BANK OF ENGLAND

# News release

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## Prudential Regulation Authority publishes rules on Solvency II

The Prudential Regulation Authority (PRA) has today published its final rules setting out how it will implement the Solvency II Directive (Solvency II) in the UK.

Solvency II puts in place a consistent and coherent solvency framework for insurers across Europe and aims to provide greater protection to policyholders by reducing the probability of an insurance firm failure. The framework better aligns capital requirements to firms' asset and liability profiles and enhances the quality of capital, providing greater protection. It also provides incentives to strengthen risk management, reporting and disclosure across the industry.

The policy statement sets out how the PRA will implement the 'long-term guarantees package'. Insurers can reduce the level of risk on some types of long-term liabilities, such as annuities, if they hold closely-matched, long-term assets to back them. The long-term guarantees package allows a firm to reduce its capital and reserving requirements, where the firm is closely matched and invested for the long term.

In addition to publishing the final rules, the PRA has also published a consultation paper on the application process for the 'volatility adjustment'. This is an adjustment to the Solvency II risk-free discount rate which will be used to value insurance liabilities. It is designed to mitigate the effect of short-term volatility in financial markets on valuation of insurers' long-term liabilities under Solvency II.

A firm wishing to use the volatility adjustment can submit a formal application after 1 April 2015. The PRA will assess applications on a case-by-case basis and will adopt a proportionate approach to reviews. The greater the impact of the volatility adjustment on the firm's financial position and risk profile, the greater the expected level of detail and justification that firms will need to provide in the application. The PRA will aim to make decisions on standalone applications (i.e. those that are not dependent on other approval decisions) to use the volatility adjustment within a six week timeline, rather than the statutory maximum of six months.

The PRA recognises that firms may wish to submit both matching adjustment (which allows firms to benefit from using assets held to maturity in a portfolio backing illiquid liabilities) and volatility adjustment applications. The PRA will operate a harmonised approval process and will consider these applications in parallel.

Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and CEO of the PRA said:

"Solvency II represents a fundamental change in the way that insurers are regulated. The papers published today provide clarity for UK firms on how the PRA will implement the new regime – acting in the interests of the wider economy and ensuring an appropriate level of policyholder protection. These publications will allow firms to finalise their preparations for Solvency II in order to be ready for the start of the regime on 1 January 2016."

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**Notes to Editors**

1. Policy Statement 2/15: Solvency II: a new regime for insurers
   http://www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps215.aspx

2. Consultation Paper 11/15: Solvency II: Supervisory approval for the volatility adjustment
   http://www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp1115.aspx

3. Solvency II will apply to around 400-450 retail and wholesale UK insurance firms and to the Lloyd's insurance market.