Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (Text with EEA relevance)

TITLE I

[X1 VALUATION AND RISK-BASED CAPITAL REQUIREMENTS (PILLAR I), ENHANCED GOVERNANCE (PILLAR II) AND INCREASED TRANSPARENCY (PILLAR III)]

CHAPTER III

RULES RELATING TO TECHNICAL PROVISIONS

SECTION 3

Methodologies to calculate technical provisions

Subsection 1

Assumptions underlying the calculation of technical provisions

Article 22

General provisions

1 Assumptions shall only be considered to be realistic for the purposes of Article 77(2) of Directive 2009/138/EC where they meet all of the following conditions:

- a insurance and reinsurance undertakings are able to explain and justify each of the assumptions used, taking into account the significance of the assumption, the uncertainty involved in the assumption as well as relevant alternative assumptions;
- b the circumstances under which the assumptions would be considered false can be clearly identified;
- c unless otherwise provided in this Chapter, the assumptions are based on the characteristics of the portfolio of insurance and reinsurance obligations, where possible regardless of the insurance or reinsurance undertaking holding the portfolio;
- d insurance and reinsurance undertakings use the assumptions consistently over time and within homogeneous risk groups and lines of business, without arbitrary changes;
- e the assumptions adequately reflect any uncertainty underlying the cash flows.

For the purpose of point (c), insurance and reinsurance undertakings shall only use information specific to the undertaking, including information on claims management and expenses, where that information better reflects the characteristics of the portfolio of insurance or reinsurance obligations than information that is not limited to the specific undertaking or where the calculation of technical provisions in a prudent, reliable and objective manner without using that information is not possible.

2 Assumptions shall only be used for the purpose of Article 77(3) of Directive 2009/138/EC where they comply with paragraph 1 of this Article.

3 Insurance and reinsurance undertakings shall set assumptions on future financial market parameters or scenarios that are appropriate and consistent with Article 75 of Directive 2009/138/EC. Where insurance and reinsurance undertakings use a model to produce projections of future financial market parameters, it shall comply with all of the following requirements:

a it generates asset prices that are consistent with asset prices observed in financial markets;
b it assumes no arbitrage opportunity;
c the calibration of the parameters and scenarios is consistent with the relevant risk-free interest rate term structure used to calculate the best estimate as referred to in Article 77(2) of Directive 2009/138/EC.

Article 23

Future management actions

1 Assumptions on future management actions shall only be considered to be realistic for the purposes of Article 77(2) of Directive 2009/138/EC where they meet all of the following conditions:

a the assumptions on future management actions are determined in an objective manner;
b assumed future management actions are consistent with the insurance or reinsurance undertaking's current business practice and business strategy, including the use of risk-mitigation techniques; where there is sufficient evidence that the undertaking will change its practices or strategy, the assumed future management actions are consistent with the changed practices or strategy;
c assumed future management actions are consistent with each other;
d assumed future management actions are not contrary to any obligations towards policy holders and beneficiaries or to legal requirements applicable to the undertaking;
e assumed future management actions take account of any public indications by the insurance or reinsurance undertaking as to the actions that it would expect to take or not take.

2 Assumptions about future management actions shall be realistic and include all of the following:

(i) a comparison of assumed future management actions with management actions taken previously by the insurance or reinsurance undertaking;

(ii) a comparison of future management actions taken into account in the current and in the past calculations of the best estimate;

(iii) an assessment of the impact of changes in the assumptions on future management actions on the value of the technical provisions.

Insurance and reinsurance undertakings shall be able to explain any relevant deviations in relation to points (i) and (ii) upon request of the supervisory authorities and, where changes in an assumption on future management actions have a significant impact on the technical provisions, the reasons for that sensitivity and how the sensitivity is taken into account in the decision-making process of the insurance or reinsurance undertaking.

