, largely set out in previous PRA supervisory statements, should be taken into account by firms.

2 Compliance with Guidelines

2.1 As set out in the Bank of England and PRA statement of policy on Interpretation of EU Guidelines and Recommendations,^{5a} the PRA expects firms to continue to make every effort to comply with existing EU Guidelines that are applicable as at the end of the transition period, to the extent that these remain relevant. The PRA expects firms to comply with all of the Guidelines that apply to them in a proportionate manner.

2.2 Those Guidelines on which further commentary is provided are:

- ancillary own-funds;
- classification of own-funds;
- ring-fenced funds;
- treatment of related undertakings, including participations;
- loss-absorbing capacity of technical provisions and deferred taxes; and
- group solvency calculation.

¹ EIOPA Set 1 of Solvency II Guidelines: https://www.eiopa.europa.eu/consultations/first-set-guidelines-solvency-ii_en.

² PRA's approach to insurance supervision: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

³ Section 3B of the Financial Services and Markets Act 2000 (FSMA): www.legislation.gov.uk/ukpga/2000/8/pdfs/ukpga_20000008_en.pdf.

⁴ Legislative and Regulatory Act 2006: www.legislation.gov.uk/ukpga/2006/51/contents.

⁵ PRA Consultation Paper CP5/15, 'Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorized firms', February 2015; <http://www.bankofengland.co.uk/pradocuments/publications/cp/2015/cp515.pdf>.

^{5a} SoP - Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU: www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.

3 Ancillary own-funds (Guidelines 1–6)

3.1 These Guidelines complement the PRA’s Solvency II framework. In particular, they complement the Own Funds Part of the PRA Rulebook and the statement of policy (SoP) on Solvency II: the PRA’s approach to insurance own fund’s permissions^{5b} in respect of the criteria for the approval of and the application procedures for ancillary own-funds (AOF). Firms should refer to the supplementary information form for AOF permissions⁶ and consider its relationship with the AOF Guidelines when preparing their applications.

3.2 Guidelines 5 and 6 identify the need for firms and the PRA to monitor on an ongoing basis the ability of an AOF item to satisfy the criteria for approval. Firms should engage with their usual supervisory contact at an early stage where any changes might affect the status or loss-absorbing characteristics of an approved AOF Item.

4 Classification of own-funds (Guidelines 1–26)

4.1 These Guidelines are organised in several sections.

Guidelines relevant to specific tiers (Guidelines 1–11)

4.2 Sections 1 to 3 set out considerations relating to items and features determining classification for Tier 1, Tier 2 and Tier 3 respectively.

4.3 Firms should follow these Guidelines when designing and classifying their capital instruments and the PRA expects this to be reflected in firms’ submissions of pre-issuance notifications as set out in the Own Funds Part of the PRA Rulebook.

4.4 In Section 2 of SS3/15⁷ the PRA sets out its expectations relating to terms permitting the call of an instrument earlier than five years from date of issue. These will be relevant in respect of Guideline 14 on call options predicated on unforeseen changes and the paragraphs referred to within that Guideline.

Guidelines relevant to all tiers (Guidelines 12–20)

4.5 Section 4 contains Guidelines relevant to all tiers. Firms should follow the approach set out in these Guidelines in order to ensure compliance with the PRA Rulebook. Guidelines 12, 18, 21-23 and 25-26 have all been restated in the SoP: The PRA’s approach to insurance own funds permissions.

4.6 In Section 3 of SS3/15 the PRA sets out its expectation regarding a broad scope for the term ‘redemption’ in line with paragraph 1.4 of the SoP on the PRA’s approach to insurance own fund permissions. (Previously Guideline 12.)

4.7 Guideline 13 sets out the considerations relevant to encumbrance. Firms should identify the substance and not simply the form of arrangements and connected transactions when considering the potential impact on the quality of capital. Firms should consider SS8/14⁸ on subordinated guarantees in the light of Guideline 13.

^{5b} SoP - Solvency II: the PRA’s approach to insurance own fund’s permissions.

⁶ PRA Solvency II approvals; www.bankofengland.co.uk/pru/Pages/authorisations/siiapprovals/applying.aspx.

⁷ PRA Supervisory Statement SS3/15, ‘Solvency II: the quality of capital instruments’, November 2024;

www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-the-quality-of-capital-instruments-ss.

⁸ PRA Supervisory Statement SS8/14, ‘Subordinated guarantees and the quality of capital for insurers’, August 2014;

www.bankofengland.co.uk/prudential-regulation/publication/2014/subordinated-guarantees-and-the-quality-of-capital-ss.

4.8 The PRA's approach to its review of potential redemptions, including the information to be provided and when it should be submitted is set out in the SoP on the PRA's approach to own fund permissions. (Previously Guideline 18.)

4.9 In considering whether an instrument includes an incentive to redeem as described in Guideline 19, firms should provide a reasoned basis for the choice of coupon structure and any other provision that might suggest an incentive to redeem. Firms should include this information as part of their pre-issuance notification.

