

Valuation of Assets and Liabilities,
Technical Provisions, Own Funds, Solvency
Capital Requirement, Minimum Capital
Requirements and Investment Rules

Chapter 5

CONTENTS

5.1.	Introduction.....	6
5.2.	Valuation of assets and liabilities	6
5.3.	Rules relating to technical provisions	6
	Calculation of technical provisions	6
	The best estimate	8
	The risk margin	8
	Risk-free interest rate term structure	9
	Matching adjustment to the relevant risk-free interest rate term structure.....	9
	Calculation of the matching adjustment	12
	Volatility adjustment to the relevant risk-free interest rate term structure	14
	Technical information	15
	Other elements to be taken into account in the calculation of technical provisions	16
	Valuation of financial guarantees and contractual options included in insurance and reinsurance contracts.....	16
	Segmentation.....	17
	Recoverables from reinsurance contracts and special purpose vehicles.....	17
	Data quality and application of approximations.....	17
	Comparison against experience.....	18
	Appropriateness of the level of technical provisions.....	18
	Increase of Technical Provisions	18
	Additional requirements for an authorised insurance undertaking carrying on long term business	18
5.4.	Own funds	19
	Determination of own funds.....	19
	Basic own funds	19
	Ancillary own funds.....	19
	Supervisory approval of ancillary own funds	19
	Surplus funds	20
	Classification of own funds.....	21
	Classification of own funds into tiers	21
	Characteristics and features used to classify own funds into tiers	22
	Classification of specific insurance own-fund items	22
	Eligibility of own funds	23
5.5.	Solvency Capital Requirement.....	24
	General provisions	24
	Calculation of the Solvency Capital Requirement	24

Capital add-on.....	26
Solvency capital requirement standard formula	26
Structure of the standard formula	26
Design of the Basic Solvency Capital Requirement.....	26
Calculation of the Basic Solvency Capital Requirement.....	28
Calculation of the equity risk sub-module and the application of the symmetric adjustment mechanism	34
Capital requirement for operational risk	35
Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes	36
Simplifications in the standard formula.....	37
Significant deviations from the assumptions underlying the standard formula calculation	37
Solvency capital requirement full and partial internal models.....	37
Applications for the approval of partial internal models.....	39
Policy for changing the full and partial internal models.....	40
Responsibilities of the Board of Directors	40
Reversion to the standard formula	41
Non-compliance of the internal model.....	41
Significant deviations from the assumptions underlying the standard formula calculation	41
Use test	41
Statistical quality standards.....	42
Calibration standards	44
Profit and loss attribution	44
Validation standards.....	45
Documentation standards.....	45
External models and data.....	46
Risk mitigation techniques	46
5.6. Minimum Capital Requirement.....	46
General provisions	46
Calculation of the Minimum Capital Requirement.....	46
Frequency and reporting in relation to the Minimum Capital Requirement	48
5.7. Investments	48
Prudent person principle: General Principles	48
Prudent Person Principle: Assets covering technical provisions	49
Prudent Person Principle: Additional Requirements for Assets covering linked long-term liabilities	49
Prudent person principle: Additional requirements where the investment risk is not borne by the policyholder.....	50
Freedom of investment.....	50
Localisation of assets and prohibition of pledging of assets	50

	Intra-company loans within a group (Intra-group Loans).....	51
5.8.	Authorised undertakings in difficulty.....	51
	Non-compliance with the Solvency Capital Requirement	51
	Recovery plan and finance scheme.....	53
5.9.	Authorised undertakings which are part of a group.....	54
5.10.	Third country insurance undertakings and third country reinsurance undertakings	54
	Technical provisions and own funds.....	54
	Solvency Capital Requirement and Minimum Capital Requirement	55
	Advantages to undertakings authorised in more than one Member State or EEA State.....	55
5.11.	Additional requirements and obligations.....	55

REVISIONS LOG

VERSION	DATE ISSUED	DETAILS
1.00	22 December 2015	Issued
2.00	25 June 2020	Refer to the Circular dated 25 th June 2020 entitled " <i>Circular on the Amendments of Chapter 5 of Part B of the Insurance Rules</i> "
3.00	23 June 2021	Refer to Circular dated 23 rd June 2021 entitled "Circular on the transposition of Directive (EU) 2019/2177"
4.00	05 August 2022	Refer to the Circular dated 05 August 2022 entitled "Circular on the amendments to the Glossary of Terms and Chapter 5 of the Insurance Rules and to the Insurance Business (Exemptions) Regulations"

