

2023 No. 1347

FINANCIAL SERVICES AND MARKETS

The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023

Made - - - - *7th December 2023*

Laid before Parliament *8th December 2023*

Coming into force in accordance with regulation 1(2)

The Treasury make the following Regulations in exercise of the powers conferred by sections 4, 84(2) and 86(5) of the Financial Services and Markets Act 2023(a).

Citation, commencement and extent

1.—(1) These Regulations may be cited as the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.

(2) These Regulations come into force for the purposes of regulation 7 on 1st April 2024 and for all other purposes on 30th June 2024.

(3) These Regulations extend to England and Wales, Scotland and Northern Ireland.

Interpretation

2.—(1) In these Regulations—

“assigned portfolio of assets” means the portfolio referred to in regulation 4(3);

“credit rating” means a credit rating defined in Article 3(1) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies(b) issued or endorsed by a credit rating agency in accordance with Article 4 of that Regulation;

“credit rating agency” means a credit rating agency registered by the FCA in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies or certified by the FCA in accordance with Article 5 of that Regulation;

“insurance undertaking” means an insurance undertaking, as defined in section 417(1) of FSMA 2000(c), in relation to which PRA rules provide for the calculation of a best estimate of future cash flows using the relevant risk-free interest rate term structure;

“PRA-authorized person” has the meaning given in section 2B(5) of FSMA 2000(d);

(a) 2023 c. 29.

(b) EUR 1060/2009. Articles 4 and 5 were amended by S.I. 2019/266, 2020/628, 1055 and 1301.

(c) 2000 c. 8. The definitions of “insurance undertaking” and “reinsurance undertaking” in section 417(1) were inserted by S.I. 2015/575 and substituted by S.I. 2019/632.

(d) Section 2B was substituted by section 6 of the Financial Services Act 2012 (c. 21).

“PRA rules” means the rules made by the PRA under FSMA 2000, as they have effect from time to time;

“reinsurance undertaking” means a reinsurance undertaking, as defined in section 417(1) of FSMA 2000, in relation to which PRA rules provide for the calculation of a best estimate of future cash flows using the relevant risk-free interest rate term structure.

(2) Any other term used in these Regulations which is used in PRA rules applicable to insurance and reinsurance undertakings has the same meaning as in those rules.

PRA duty to publish technical information

3.—(1) Every quarter the PRA must publish on its website—

- (a) for each currency, duration, credit quality and asset class the PRA considers appropriate, a fundamental spread for the calculation of the matching adjustment to the relevant risk-free interest rate term structure used to calculate the best estimate for a portfolio of long-term insurance or reinsurance obligations, and
- (b) such other information as the PRA considers appropriate relating to the calculation of—
 - (i) technical provisions, and
 - (ii) the SCR on the basis of the standard formula.

(2) Paragraph 17(9)(b) of Schedule 6A to the Bank of England Act 1998^(a) (restriction on delegation of functions by the Prudential Regulation Committee) does not prohibit the making of a rule that imposes an obligation on PRA-authorised persons by reference to information published by the PRA under this regulation.

Application of the matching adjustment

4.—(1) This regulation applies where an insurance or reinsurance undertaking (“the undertaking”) applies to the PRA to disapply or modify its rules, such that the applicant undertaking may apply a matching adjustment to the relevant risk-free interest rate term structure in order to calculate the best estimate of a portfolio of long-term insurance or reinsurance obligations.

(2) Where this regulation applies, the PRA must grant the application where each of the conditions set out in paragraphs (3) to (9) and (11) is met.

(3) The undertaking must assign a portfolio of assets, consisting of bonds or other assets with similar cash flow characteristics, to cover the best estimate of the portfolio of insurance or reinsurance obligations.

(4) The credit quality of the assets in the portfolio referred to in paragraph (3) must be capable of being assessed through a credit rating or the undertaking’s internal credit assessment of a comparable standard.

(5) The undertaking must maintain the assignment referred to in paragraph (3) over the lifetime of the obligations, except for the purpose of maintaining the replication of expected cash flows between assets and liabilities where the cash flows have materially changed.

(6) The portfolio of long-term insurance or reinsurance obligations to which the matching adjustment is applied and the assigned portfolio of assets must be—

- (a) identified, and
- (b) organised and managed separately from the other activities of the undertaking.