Guidelines relating to items not on the lists of own fund items (Guidelines 21–26)

4.10 Section 5 covers the approach to the approval of items not on the lists of own-funds in the PRA Rulebook. Guidelines 21 – 23, 25 and 26 have been restated in the SoP on the PRA's approach to own fund permissions. Firms should engage with their usual supervisory contact at an early stage if they are considering development of an own-fund item not on the lists.

5 Ring-fenced funds (Guidelines 1–17)

5.1 These Guidelines complement the PRA Rulebook regarding ring-fenced funds (RFF).

Identification of RFF (Guidelines 1–4)

5.2 Guidelines 1 to 4 describe the characteristics of RFF together with details of arrangements, restrictions and types of business which are generally inside or outside the scope of the RFF regime. Firms should follow the approaches set out in these Guidelines in determining whether they need to recognise RFF. In particular, the PRA draws firms' attention to paragraph 1.13 of Guideline 3 which makes clear that all restrictions in place at the time of calculation of the Solvency Capital Requirement (SCR) should be taken into account, irrespective of the time period for which those restrictions apply.

5.3 In SS14/15⁹ the PRA sets out its expectation that the restrictions on assets and own funds resulting from the nature of, and regulatory regime for, with-profits insurance business in the United Kingdom will generally mean that each with-profits fund displays the characteristics of a RFF under Solvency II.

Materiality (Guideline 5)

5.4 Firms should follow Guideline 5 paragraph 1.17 when assessing whether a RFF is not material and documenting their assessment. Firms should send such assessments to their usual supervisory contact.

5.5 Where a RFF is not material, firms should apply paragraph 1.16 of Guideline 5.

Identification of assets and liabilities in RFF (Guidelines 6–8)

5.6 Firms should follow Guidelines 6 to 8 in determining the assets and liabilities within the scope of RFF. The PRA's approach to with-profits business, as set out in the With-profits Part of the PRA Rulebook, and supervisory statement SS14/15, will apply to those firms which have with-profits funds and their treatment as RFF. The PRA notes that Guideline 8 will be of particular relevance to with-profits funds and the treatment of profit-sharing arrangements whereby transfers to shareholders arise from the distribution of discretionary benefits to policyholders. The treatment of other types of profit-sharing arrangements will depend on the structure of the business and the scheme or other legal arrangement that specify the

⁹ PRA Supervisory Statement SS14/15, 'With-profits', November 2024; www.bankofengland.co.uk/pradocuments/publications/ss/2015/ss1415.pdf.

mechanism by which amounts are distributed to shareholders and policyholders. Firms with more complex arrangements should engage with their usual supervisory contact regarding their treatment.

Calculations and reporting in respect of RFF (Guidelines 9–15, and 17)

5.7 Firms should follow Guidelines 9 to 13, and 17 in carrying out the calculations required by in the PRA Rulebook in respect of the:

- notional SCR for the purpose of calculating any required adjustment to own-funds;
- notional SCRs to be aggregated for the purpose of standard formula calculations for RFF and matching adjustment portfolios;
- calculation of the SCR as a whole for internal model firms; and
- reporting of the SCR by risk module by standard formula firms.

5.8 On Guideline 14, firms should engage with their usual supervisory contact at an early stage in order to discuss what evidence the PRA would need in order to be satisfied with the proposed methodology.

6 Treatment of related undertakings, including participations (Guidelines 1–9)

6.1 These Guidelines complement the PRA Rulebook in respect of related undertakings, including participations. They cover the identification of related undertakings and their treatment both for capital resources and capital requirements purposes.

Identification (Guidelines 1–2)

6.2 Guidelines 1 and 2 address the identification of related undertakings and participations. Firms should consider both shareholdings and the existence of dominant or significant influence when identifying related undertakings. This should not be considered a static assessment; firms should have in place procedures to identify and update their position where there are changes to shareholdings or the relationship between the firm and other entities, which might lead to the creation, or removal of, dominant or significant influence.

6.3 Firms should consider both direct and indirect holdings when identifying related undertakings.

Strategic participations (Guideline 3)

6.4 The PRA Rulebook sets out tests a firm must be able to meet before an equity investment in a related undertaking can be considered strategic. Firms should follow Guideline 3 when seeking to demonstrate that these tests are met and be able to provide credible supporting evidence set out in paragraph 1.26 of the Guideline. In particular, the PRA draws firms' attention to the need to demonstrate that the value of the equity investment is likely to be materially less volatile than other equities. Firms should justify the selection of equities used for comparison.

Adjustment to own-funds to reflect value of holdings in financial and credit institutions (Guidelines 4–6)

6.5 Firms should observe Guidelines 4 and 5 which support the carrying out of the calculations required by Own Funds 3K. Where a deduction from own-funds is necessary, and where a

straightforward application of Own Funds 3K.5 is not possible, firms should follow Guideline 6 to identify the tier of own-funds to which the adjustment should apply.