5.1. Introduction

- 5.1.1 This Chapter lays down the Insurance Rules to be complied with in terms of articles 4, 14, 15, 16, 17, 18A, 18D and 18E of the Act relating to the valuation of assets and liabilities, technical provisions, own funds, Solvency Capital Requirement, Minimum Capital Requirement and investment rules “Solvency II – Pillar 1 Requirements”. An authorised insurance undertaking, an authorised reinsurance undertaking, a captive insurance undertaking and a captive reinsurance undertaking (“an authorised undertaking”) is to value its assets and liabilities in accordance with this Chapter. This Chapter also lays down Insurance Rules for the calculation of the technical provisions, the determination of own funds and the differentiation between basic own funds and ancillary own funds classifying them in different tiers. Finally, this Chapter also deals with the calculation of the Solvency Capital Requirement and the Minimum Capital Requirement and the manner in which an authorised undertaking shall invest its assets.
- 5.1.2 A third country insurance undertaking and a third country reinsurance undertaking authorised under article 7 of the Act shall be required to comply with Section 5.10 of this Chapter.

5.2. Valuation of assets and liabilities

- 5.2.1 Pursuant to article 18D of the Act, an authorised undertaking shall, except where otherwise provided for, value assets and liabilities as follows:
- (a) assets at the amount for which they could be exchanged between knowledgeable willing parties in an arm’s length transaction;
 - (b) liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm’s length transaction.
- 5.2.2 When valuing liabilities pursuant to paragraph 5.2.1(b), no adjustment shall be made to take account of the own credit standing of an authorised undertaking.

5.3. Rules relating to technical provisions

Calculation of technical provisions

- 5.3.1 In accordance with article 18E of the Act, an authorised undertaking shall establish and maintain technical provisions with respect to all of its insurance and reinsurance obligations towards policyholders and insureds of insurance or reinsurance contracts.

5.3.2 The value of technical provisions shall correspond to the current amount that an authorised undertaking would have to pay if it was to transfer its obligations immediately to another authorised undertaking or another undertaking authorised under Article 14 of the Solvency II Directive.

5.3.3 An authorised undertaking shall calculate its technical provisions:

- (a) in a way that the calculation makes use of and is consistent with the information provided by the financial markets and generally available data on underwriting risks (market consistency);
- (b) in a prudent, reliable and objective manner;
- (c) following the principles set out in paragraphs 5.3.2, 5.3.3 (a) and (b);
- (d) taking into account the principles set out in paragraphs 5.2.1 and 5.2.2; and
- (e) in accordance with paragraphs 5.3.4 to 5.3.45 of this Chapter, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 86 of the Solvency II Directive.

5.3.4 The value of technical provisions shall be equal to the sum of a best estimate and a risk margin as set out in paragraphs 5.3.7 to 5.3.9.

5.3.5 An authorised undertaking shall value the best estimate and the risk margin separately, except where paragraph 5.3.6 applies.

5.3.6 An authorised undertaking shall not value the best estimate and the risk margin separately 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 shall be determined on the basis of the market value of those financial instruments.

The best estimate

5.3.7 The best estimate shall:

- (a) correspond to the probability-weighted average of future cash-flows, taking account of the time value of money (expected present value of future cash-flows), using the relevant risk-free interest rate term structure; and
- (b) be calculated:
 - (i) based upon up-to-date and credible information and realistic assumptions;
 - (ii) using adequate, applicable and relevant actuarial and statistical methods;
 - (iii) gross, without deduction of the amounts recoverable from reinsurance contracts and reinsurance special purpose vehicles, which amounts an undertaking shall calculate separately, in accordance with paragraphs 5.3.41 to 5.3.43.

5.3.8 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 paragraph 5.3.6), shall take account of all the cash in- and out-flows required to settle the insurance and reinsurance obligations over the lifetime thereof.

The risk margin

5.3.9 The risk margin shall be such as to ensure that the value of the technical provisions is equivalent to the amount that an authorised undertaking would be expected to require in order to take over and meet the insurance and reinsurance obligations over their lifetime.

5.3.10 Where an authorised undertaking values the best estimate and the risk margin separately in accordance with paragraph 5.3.5:

- (a) the risk margin shall be calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance or reinsurance undertaking's obligations over the lifetime thereof;
- (b) the rate used in the determination of the cost of providing that amount of eligible own funds (Cost-of-Capital rate) shall be the same for all authorised undertakings, and shall be reviewed periodically;
- (c) the Cost-of-Capital rate used shall be equal to the additional rate, above the relevant risk-free interest rate, that an authorised undertaking would incur holding an amount of eligible own funds, as set out in this Chapter, equal to the Solvency Capital Requirement necessary to support insurance and reinsurance obligations over the lifetime of those obligations.