(7) Subject to paragraph (8), the expected cash flows of the assigned portfolio of assets must replicate each of the expected cash flows of the portfolio of insurance or reinsurance obligations in the same currency.

(a) 1998 c. 11. Schedule 6A was inserted by section 13 of and Schedule 1 to the Bank of England and Financial Services Act 2016 (c. 14).

(8) Any mismatch between the expected cash flows referred to in paragraph (7) must not give rise to risks which are material in relation to the risks inherent in the insurance or reinsurance business to which the matching adjustment is applied.

(9) The cash flows of the assigned portfolio of assets must be fixed and not capable of being changed by the issuers of the assets or any third parties, except—

- (a) where—
 - (i) the risks to the quality of matching are not material, and
 - (ii) only such limited proportion of the portfolio as the PRA may determine is affected;
- (b) where the cash flows of the assigned portfolio of assets are linked to inflation, and the assets replicate the cash flows of the portfolio of insurance or reinsurance obligations that are linked to inflation; or
- (c) in a case where issuers of the assets or third parties have the right to change the cash flows of an asset, where sufficient compensation is paid to secure an equivalent cash flow by reinvesting the compensation in an asset of equivalent or better quality.

(10) In paragraph (9)(a), whether a risk is material is to be determined in accordance with any PRA rules referred to in regulation 7(b).

(11) The undertaking's application must comply with the requirements of, or imposed under, section 138BA of FSMA 2000(a) (disapplication or modification of rules in individual cases) and the undertaking must comply with rules referred to in regulation 7(a).

(12) This regulation does not prevent the PRA from exercising its powers under section 138BA of FSMA 2000 where an undertaking to whom the PRA has granted a permission to disapply or modify PRA rules in accordance with paragraph (2) has failed to meet any of the conditions—

- (a) set out in paragraphs (3) to (9) and (11),
- (b) set out in rules referred to in regulation 7(b), or
- (c) imposed under section 138BA(4)(a) of FSMA 2000.

Calculation of the matching adjustment

5.—(1) For each currency the matching adjustment referred to in regulation 4(1) must be equal to the difference of—

- (a) the annual effective rate, calculated as the single discount rate that, where applied to the cash flows of the portfolio of insurance or reinsurance obligations, results in a value that is equal to the value of the portfolio of assigned assets; and
- (b) the annual effective rate, calculated as the single discount rate that, where applied to the cash flows of the portfolio of insurance or reinsurance obligations, results in a value that is equal to the value of the best estimate of the portfolio of insurance or reinsurance obligations where the time value of money is taken into account using the basic relevant risk-free interest rate term structure.

(2) For the purpose of the calculation referred to in paragraph (1)—

- (a) “assigned assets” only includes assets whose expected cash flows are required to replicate the cash flows of the portfolio of insurance and reinsurance obligations, excluding any assets in excess of that;
- (b) valuations must comply with any requirements set out in PRA rules.

(3) In paragraph (2), the “expected cash flow” of an asset means the cash flow of the asset adjusted to allow for the probability of default of the asset that corresponds to the element of the fundamental spread set out in regulation 6(3)(a) or, where no reliable credit spread can be derived from the default statistics, the portion of the long term average of the spread over the basic relevant risk-free interest rate (as provided in regulation 6(4) and (5)).

(a) Section 138BA was inserted by section 34 of the Financial Services and Markets Act 2023 (c. 29).

(4) The matching adjustment must not include the fundamental spread (as calculated in accordance with regulation 6) reflecting the risks retained by the insurance or reinsurance undertaking.

(5) The deduction of the fundamental spread under paragraph (4) from the result of the calculation set out in paragraph (1) must include only the portion of the fundamental spread (as calculated in accordance with regulation 6) that has not already been reflected in the adjustment to the cash flows of the assigned portfolio of assets in accordance with paragraphs (1) to (3).

Calculation of fundamental spread

6.—(1) The fundamental spread referred to in regulation 5 must be calculated in a transparent, prudent, reliable and objective manner that is consistent over time and based on relevant indices where available.

(2) The fundamental spread must be calculated in accordance with paragraphs (3) to (9).

(3) The fundamental spread must be 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.