SCR calculations in respect of related undertakings (Guidelines 7–9)

6.6 Guidelines 7 to 9 set out how firms should reflect related undertakings in their SCR calculations, whether those calculations are performed using the standard formula or an internal model. When applying the standard formula to related undertakings and participations, firms should have regard to the relevant assumptions underlying the standard formula.¹⁰ The PRA regards the assumption that the value of an equity investment cannot fall below zero as particularly relevant where a related undertaking is valued on the adjusted equity method; or where any commitment by an insurance firm to provide support to a related undertaking is not captured by the counterparty default module. In addition, when a firm has identified a related undertaking where it does not hold an equity investment or its holding is a relatively small percentage, firms should consider whether the equity investment is representative of its exposure to that related undertaking.

6.7 In relation to paragraph 1.40 of Guideline 9, firms should also refer to supervisory statement SS6/15¹¹ where the firm calculates its solo-level SCR using an internal model.

7 Loss-absorbing capacity of technical provisions and deferred taxes (Guidelines 1–22)

7.1 These Guidelines provide guidance on how firms should calculate loss-absorbing capacity of technical provisions (LACTP) and deferred tax (LACDT) in both the solo and group SCR calculation using the standard formula.

Adjustment for the loss-absorbing capacity of deferred taxes — calculation (Guidelines 6–9)

7.2 These Guidelines address how firms should calculate the loss-absorbing capacity of deferred tax at a solo level. They cover the appropriate level of granularity which firms should apply to the calculation, valuation principles to be used and the extent to which undertakings can use group relief. The PRA expects firms to refer to SS2/14¹² which sets out further details regarding PRA expectations in relation to group relief and the need to avoid inappropriate set-off.

Adjustment for the loss-absorbing capacity of deferred taxes — calculation (Guidelines 10–14)

7.3 These Guidelines address how firms should recognise the loss-absorbing capacity of deferred tax at a solo level. In complying with these Guidelines firms should also refer to SS2/14, in particular regarding:

- double counting of deferred tax liabilities;
- assumptions regarding the post shock environment;

¹⁰ Published by EIOPA 30 July 2014: https://eiopa.europa.eu/Publications/Standards/ EIOPA-14-322_Underlying_Assumptions.pdf.

¹¹ PRA Supervisory Statement SS6/15, 'Solvency II: the internal model treatment of participations', November 2024; www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-the-internal-model-treatment-of-participations-ss.

¹² PRA Supervisory Statement SS2/14, 'Solvency II: recognition of deferred tax', updated November 2024; www.bankofengland.co.uk/prudential-regulation/publication/2014/solvency2-recognition-of-deferred-tax-ss.

- projection horizons;
- contract boundary assumptions; and
- risk margin.

8 Group solvency (Guidelines 1–27)

8.1 These Guidelines are aimed at clarifying the requirements on the calculation of group solvency, including the scope of group supervision, the level(s) at which groups are supervised and the approach to calculating group solvency.

8.2 The PRA has additional commentary in respect of the following Guidelines on the scope of group supervision and the level of which groups are supervised (Guidelines 1–5 and SS9/15¹³ paragraph 3A which restates Guideline 6).

8.3 Firms are responsible for providing guidance to related undertakings and ensuring the accuracy and completeness of information from related undertakings. Where the ultimate parent is not an authorised firm, the parent entity should nonetheless take responsibility for these matters. If necessary, the PRA will use its power of direction over the ultimate parent to ensure that this occurs.

Parent insurance or reinsurance undertaking, insurance holding company or mixed financial holding company headquartered in a third country (Guideline 5)

8.4 The PRA applies Guideline 5 such that firms are not always required to apply group supervision at the level of the ultimate undertaking in the UK. Instead, they can apply group supervision solely at the level of the ultimate parent located in a third country, if the third country is a designated overseas jurisdiction and certain other requirements are met.¹⁴ In that case the PRA's rules apply requirements at the level of the ultimate undertaking in the UK, although the PRA may grant waivers. If, therefore, a firm considers that it would be appropriate for group supervision to be exercised solely at the level of the ultimate third-country parent, it should apply for a modification of the relevant PRA rules in accordance with Section 138A of FSMA.

¹³ PRA Supervisory Statement SS9/15, 'Solvency II: Group supervision', November 2024; www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-group-supervision-ss

¹⁴ Under regulation 11 for the purposes of regulation 14 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 (overseas insurance regime)

Annex – updates to SS22/15

This annex details changes made to SS22/15 following its initial publication in April 2015.

2024

November 2024

This SS has been updated alongside the publication of Policy Statement (PS) 15/24 - Review of Solvency II: Restatement of assimilated law.¹⁵ This includes updating all previous references to the Commission Delegated Regulation (EU) 2015/35 so as to now refer to the relevant rule(s) in the PRA Rulebook. In addition, the following changes were made:

- updating the wording in paragraph 2.1 to remove the reference to the Solvency II Directive and include reference to the SoP - Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU;
- updating paragraph 8.2 following the restatement of Group Solvency Guideline 6 into SS9/15 - 'Solvency II: Group supervision'; and
- minor re-wording in paragraph 8.4 to reflect the applicability of Group Solvency Guideline 5 in the context of an overseas insurance regime.

¹⁵ www.bankofengland.co.uk/prudential-regulation/publication/2024/november/review-of-solvency-ii-restatement-of-assimilated-law-policy-statement.