Risk-free interest rate term structure

5.3.11 The relevant risk-free interest rate term structure referred to in paragraph 5.3.7(a):

- (a) shall be consistent with the information derived from relevant financial instruments.
- (b) takes into account relevant financial instruments of those maturities where the markets for those financial instruments as well as for bonds are deep, liquid and transparent; and
- (c) shall be extrapolated for maturities where the markets for the relevant financial instruments or for bonds are no longer deep, liquid and transparent.

5.3.12 For the purposes of paragraph 5.3.11(c), the extrapolated part of the relevant risk-free interest rate term structure shall be based on forward rates converging smoothly from one or a 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.

Matching adjustment to the relevant risk-free interest rate term structure

5.3.13 An authorised undertaking may, subject to the prior approval of the competent authority apply a matching adjustment to the relevant risk-free interest rate term

structure to calculate the best estimate of a portfolio of long term insurance or reinsurance obligations, including annuities stemming from general business insurance or reinsurance contracts.

5.3.14 An authorised undertaking shall apply to the competent authority for approval to use the matching adjustment, pursuant to paragraph 5.3.13 where the following conditions are met:

- (a) the undertaking has assigned a portfolio of assets, consisting of bonds and other assets with similar cash flow characteristics, to cover the best estimate of the portfolio of insurance or reinsurance obligations;
- (b) the undertaking maintains the assignment referred to in paragraph (a) 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;
- (c) the portfolio of insurance or reinsurance obligations to which the matching adjustment is applied and the assigned portfolio of assets are identified, organised and managed separately from other activities of the undertaking;
- (d) the assigned portfolio of assets referred to in paragraph (c), cannot be used to cover losses arising from other activities of the undertaking;
- (e) the expected cash flows of the assigned portfolio of assets replicate each of the expected cash flows of the portfolio of insurance or reinsurance obligations in the same currency;
- (f) any mismatch between the expected cash flows referred to in paragraph (e) does 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;
- (g) the insurance or reinsurance contracts underlying the portfolio of insurance or reinsurance obligations do not give rise to future premium payments;

- (h) the only underwriting risks connected to the portfolio of insurance or reinsurance obligations are longevity risk, expense risk, revision risk and mortality risk;
- (i) where the underwriting risk connected to the portfolio of insurance or reinsurance obligations include mortality risk, the best estimate of the portfolio of insurance or reinsurance obligations does not increase by more than 5% under a mortality risk stress that is calibrated in accordance with paragraphs 5.5.3 to 5.5.6;
- (j) the contracts underlying the portfolio of insurance or reinsurance obligations include:
 - (i) no options for the policyholder; or
 - (ii) only a surrender option where the surrender value not exceeding the value of the assets, valued in accordance with paragraphs 5.2.1 and 5.2.2, covering the insurance or reinsurance obligations at the time the surrender option is exercised;
- (k) the cash-flows of the assigned portfolio of assets are fixed, except for a dependence on inflation, provided that those assets replicate the cash flows of the portfolio of insurance or reinsurance obligations that depend on inflation and cannot be changed by the issuers of the assets or any third parties;
- (l) the undertaking does not apply a volatility adjustment to the risk-free interest rate term structure in accordance with paragraphs 5.3.25 to 5.3.34;
- (m) the undertaking does not apply a transitional measure on the risk-free interest rates in accordance with regulation 15 of the Insurance Business (Solvency II Transitional Provisions) Regulations, 2015.

5.3.15 For the purposes of paragraphs 5.3.14 and 5.3.16, the insurance or reinsurance obligations of an insurance or reinsurance contract shall not be split into different parts when composing the portfolio of insurance or reinsurance obligations.

5.3.16 Where issuers or third parties have the right to change the cash flows of an asset, that right shall not disqualify the asset for admissibility to the assigned portfolio in accordance with paragraph 5.3.14(k), provided that the investor receives sufficient compensation to allow it to obtain the same cash flow by re-investing the compensation in assets of an equivalent or better credit quality.

5.3.17 An authorised undertaking that applies the matching adjustment to a portfolio of insurance or reinsurance obligations shall not revert back to the approach that does not include a matching adjustment.