(4) For exposures to the central government of the United Kingdom and the Bank of England, where the fundamental spread would otherwise be 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 (the “average spread”), the fundamental spread must be 30% of the average spread.

(5) For assets other than exposures to the central government of the United Kingdom and the Bank of England, where the fundamental spread would otherwise be 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 (the “average spread”), the fundamental spread must be 35% of the average spread.

(6) For the purposes of this regulation—

- (a) the calculation of the “credit spread” must be based on the assumption that in case of default 30% of the market value of the assets can be recovered;
- (b) the “probability of default” must be based on long-term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class;
- (c) the “expected loss” must be based on long-term statistics that are relevant to changes in the credit quality of the asset and correspond to the probability-weighted loss the insurance or reinsurance undertaking incurs where the asset is downgraded to a lower credit quality and is replaced immediately afterwards, and the calculation of the expected loss must be based on the assumption that the replacing asset meets all of the following criteria—
 - (i) the replacing asset has the same cash flow pattern as the replaced asset before downgrade;
 - (ii) the replacing asset belongs to the same asset class as the replaced asset;
 - (iii) the replacing asset has the same credit quality as the replaced asset before downgrade or a higher one;
- (d) the “long-term average of the spread over the risk-free interest rate” must be based on data relating to the previous 30 years;
- (e) the methods to derive the fundamental spread of a bond must be the same for each currency and each country and may be different for government bonds and for other bonds.

(7) For the purposes of paragraph (6)(b) or (c), where no reliable credit spread can be derived from the statistics, the fundamental spread must be equal to the portion of the long-term average of the spread over the risk-free interest rate set out in paragraph (4) or (5).

(8) Where part of the data referred to in paragraph (6)(d) is not available or where the available data is not reliable, constructed data based on prudent assumptions may be used; and the constructed data must be based on available and reliable data relating to the previous 30 years.

(9) The fundamental spread calculated in accordance with this regulation may be increased in accordance with PRA rules referred to in regulation 7(e) or 7(f).

Power of PRA to make rules

7. Notwithstanding regulations 4 to 6, the PRA's power to make general rules under section 137G of FSMA 2000(a) (the PRA's general rules) continues to include power to make rules—

- (a) setting out conditions, in addition to those set out in regulation 4, under which an insurance or reinsurance undertaking is eligible to apply a matching adjustment, limited to conditions about—
 - (i) the eligibility of insurance or reinsurance obligations for inclusion in the portfolio to which the matching adjustment is applied; and
 - (ii) the management of risks in relation to that portfolio or the assigned portfolio of assets;
- (b) setting out the circumstances in which a risk is to be treated as material for the purposes of regulation 4(9)(a);
- (c) requiring an insurance or reinsurance undertaking to limit the value of the matching adjustment for the period during which the undertaking has failed to meet any of the conditions—
 - (i) set out in paragraphs (3) to (9) and (11) of regulation 4,
 - (ii) set out in rules made under paragraph (b), or
 - (iii) imposed under section 138BA(4)(a) of FSMA 2000;
- (d) concerning adjustments to be made by an insurance or reinsurance undertaking to any information published by the PRA under regulation 3(1)(a) to reflect more precisely the credit quality of assets;
- (e) requiring an insurance or reinsurance undertaking whose assigned portfolio of assets includes assets without fixed cash flows (excluding assets of the kind specified in regulation 4(9)(b) or (c)) to increase the fundamental spread calculated in accordance with regulation 6 by an amount to be determined in accordance with the rules;
- (f) permitting an insurance or reinsurance undertaking to increase the fundamental spread calculated in accordance with regulation 6 and any applicable rules made under paragraph (e) where the undertaking considers an increase is necessary to ensure that the fundamental spread covers all the risks retained by the undertaking.

PRA's functions and powers under FSMA 2000

8.—(1) FSMA 2000 applies in relation to regulations 5 (calculation of the matching adjustment) and 6 (calculation of fundamental spread) with the modifications set out in paragraphs (2) to (8).

(2) Section 39(b) (exemption of appointed representatives) applies as if in subsection (4)—

- (a) “or” at the end of paragraph (a) were omitted;
- (b) after paragraph (a) there were inserted—
 - “(aa) regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023, or”.

(a) Section 137G was inserted by section 24 of the Financial Services Act 2012.