3 For the purpose of paragraph 1, insurance and reinsurance undertakings shall establish a comprehensive future management actions plan, approved by the administrative, management or supervisory body of the insurance and reinsurance undertaking, which provides for all of the following:

- a the identification of future management actions that are relevant to the valuation of the technical provisions;
- b the identification of the specific circumstances in which the insurance or reinsurance undertaking would reasonably expect to carry out each respective future management action referred to in point (a);
- c the identification of the specific circumstances in which the insurance or reinsurance undertaking may not be able to carry out each respective future management action referred to in point (a), and a description of how those circumstances are considered in the calculation of technical provisions;
- d the order in which future management actions referred to in point (a) would be carried out and the governance requirements applicable to those future management actions;
- e a description of any on-going work required to ensure that the insurance or reinsurance undertaking is in a position to carry out each respective future management action referred to in point (a);
- f a description of how the future management actions referred to in point (a) have been reflected in the calculation of the best estimate;
- g a description of the applicable internal reporting procedures that cover the future management actions referred to in point (a) included in the calculation of the best estimate;

4 Assumptions about future management actions shall take account of the time needed to implement the management actions and any expenses caused by them.

5 The system for ensuring the transmission of information shall only be considered to be effective for the purpose of **[**[F1]the governance requirements set out in rule 2.2 of the Conditions Governing Business part of the PRA Rulebook**]** where the reporting procedures referred to in point (g) of paragraph 3 of this Article include at least an annual communication to the administrative, supervisory or management body.

Textual Amendments

F1 Words in Art. 23(5) substituted (31.12.2020) by The Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 (S.I. 2019/407), regs. 1(2), **11(9)** (as amended by S.I. 2020/1385, regs. 1(2), 54(2) and with savings in S.I. 2019/680, reg. 11)

Article 24

Future discretionary benefits

Where future discretionary benefits depend on the assets held by the insurance or reinsurance undertaking, undertakings shall base the calculation of the best estimate on the assets currently held by the undertakings and shall assume future changes of their asset allocation in accordance with Article 23. The assumptions on the future returns of the assets shall be consistent with the relevant risk-free interest rate term structure, including where applicable a matching adjustment, a volatility adjustment, or a transitional measure on the risk-free rate, and the valuation of the assets in accordance with Article 75 of Directive 2009/138/EC.

Article 25

Separate calculation of the future discretionary benefits

When calculating technical provisions, insurance and reinsurance undertakings shall determine separately the value of future discretionary benefits.

Article 26

Policyholder behaviour

When determining the likelihood that policy holders will exercise contractual options, including lapses and surrenders, insurance and reinsurance undertakings shall conduct an analysis of past policyholder behaviour and a prospective assessment of expected policyholder behaviour. That analysis shall take into account all of the following:

(a) how beneficial the exercise of the options was and will be to the policy holders under circumstances at the time of exercising the option;

(b) the influence of past and future economic conditions;

(c) the impact of past and future management actions;

(d) any other circumstances that are likely to influence decisions by policyholders on whether to exercise the option.

The likelihood shall only be considered to be independent of the elements referred to in points (a) to (d) where there is empirical evidence to support such an assumption.

Subsection 2

Information underlying the calculation of best estimates

Article 27

Credibility of information

Information shall only be considered to be credible for the purposes of Article 77(2) of Directive 2009/138/EC where insurance and reinsurance undertakings provide evidence of the credibility of the information taking into account the consistency and objectivity of that information, the reliability of the source of the information and the transparency of the way in which the information is generated and processed.

Subsection 3

Cash flow projections for the calculation of the best estimate

Article 28

Cash flows

The cash flow projection used in the calculation of the best estimate shall include all of the following cash flows, to the extent that these cash flows relate to existing insurance and reinsurance contracts:

(a) benefit payments to policy holders and beneficiaries;

(b) payments that the insurance or reinsurance undertaking will incur in providing contractual benefits that are paid in kind;

(c) payments of expenses as referred to in point (1) of Article 78 of Directive 2009/138/EC;

(d) premium payments and any additional cash flows that result from those premiums;

(e) payments between the insurance or reinsurance undertaking and intermediaries related to insurance or reinsurance obligations;

(f) payments between the insurance or reinsurance undertaking and investment firms in relation to contracts with index-linked and unit-linked benefits;

(g) payments for salvage and subrogation to the extent that they do not qualify as separate assets or liabilities in accordance with **[**[F2]UK-adopted international accounting standards**]**;

(h) taxation payments which are, or are expected to be, charged to policy holders or are required to settle the insurance or reinsurance obligations.