5.3.18 Where an authorised undertaking that applies the matching adjustment is no longer able to comply with the conditions set out in paragraph 5.3.14, such undertaking shall immediately:

- (a) inform the competent authority; and
- (b) take the necessary measures to restore compliance with these conditions.

5.3.19 Where an authorised undertaking is not able to restore compliance with the conditions indicated in paragraph 5.3.14 within two months of the date of non-compliance, such undertaking shall cease to apply the matching adjustment to any of its insurance or reinsurance obligations and shall not apply the matching adjustment for a period of a further 24 months.

Calculation of the matching adjustment

5.3.20 This Section of the Chapter applies to an authorised undertaking that has been granted a matching adjustment approval by the competent authority.

5.3.21 The matching adjustment shall be calculated for each currency in accordance with the following principles:

- (a) the matching adjustment shall be equal to the difference of the following:
 - (i) 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 in accordance with paragraph 5.2.1 and 5.2.2 of the portfolio of assigned assets;

- (ii) 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 risk-free interest rate term structure;
- (b) the matching adjustment shall not include the fundamental spread reflecting the risks retained by the authorised undertaking;
- (c) notwithstanding paragraph 5.3.21(a), 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 the investment grade credit quality of the same duration and asset class;
- (d) the use of external credit assessments in the calculation of the matching adjustment shall be in line with the specifications referred to in the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 111(1)(n) of the Solvency II Directive.

5.3.22 For the purposes of paragraph 5.3.21(b), and subject to paragraph 5.3.24 the fundamental spread shall be:

- (a) equal to the sum of the following:
 - (i) the credit spread corresponding to the probability of default of the assets; and
 - (ii) the credit spread corresponding to the expected loss resulting from downgrading of the assets;
- (b) for exposures to Member States' or 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;
- (c) for assets other than exposures to Member States' or 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.

5.3.23 The probability of default referred to in paragraph 5.3.22(a)(i) shall be based on long-term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class.

5.3.24 Where no reliable credit spread can be derived from the default statistics referred to in paragraph 5.3.23, 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 paragraphs 5.3.22(b) and (c).

Volatility adjustment to the relevant risk-free interest rate term structure

5.3.25 An authorised undertaking may apply a volatility adjustment to the relevant risk-free interest rate term structure in order to calculate the best estimate referred to in paragraphs 5.3.7 and 5.3.8. Prior to the application of a volatility adjustment, the undertaking concerned shall inform the competent authority of its intention:

- (a) to apply the volatility adjustment with detailed explanations for the application and the date from which such an adjustment would apply from;
- (b) to no longer apply the volatility adjustment with detailed explanations and the date from which such an adjustment would not apply from.

5.3.26 The volatility adjustment to the relevant risk-free interest rate term structure for each relevant currency shall be based on the spread between the interest rate that could be earned from assets included in a reference portfolio for that currency and the rates of the basic risk-free interest rate term structure for that currency.

5.3.27 The reference portfolio referred to in paragraph 5.3.26 above shall be representative for the assets which are denominated in that currency and which an authorised undertaking is invested in to cover the best estimate for insurance and reinsurance obligations denominated in that currency.

5.3.28 The amount of the volatility adjustment to risk-free interest rates shall correspond to 65 % of the risk-corrected currency spread. The risk-corrected currency spread shall be calculated as the difference between the spread referred to in paragraph 5.3.26 and the portion of that spread that is attributable

to a realistic assessment of expected losses, unexpected credit risk or any other risk, of the assets.

- 5.3.29 The volatility adjustment shall apply only to the relevant risk-free interest rates of the term structure that are not derived by means of extrapolation in accordance with paragraphs 5.3.11 and 5.3.12. Where an authorised undertaking applies a volatility adjustment, the extrapolation of the relevant risk-free interest rate term structure referred to in paragraphs 5.3.11 and 5.3.12 shall be based on the risk-free interest rates adjusted with the volatility adjustment.
- 5.3.30 For each relevant country, the volatility adjustment to the risk-free interest rates referred to in paragraphs 5.3.28 and 5.3.29, for the currency of that country, shall before the application of the 65% factor, be increased by the difference between the risk-corrected country spread and twice the risk-corrected currency spread, whenever that difference is positive and the risk-corrected country spread is higher than 85 basis points.
- 5.3.31 The increased volatility adjustment referred to in paragraph 5.3.30 shall be applied to the calculation of the best estimate for insurance and reinsurance obligations of products sold in the insurance market of that country.
- 5.3.32 The risk-corrected country spread is calculated in the same way as the risk-corrected currency spread for the currency of that country, but based on a reference portfolio that is representative for the assets which authorised undertakings are invested in to cover the best estimate for insurance and reinsurance obligations of products sold in the insurance market of that country and denominated in the currency of that country.
- 5.3.33 The volatility adjustment shall not be applied with respect to insurance and reinsurance obligations where the relevant risk-free interest rate term structure to calculate the best estimate for those obligations includes a matching adjustment under paragraphs 5.3.13 to 5.3.17.
- 5.3.34 Notwithstanding paragraphs 5.5.3 to 5.5.6, the Solvency Capital Requirement shall not cover the risk of loss of basic own funds resulting from changes of the volatility adjustment.