(b) Subsection (4) was substituted by paragraph 5 of Schedule 18 to the Financial Services Act 2012 and amended by S.I. 2019/632.

- (3) Section 66B(a) (misconduct: action by the PRA) applies as if in subsection (4)—
- (a) “or” at the end of paragraph (a) were omitted;
 - (b) after paragraph (a) there were inserted—
 - “(aa) imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023, or”.
- (4) Section 168(b) (appointment of persons to carry out investigations in particular cases) applies as if in subsection (4)—
- (a) “or” at the end of paragraph (jc) were omitted;
 - (b) after paragraph (jc) there were inserted—
 - “(jd)an authorised person may have contravened regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023; or”.
- (5) Section 204A(c) (meaning of “relevant requirement” and “appropriate regulator”) applies as if—
- (a) in subsection (2)—
 - (i) “or” at the end of paragraph (c) were omitted;
 - (ii) “or” were inserted at the end of paragraph (d);
 - (iii) after paragraph (d) there were inserted—
 - “(e) by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”;
 - (b) in subsection (3), after paragraph (f) there were inserted—
 - “(g) a requirement under regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”.
- (6) Section 380(d) (injunctions) applies as if—
- (a) in subsection (6), in paragraph (a)—
 - (i) “or” at the end of sub-paragraph (v) were omitted;
 - (ii) “or” were inserted at the end of sub-paragraph (vi);
 - (iii) after sub-paragraph (vi) there were inserted—
 - “(vii) which is imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”;
 - (b) in subsection (8)—
 - (i) “or” at the end of paragraph (b) were omitted;
 - (ii) “or” were inserted at the end of paragraph (c);
 - (iii) after paragraph (c) there were inserted—
 - “(d) a requirement under regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”.
- (7) Section 382(e) (restitution orders) applies as if—
- (a) in subsection (9), in paragraph (a)—
 - (i) “or” at the end of sub-paragraph (iii) were omitted;

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- (a) Section 66B was inserted by section 32 of the Financial Services (Banking Reform) Act 2013 (c. 33) and subsection (4) was amended by S.I. 2019/632.
 - (b) Subsection (4) was amended by S.I. 2017/1255. There are other amendments but none is relevant.
 - (c) Section 204A was inserted by paragraph 10 of Part 4 of Schedule 9 to the Financial Services Act 2012 and amended by S.I. 2015/1864 and 2016/225. There are other amendments but none is relevant.
 - (d) Section 380(6)(a) was amended by paragraph 19 of Part 5 of Schedule 9 to the Financial Services Act 2012 and S.I. 2016/225, and section 380(8) was inserted by paragraph 19 of Part 5 of Schedule 9 to the Financial Services Act 2012. There are other amendments but none is relevant.
 - (e) Subsection (9) was amended by paragraph 21 of Part 5 of Schedule 9 to the Financial Services Act 2012. There are other amendments but none is relevant.

- (ii) “or” were inserted at the end of sub-paragraph (iv);
- (iii) after sub-paragraph (iv) there were inserted—
 - “(v) which is imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”;
- (b) in subsection (11)—
 - (i) “or” at the end of paragraph (b) were omitted;
 - (ii) “or” were inserted at the end of paragraph (c);
 - (iii) after paragraph (c) there were inserted—
 - “(d) a requirement which is imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”.
- (8) Section 384(a) (power of FCA or PRA to require restitution) applies as if—
 - (a) in subsection (7)—
 - (i) “or” at the end of paragraph (c) were omitted;
 - (ii) “or” were inserted at the end of paragraph (d);
 - (iii) after paragraph (d) insert there were inserted—
 - “(e) a requirement which is imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”;
 - (b) in subsection (9)—
 - (i) “or” at the end of paragraph (b) were omitted;
 - (ii) “or” were inserted at the end of paragraph (c);
 - (iii) after paragraph (c) there were inserted—
 - “(d) a requirement which is imposed by regulation 5 or 6 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.”.