Textual Amendments

F2 Words in Art. 28(g) substituted (31.12.2020) by The Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 (S.I. 2019/407), regs. 1(2), **11(10)** (as amended by S.I. 2019/1390, regs. 1(4), **11(3)(g)**; S.I. 2020/1385, regs. 1(2), **54(2)**; and with savings in S.I. 2019/680, **reg. 11**); 2020 c. 1, Sch. 5 para. 1(1)

Article 29

Expected future developments in the external environment

The calculation of the best estimate shall take into account expected future developments that will have a material impact on the cash in- and out-flows required to settle the insurance and reinsurance obligations over the lifetime thereof. For that purpose future developments shall include demographic, legal, medical, technological, social, environmental and economic developments including inflation as referred to in point (2) of Article 78 of Directive 2009/138/EC.

Article 30

Uncertainty of cash flows

The cash flow projection used in the calculation of the best estimate shall, explicitly or implicitly, take account of all uncertainties in the cash flows, including all of the following characteristics:

(a) uncertainty in the timing, frequency and severity of insured events;

(b) uncertainty in claim amounts, including uncertainty in claims inflation, and in the period needed to settle and pay claims;

(c) uncertainty in the amount of expenses referred to in point (1) of Article 78 of Directive 2009/138/EC;

(d) uncertainty in expected future developments referred to in Article 29 to the extent that it is practicable;

(e) uncertainty in policyholder behaviour;

(f) dependency between two or more causes of uncertainty;

(g) dependency of cash flows on circumstances prior to the date of the cash flow.

Article 31

Expenses

1 A cash flow projection used to calculate best estimates shall take into account all of the following expenses, which relate to recognised insurance and reinsurance obligations of insurance and reinsurance undertakings and which are referred to in point (1) of Article 78 of Directive 2009/138/EC:

a administrative expenses;
b investment management expenses;
c claims management expenses;
d acquisition expenses.

The expenses referred to in points (a) to (d) shall take into account overhead expenses incurred in servicing insurance and reinsurance obligations.

2 Overhead expenses shall be allocated in a realistic and objective manner and on a consistent basis over time to the parts of the best estimate to which they relate.

3 Expenses in respect of reinsurance contracts and special purpose vehicles shall be taken into account in the gross calculation of the best estimate.

4 Expenses shall be projected on the assumption that the undertaking will write new business in the future.

Article 32

Contractual options and financial guarantees

When calculating the best estimate, insurance and reinsurance undertakings shall take into account all of the following:

(a) all financial guarantees and contractual options included in their insurance and reinsurance policies;

(b) all factors which may affect the likelihood that policy holders will exercise contractual options or realise the value of financial guarantees.

Article 33

Currency of the obligation

The best estimate shall be calculated separately for cash flows in different currencies.

Article 34

Calculation methods

1 The best estimate shall be calculated in a transparent manner and in such a way as to ensure that the calculation method and the results that derive from it are capable of review by a qualified expert.

2 The choice of actuarial and statistical methods for the calculation of the best estimate shall be based on their appropriateness to reflect the risks which affect the underlying cash flows and the nature of the insurance and reinsurance obligations. The actuarial and statistical methods shall be consistent with and make use of all relevant data available for the calculation of the best estimate.

3 Where a calculation method is based on grouped policy data, insurance and reinsurance undertakings shall ensure that the grouping of policies creates homogeneous risk groups that appropriately reflect the risks of the individual policies included in those groups.