[Technical information](#)

- 5.3.35 An authorised undertaking shall use the technical information referred to in Article 77e (1) of the Solvency II Directive, adopted by means of implementing acts of the European Commission in accordance with Article 77e (2) of the said Directive, when calculating:

- (a) the best estimate in accordance with paragraphs 5.3.4 to 5.3.10 of this Chapter;
- (b) the matching adjustment in accordance with paragraphs 5.3.21 to 5.3.24 of this Chapter;
- (c) the volatility adjustment in accordance with paragraphs 5.3.25 to 5.5.34 of this Chapter.

5.3.36 With respect to currencies and national markets, where the adjustment referred to in Article 77e(1)(c) of the Solvency II Directive is not set out in the implementing acts referred to in paragraph 5.3.35, no volatility adjustment shall be applied by an authorised undertaking to the relevant risk-free interest rate term structure to calculate the best estimate.

Other elements to be taken into account in the calculation of technical provisions

5.3.37 When calculating technical provisions, an authorised undertaking shall in addition take account of the following:

- (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 and insureds, including future discretionary bonuses, which an authorised undertaking is expected to make, whether or not those payments are contractually guaranteed, unless those payments fall under paragraph 5.4.11.

Valuation of financial guarantees and contractual options included in insurance and reinsurance contracts

5.3.38 When calculating technical provisions, an authorised undertaking shall take account of the value of financial guarantees and any contractual options included in insurance and reinsurance policies.

5.3.39 Any assumptions made by an authorised undertaking with respect to the likelihood that policy holders will exercise contractual options, including lapses and surrenders, shall:

- (a) be realistic and based on current and credible information; and
- (b) take into account, either explicitly or implicitly, of the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

Segmentation

5.3.40 When calculating its technical provisions, an authorised undertaking shall segment its insurance and reinsurance obligations into homogeneous risk groups, and as a minimum by lines of business.

Recoverables from reinsurance contracts and special purpose vehicles

5.3.41 An authorised undertaking shall calculate the amounts recoverable from reinsurance contracts, special purpose vehicles including reinsurance special purpose vehicles authorised under the Reinsurance Special Purpose Vehicles Regulations, 2016, in accordance with paragraphs 5.3.1 to 5.3.40.

5.3.42 For the purposes of paragraph 5.3.41, an authorised undertaking shall take account of the time difference between amounts becoming recoverable and the actual receipt of those amounts.

5.3.43 An authorised undertaking shall adjust the result from the calculation referred to in paragraph 5.3.41, to take into account the expected losses due to default of the counterparty. That adjustment shall 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).

Data quality and application of approximations

5.3.44 An authorised undertaking shall have internal processes and procedures in place to ensure that the data used in the calculation of their technical provisions is appropriate, complete and accurate.

5.3.45 Where, an authorised undertaking has 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 special purpose vehicles, appropriate approximations, including case-by-case approaches, may be used in the calculation of the best estimate.

Comparison against experience

- 5.3.46 An authorised undertaking shall have processes and procedures in place to ensure that best estimates and assumptions underlying the calculation of best estimates are regularly compared against experience.
- 5.3.47 Where the comparison referred to in paragraph 5.3.46 identifies that a systematic deviation exists between experience and the best estimate calculations of an authorised undertaking, the undertaking concerned shall make appropriate adjustments to the actuarial methods being used and/or the assumptions being made.

Appropriateness of the level of technical provisions

- 5.3.48 An authorised undertaking shall, upon request by the competent authority, demonstrate:
- (a) the appropriateness of the level of the undertaking's technical provisions;
 - (b) the applicability and relevance of the methods applied; and
 - (c) the adequacy of the underlying statistical data used.