Review

- 9.**—(1) The Treasury must from time to time—
- (a) carry out a review of the regulatory provision contained in regulations 3 to 8, and
 - (b) publish a report setting out the conclusions of the review.
- (2) The first report must be published before the end of the period of 5 years beginning with 1st April 2024.
- (3) Subsequent reports must be published at intervals not exceeding 5 years.
- (4) Each report must in particular—
- (a) set out the objectives intended to be achieved by the regulatory provision referred to in paragraph (1)(a),
 - (b) assess the extent to which those objectives are achieved,
 - (c) assess whether those objectives remain appropriate, and
 - (d) if those objectives remain appropriate, assess the extent to which they could be achieved in another way which involves less onerous regulatory provision.
- (5) In this regulation “regulatory provision” has the same meaning as in sections 28 to 32 of the Small Business, Enterprise and Employment Act 2015(b) (duty to review regulatory provisions in secondary legislation) (see section 32 of that Act).

(a) Subsection (7)(d) was inserted by paragraph 3(4) of Schedule 10 to the Financial Services (Banking Reform) Act 2013. Subsection (9) was inserted by paragraph 23 of Part 5 of Schedule 9 to the Financial Services Act 2012 and amended by S.I. 2019/632.

(b) 2015 c. 26.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations, together with rules to be made by the Prudential Regulation Authority (“PRA”), restate some provisions of Articles 53 and 54 of Commission Delegated Regulation (EU) 2015/35 of 10th October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) (“Regulation 2015/35”) and some provisions of regulations 4B and 42 of the Solvency 2 Regulations 2015 (S.I. 2015/575), in some cases with modifications. Those provisions of Regulation 2015/35 and the Solvency 2 Regulations 2015 are revoked by section 1(1) of, and Schedule 1 to, the Financial Services and Markets Act 2023 (c. 29) and the revocations are due to come into force on 30th June 2024. The draft PRA rules are available at www.bankofengland.co.uk/prudential-regulation/publication/2023/september/review-of-solvency-ii-reform-of-the-matching-adjustment and from the PRA at the address given below, and are also due to come into force on 30th June 2024.

For the purposes of these Regulations, “insurance undertaking” and “reinsurance undertaking” are defined so as to capture only those undertakings to which the Insurance Rules for UK Solvency II firms’ sector of the PRA Rulebook applies.

Regulation 3 requires the PRA to publish technical information for the purpose of calculating an insurance or reinsurance undertaking’s technical provisions and the solvency capital requirement on the basis of the standard formula. Requirements for undertakings to maintain technical provisions and as to the application of (and basis for) the solvency capital requirement are set out in PRA rules. Technical provisions are the reserves an undertaking must hold against their expected future claims due to policyholders and beneficiaries, including a buffer against the risk of the failure of the undertaking. The solvency capital requirement is the level of capital an undertaking must maintain to absorb losses in an extreme event, and which gives reasonable assurance to policy holders and beneficiaries that payments will be made as they fall due. Either it is calculated according to the standard formula (prescribed in legislation and PRA rules) or according to an internal model (subject to approval from the regulator).

Regulation 4 requires the PRA to grant an insurance or reinsurance undertaking approval to apply a matching adjustment where the undertaking complies with the specified conditions. Regulations 5 and 6 provide how the matching adjustment and fundamental spread are to be calculated. Further provision about the calculation of the matching adjustment is to be set out in PRA rules. Permission to apply a “matching adjustment” allows an undertaking which holds long-term assets which match the cash flows of long-term insurance liabilities to recognise as capital part of as yet unearned future cash flows. The “fundamental spread” represents the risks retained by an undertaking with permission to apply a matching adjustment, and is excluded from the calculation of the matching adjustment.

Regulation 7 makes provision about PRA rules related to regulations 3 to 6. Regulation 8 ensures the PRA has available powers under the Financial Services and Markets Act 2000 (c. 8) to secure compliance with regulations 5 and 6. Regulation 9 provides that these Regulations must be reviewed by the Treasury within 5 years of their coming into force.

The rules made by the PRA are available on www.prulebook.co.uk and copies of the rules can be obtained from the PRA, 20 Moorgate, London EC2R 6DA, where they are also available for inspection.

A full impact assessment of the effect that this instrument will have on the costs of business, the voluntary sector and community bodies is available from HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ and is published with the Explanatory Memorandum alongside this instrument at www.legislation.gov.uk.

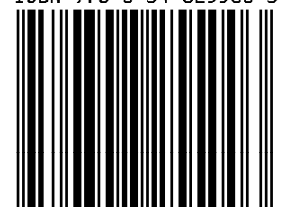
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