4 Insurance and reinsurance undertakings shall analyse the extent to which the present value of cash flows depend both on the expected outcome of future events and developments and on how the actual outcome in certain scenarios could deviate from the expected outcome.

5 Where the present value of cash flows depends on future events and developments as referred to in paragraph 4, insurance and reinsurance undertakings shall use a method to calculate the best estimate for cash flows which reflects such dependencies.

Article 35

Homogeneous risk groups of life insurance obligations

The cash flow projections used in the calculation of best estimates for life insurance obligations shall be made separately for each policy. Where the separate calculation for each policy would be an undue burden on the insurance or reinsurance undertaking, it may carry out the projection by grouping policies, provided that the grouping complies with all of the following requirements:

(a) there are no significant differences in the nature and complexity of the risks underlying the policies that belong to the same group;

(b) the grouping of policies does not misrepresent the risk underlying the policies and does not misstate their expenses;

(c) the grouping of policies is likely to give approximately the same results for the best estimate calculation as a calculation on a per policy basis, in particular in relation to financial guarantees and contractual options included in the policies.

Article 36

Non-life insurance obligations

1 The best estimate for non-life insurance obligations shall be calculated separately for the premium provision and for the provision for claims outstanding.

2 The premium provision shall relate to future claim events covered by insurance and reinsurance obligations falling within the contract boundary referred to in Article 18. Cash flow projections for the calculation of the premium provision shall include benefits, expenses and premiums relating to these events.

3 The provision for claims outstanding shall relate to claim events that have already occurred, regardless of whether the claims arising from those events have been reported or not.

4 Cash flow projections for the calculation of the provision for claims outstanding shall include benefits, expenses and premiums relating to the events referred to in paragraph 3.

Subsection 4

Risk margin

Article 37

Calculation of the risk margin

1 The risk margin for the whole portfolio of insurance and reinsurance obligations shall be calculated using the following formula[F3]:

$$RM = CoC \times \sum_{t \geq 0} \frac{SCR(t) \times \max(\lambda^{t}, \lambda_{floor})}{(1 + r(t+1))^{t+1}}$$

where:

(a) *CoC* denotes the Cost-of-Capital rate;

(b) the sum covers all integers including zero;

(c) SCR(t) denotes the Solvency Capital Requirement referred to in Article 38(2) after t years;

(d) r(t + 1) denotes the basic risk-free interest rate for the maturity of t + 1 years.

(e) [F4"λ" denotes the risk tapering factor, and equals—

(i) 0.9 for life insurance and reinsurance obligations, and

(ii) 1.0 for non-life insurance and reinsurance obligations;

(f) "

λt

" denotes the risk tapering factor to the power of t years;

(g) "

$\lambda floor$

" denotes the floor of the risk tapering factor, and equals 0.25.]

The basic risk-free interest rate r(t + 1) shall be chosen in accordance with the currency used for the financial statements of the insurance and reinsurance undertaking.

2 Where insurance and reinsurance undertakings calculate their Solvency Capital Requirement using an approved internal model and determine that the model is appropriate to calculate the Solvency Capital Requirement referred to in Article 38(2) for each point in time over the lifetime of the insurance and reinsurance obligations, the insurance and reinsurance undertakings shall use the internal model to calculate the amounts *SCR*(*t*) referred to in paragraph 1.

3 Insurance and reinsurance undertakings shall allocate the risk margin for the whole portfolio of insurance and reinsurance obligations to the lines of business referred to in Article 80 of Directive 2009/138/EC. The allocation shall adequately reflect the contributions of the lines of business to the Solvency Capital Requirement referred to in Article 38(2) over the lifetime of the whole portfolio of insurance and reinsurance obligations.