Increase of Technical Provisions

- 5.3.49 Where the calculation of the technical provisions of an authorised undertaking does not comply with paragraphs 5.3.1 to 5.3.47, the competent authority shall require such undertaking to increase the amount of technical provisions so that they correspond to the level determined in those paragraphs.

Additional requirements for an authorised insurance undertaking carrying on long term business

- 5.3.50 In the case of an authorised insurance undertaking carrying on long term business, such undertaking shall ensure that premium for new business shall be sufficient, on reasonable actuarial assumptions, to enable such undertaking to meet all its commitments and, in particular, to establish adequate technical provisions. For that purpose, all aspects of the financial situation of the authorised insurance undertaking carrying on long term business may be taken into account, without the input from resources other than premiums and income earned thereon being systematic and permanent in a way that it may jeopardise the solvency of the undertaking concerned in the long term.

5.4. Own funds

5.4.1 Pursuant to article 14 of the Act, the own funds of an authorised undertaking shall comprise the sum of basic own funds and ancillary own funds.

Determination of own funds

Basic own funds

5.4.2 The basic own funds of an authorised undertaking shall consist of the following items:

- (a) the excess of assets over liabilities (valued in accordance with paragraphs 5.2.1 to 5.3.49, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 86 of the Solvency II Directive), less the amount of own shares held by the undertaking; and
- (b) subordinated liabilities.

Ancillary own funds

5.4.3 The ancillary own funds of an authorised undertaking shall consist of items (other than 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):

- (a) unpaid share capital that has not been called up;
- (b) letters of credit and guarantees;
- (c) any other legally binding commitments received by an authorised undertaking.

5.4.4 Where an item of ancillary own-funds becomes paid in or called up, it shall be treated as an asset and the item shall cease to be treated as an item of ancillary own-funds.

Supervisory approval of ancillary own funds

5.4.5 Pursuant to article 14(2) of the Act, and subject to paragraphs 5.4.6, an authorised undertaking shall apply to the competent authority for permission to take the amount of an ancillary own fund item into account.

5.4.6 Where the competent authority receives an application pursuant to paragraph 5.4.5, the competent authority shall approve either:

- (a) a monetary amount for each ancillary own-fund item; or
- (b) a method by which to determine the amount of each ancillary own-fund item, together with the amount determined in accordance with that method, for a specified period of time.

5.4.7 For each ancillary own-fund item, the competent authority shall base its approval on an assessment of the following:

- (a) the status of the counterparties concerned, in relation to their ability and willingness to pay;
- (b) the recoverability of the funds, taking account of the legal form of the ancillary own fund item, and any conditions which would prevent the item from being successfully paid in or called up;
- (c) any information on the outcome of past calls which an authorised undertaking has made for such ancillary own funds, to the extent that information can be reliably used to assess the expected outcome of future calls.

5.4.8 An authorised undertaking may only attribute an amount to an item of ancillary own funds to the extent that it:

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

5.4.9 Where an ancillary own-fund item has a fixed nominal value, the amount of that item shall be equal to its nominal value, where it appropriately reflects its loss-absorbency.

Surplus funds

5.4.10 Surplus funds shall be deemed to be accumulated profits which have not been made available for distribution to policy holders and insureds.

5.4.11 Surplus funds shall not be considered as insurance and reinsurance liabilities to the extent that they fulfil the criteria set out in paragraph 5.4.13.

Classification of own funds

5.4.12 Own-fund items shall be classified into three tiers. The classification of those items shall depend upon whether they are basic own fund or ancillary own-fund items.

5.4.13 An authorised undertaking shall only include an own fund item in Tier 1 where:

- (a) it is an item of basic own-funds; and
- (b) it substantially possesses the characteristics set out in paragraphs 5.4.18(a) and 5.4.18(b), taking into consideration the features set out in paragraph 5.4.19.

5.4.14 An authorised undertaking shall only include an own funds item in Tier 2 where it is an item of:

- (a) basic own-funds, and it substantially possesses the characteristics set out in paragraph 5.4.18(b), taking into consideration the features set out in paragraphs 5.4.19;
- (b) ancillary own-funds, and it substantially possesses the characteristics set out in paragraphs 5.4.18(a) and 5.4.18(b), taking into consideration the features set out in paragraphs 5.4.19.

5.4.15 An authorised undertaking shall only include in Tier 3 an item of:

- (a) a basic own-fund item which does not fall under paragraphs 5.4.13 and 5.4.14(a); and
- (b) an ancillary own-fund item which does not fall under paragraph 5.4.14(b).