Textual Amendments

F3 Art. 37(1) formula substituted (31.12.2023) by The Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 (S.I. 2023/1346), regs. 1(1), **2(2)(a)**

F4 Art. 37(1)(e)-(g) inserted (31.12.2023) by The Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 (S.I. 2023/1346), regs. 1(1), **2(2)(b)**

Article 38

Reference undertaking

1 The calculation of the risk margin shall be based on all of the following assumptions:

a the whole portfolio of insurance and reinsurance obligations of the insurance or reinsurance undertaking that calculates the risk margin (the original undertaking) is taken over by another insurance or reinsurance undertaking (the reference undertaking);

b notwithstanding point (a), where the original undertaking simultaneously pursues both life and non-life insurance activities according to Article 73(5) of Directive 2009/138/EC, the portfolio of insurance obligations relating to life insurance activities and life reinsurance obligations and the portfolio of insurance obligations relating to non-life insurance activities and non-life reinsurance obligations are taken over separately by two different reference undertakings;

c the transfer of insurance and reinsurance obligations includes any reinsurance contracts and arrangements with special purpose vehicles relating to these obligations;

d the reference undertaking does not have any insurance or reinsurance obligations or own funds before the transfer takes place;

e after the transfer, the reference undertaking does not assume any new insurance or reinsurance obligations;

f after the transfer, the reference undertaking raises eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof;

g after the transfer, the reference undertaking has assets which amount to the sum of its Solvency Capital Requirement and of the technical provisions net of the amounts recoverable from reinsurance contracts and special purpose vehicles;

h the assets are selected in such a way that they minimise the Solvency Capital Requirement for market risk that the reference undertaking is exposed to;

i the Solvency Capital Requirement of the reference undertaking captures all of the following risks:

(i) underwriting risk with respect to the transferred business,

(ii) where it is material, the market risk referred to in point (h), other than interest rate risk,

(iii) credit risk with respect to reinsurance contracts, arrangements with special purpose vehicles, intermediaries, policyholders and any other material exposures which are closely related to the insurance and reinsurance obligations,

(iv) operational risk;

j the loss-absorbing capacity of technical provisions, referred to in Article 108 of Directive 2009/138/EC, in the reference undertaking corresponds for each risk to the loss-absorbing capacity of technical provisions in the original undertaking;

k there is no loss-absorbing capacity of deferred taxes as referred to in Article 108 of Directive 2009/138/EC for the reference undertaking;

l the reference undertaking will, subject to points (e) and (f), adopt future management actions that are consistent with the assumed future management actions, as referred to in Article 23, of the original undertaking.

2 Over the lifetime of the insurance and reinsurance obligations, the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations referred to in the first subparagraph of Article 77(5) of Directive 2009/138/EC shall be assumed to be equal to the Solvency Capital Requirement of the reference undertaking under the assumptions set out in paragraph 1.

3 For the purposes of point (i) of paragraph 1, a risk shall be considered to be material where its impact on the calculation of the risk margin could influence the decision-making or the judgment of the users of that information, including supervisory authorities.

Article 39

Cost-of-Capital rate

The Cost-of-Capital rate referred to in Article 77(5) of Directive 2009/138/EC shall be assumed to be equal to **[**[F5]4%**]**.

Textual Amendments

F5 Word in Art. 39 substituted (31.12.2023) by The Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 (S.I. 2023/1346), regs. 1(1), **2(3)**

Subsection 5

Calculation of technical provisions as a whole

Article 40

Circumstances in which technical provisions shall be calculated as a whole and the method to be used

1 For the purposes of the second subparagraph of Article 77(4) of Directive 2009/138/EC, reliability shall be assessed pursuant to paragraphs 2 and 3 of this Article and technical provisions shall be valued pursuant to paragraph 4 of this Article.

2 The replication of cash flows shall be considered to be reliable where those cash flows are replicated in amount and timing in relation to the underlying risks of those cash flows and in all possible scenarios. The following cash flows associated with insurance or reinsurance obligations cannot be reliably replicated:

- a cash flows associated with insurance or reinsurance obligations that depend on the likelihood that policy holders will exercise contractual options, including lapses and surrenders;
- b cash flows associated with insurance or reinsurance obligations that depend on the level, trend, or volatility of mortality, disability, sickness and morbidity rates;
- c all expenses that will be incurred in servicing insurance and reinsurance obligations.

3 Financial instruments shall be considered to be financial instruments for which a reliable market value is observable where those financial instruments are traded on an active, deep, liquid and transparent market. Active markets shall also comply with Article 10(4).

4 Insurance and reinsurance undertakings shall determine the value of technical provisions on the basis of the market price of the financial instruments used in the replication.

Subsection 6

Recoverables from reinsurance contracts and special purpose vehicles

Article 41

General provisions

1 The amounts recoverable from reinsurance contracts and special purpose vehicles shall be calculated consistently with the boundaries of the insurance or reinsurance contracts to which those amounts relate.

2 The amounts recoverable from special purpose vehicles, the amounts recoverable from finite reinsurance contracts as referred to in Article 210 of Directive 2009/138/EC and the amounts recoverable from other reinsurance contracts shall each be calculated separately. The amounts recoverable from a special purpose vehicle shall not exceed the aggregate maximum risk exposure of that special purpose vehicle to the insurance or reinsurance undertaking.

3 For the purpose of calculating the amounts recoverable from reinsurance contracts and special purpose vehicles, cash flows shall only include payments in relation to compensation of insurance events and unsettled insurance claims. Payments in relation to other events or settled insurance claims shall be accounted for outside the amounts recoverable from reinsurance contracts and special purpose vehicles and other elements of the technical provisions. Where a deposit has been made for the cash flows, the amounts recoverable shall be adjusted accordingly to avoid a double counting of the assets and liabilities relating to the deposit.

4 The amounts recoverable from reinsurance contracts and special purpose vehicles for non-life insurance obligations shall be calculated separately for premium provisions and provisions for claims outstanding in the following manner:

a the cash flows relating to provisions for claims outstanding shall include the compensation payments relating to the claims accounted for in the gross provisions for claims outstanding of the insurance or reinsurance undertaking ceding risks;
b the cash flows relating to premium provisions shall include all other payments.

5 Where cash flows from the special purpose vehicles to the insurance or reinsurance undertaking do not directly depend on the claims against the insurance or reinsurance undertaking ceding risks, the amounts recoverable from those special purpose vehicles for future claims shall only be taken into account to the extent that it can be verified in a prudent, reliable and objective manner that the structural mismatch between claims and amounts recoverable is not material.

Article 42

Counterparty default adjustment

1 Adjustments to take account of expected losses due to default of a counterparty referred to in Article 81 of Directive 2009/138/EC shall be calculated separately from the rest of the amounts recoverable.

2 The adjustment to take account of expected losses due to default of a counterparty shall be calculated as the expected present value of the change in cash flows underlying the amounts recoverable from that counterparty, that would arise if the counterparty defaults, including as a result of insolvency or dispute, at a certain point in time. For that purpose, the change in

cash flows shall not take into account the effect of any risk mitigating technique that mitigates the credit risk of the counterparty, other than risk mitigating techniques based on collateral holdings. The risk mitigating techniques that are not taken into account shall be separately recognised without increasing the amount recoverable from reinsurance contracts and special purpose vehicles.

3 The calculation referred to in paragraph 2 shall take into account possible default events over the lifetime of the reinsurance contract or arrangement with the special purpose vehicle and whether and how the probability of default varies over time. It shall be carried out separately by each counterparty and for each line of business. In non-life insurance, it shall also be carried out separately for premium provisions and provisions for claims outstanding.

4 The average loss resulting from a default of a counterparty, referred to in Article 81 of Directive 2009/138/EC, shall not be assessed at lower than 50 % of the amounts recoverable excluding the adjustment referred to in paragraph 1, unless there is a reliable basis for another assessment.

5 The probability of default of a special purpose vehicle shall be calculated on the basis of the credit risk inherent in the assets held by the special purpose vehicle.