Classification of own funds into tiers

5.4.16 When classifying its own funds items, an authorised undertaking shall refer to the list of own fund items set out in Section 2, Chapter IV of the EU Commission Delegated Regulation.

5.4.17 Where an own-fund item is not covered by the list referred to in paragraph 5.4.16, an authorised undertaking shall:

(a) classify such own fund item in accordance with the criteria laid down in paragraphs 5.4.13 to 5.4.15; and

(b) apply to the competent authority to approve the classification of own funds.

Characteristics and features used to classify own funds into tiers

5.4.18 The characteristics referred to in paragraphs 5.4.13(b) and 5.4.14 are the following:

(a) 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

(b) 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 towards policy holders and insureds of insurance and reinsurance contracts, have been met (subordination).

5.4.19 When assessing the extent to which own-fund items possess the characteristics set out in paragraph 5.4.18, currently and in the future, an authorised undertaking shall consider:

(a) the duration of the item, in particular whether the item is dated or not, and where an own-fund item is dated, the relative duration of the item as compared to the duration of the insurance and reinsurance obligations of the undertaking shall be considered (sufficient duration);

(b) whether the item is free from requirements or incentives to redeem the nominal sum (absence of incentives to redeem);

(c) whether the item is free from mandatory fixed charges (absence of mandatory servicing costs); and

(d) whether the item is clear of encumbrances (absence of encumbrances).

Classification of specific insurance own-fund items

5.4.20 Without prejudice to paragraphs 5.4.16 and 5.4.17, the EU Commission Delegated Regulation and any regulatory technical standards issued pursuant to

Article 97(1) of the Solvency II Directive, the following classifications shall be applied:

- (a) surplus funds falling under paragraph 5.4.11 shall be classified in Tier 1;
- (b) letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council of 26th June 2013, shall be classified in Tier 2.

Eligibility of own funds

Eligibility and limits applicable to Tiers

5.4.21 As far as the compliance with the Solvency Capital Requirement is concerned, at least the following conditions shall be met:

- (a) more than one third of the eligible own funds of the authorised undertaking is accounted for by Tier 1 own funds;
- (b) less than one third of the eligible own funds of the authorised undertaking is accounted for by Tier 3 own funds.

5.4.22 As far as compliance with the Minimum Capital Requirement is concerned, as a minimum, more than 50% of the eligible basic own funds of the authorised undertaking must be accounted for by Tier 1 own funds.

5.4.23 The eligible amount of own funds to cover the Solvency Capital Requirement referred to in article 15 of the Act shall be equal to the sum of:

- (a) the amount of Tier 1;
- (b) the eligible amount of Tier 2; and
- (c) the eligible amount of Tier 3.

5.4.24 The eligible amount of basic own funds to cover the Minimum Capital Requirement referred to in article 17 of the Act shall be equal to the sum of:

- (a) the amount of Tier 1; and
- (b) the eligible amount of basic own-fund items classified in Tier 2.

5.5. Solvency Capital Requirement

General provisions

5.5.1 In terms of article 15 of the Act, an authorised undertaking shall hold eligible own funds covering the Solvency Capital Requirement.

Calculation of the Solvency Capital Requirement

5.5.2 An authorised undertaking shall calculate its Solvency Capital Requirement:

- (a) in accordance with the standard formula;
- (b) by using a full internal model approved by the competent authority; or
- (c) by using a partial internal model approved by the competent authority and the standard formula.

5.5.3 An authorised undertaking shall calculate its Solvency Capital Requirement on the presumption that the undertaking will pursue its business as a going concern.

5.5.4 The Solvency Capital Requirement of an authorised undertaking:

- (a) shall be calibrated so as to ensure that all quantifiable risks to which the undertaking is exposed are taken into account;
- (b) shall cover at least the following risks:
 - (i) non-life underwriting risk,
 - (ii) life underwriting risk,
 - (iii) health underwriting risk,
 - (iv) market risk,
 - (v) credit risk, and
 - (vi) operational risk; and

(c) shall cover the new business expected to be written over the following 12 months and the unexpected losses with respect to the existing business.

5.5.5 The Solvency Capital Requirement of an authorised undertaking shall correspond to the Value-at-Risk of the basic own funds of an authorised undertaking subject to a confidence level of 99.5 % over a one-year period.

5.5.6 When calculating the Solvency Capital Requirement, an authorised undertaking shall take account of the effect of risk-mitigation techniques, provided that credit risk and other risks arising from the use of such techniques are properly reflected in the Solvency Capital Requirement.

5.5.7 Notwithstanding paragraphs 5.5.2 to 5.5.6, the Solvency Capital Requirement of an authorised undertaking shall not cover the risk of loss of basic own funds resulting from changes of the volatility adjustment.

Frequency of calculation

5.5.8 An authorised undertaking shall calculate its Solvency Capital Requirement and report the result of that calculation to the competent authority at least once a year.

5.5.9 An authorised undertaking shall hold eligible own funds which cover its last reported Solvency Capital Requirement.

5.5.10 An authorised undertaking shall monitor the amount of eligible own funds and its Solvency Capital Requirement on an ongoing basis.

5.5.11 If the risk profile of an authorised undertaking deviates significantly from the assumptions underlying its last reported Solvency Capital Requirement, the undertaking concerned shall recalculate its Solvency Capital Requirement without delay and report it to the competent authority.

5.5.12 Where there is evidence to suggest that the risk profile of an authorised undertaking has altered significantly since the date on which the Solvency Capital Requirement was last reported by the undertaking, where so requested by the competent authority, the undertaking shall recalculate its Solvency Capital Requirement.

Capital add-on

5.5.13 In the circumstances referred to in paragraph 5.5.12, where the risk profile of an authorised undertaking has altered significantly, and pursuant to article 31C(1)(a) of the Act, the competent authority has imposed on the undertaking a capital add-on, it shall make every effort to remedy the deficiencies that led to the imposition of a capital add-on in accordance with article 31C(3) of the Act.

5.5.14 Except as provided for in paragraph 5.5.15 and in accordance with article 31C(5) of the Act, the Solvency Capital Requirement of an authorised undertaking for the purposes of paragraph 5.5.13 shall be composed of:

- (a) the Solvency Capital Requirement before the imposition of the capital add-on; and
- (b) the amount of the capital add-on imposed by the competent authority.

5.5.15 The Solvency Capital Requirement of an authorised undertaking shall not include any capital add-on imposed by the competent authority in accordance with article 31(C)(1)(c) of the Act, for the purposes of calculating the risk margin referred to in paragraph 5.3.9.

Solvency capital requirement standard formula

Structure of the standard formula

5.5.16 When an authorised undertaking is calculating its Solvency Capital Requirement, on the basis of the standard formula, its Solvency Capital Requirement shall be the sum of the following items:

- (a) the Basic Solvency Capital Requirement, as laid down paragraphs 5.5.17 to 5.5.26;
- (b) the capital requirement for operational risk, as laid down in paragraphs 5.5.46 to 5.5.48;
- (c) the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, as laid down in paragraphs 5.5.49 and 5.5.50.

Design of the Basic Solvency Capital Requirement

5.5.17 For the purposes of calculating its Basic Solvency Capital Requirement an authorised undertaking shall:

(a) calculate the capital requirements for the following risk modules:

(i) non-life underwriting risk;

(ii) life underwriting risk;

(iii) health underwriting risk;

(iv) market risk; and

(v) counterparty default risk.

(b) aggregate the capital requirements referred to in paragraph (a) in accordance with the following formula:

$$\text{Basic Solvency Capital Requirement} = \sqrt{\sum_{i,j} \text{Corr}_{i,j} \times \text{SCR}_i \times \text{SCR}_j}$$

where:

(i) 'SCR_i' and 'SCR_j' 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;

(ii) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'; and

(iii) the factor 'Corr_{i,j}' denotes the item set out in row 'i' and column 'j' of the following correlation matrix:

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

5.5.18 For the purposes of calculating the capital requirements referred to in paragraphs 5.5.17(a) (i), (ii) and (iii) for the non-life underwriting risk, the life

underwriting risk, and the health underwriting risk, an undertaking shall allocate its insurance or reinsurance operations to the underwriting risk module that best reflects the technical nature of the underlying risks.

5.5.19 The correlation coefficients for the aggregation of the risk modules referred to in paragraph 5.5.17, as well as the calibration of the capital requirements for each risk module, shall result in an overall Solvency Capital Requirement which complies with the principles set out in paragraphs 5.5.3 to 5.5.6.

5.5.20 Each of the risk modules referred to above shall be calibrated using a Value-at-Risk measure, with a 99.5% confidence level, over a one-year period.

5.5.21 Where appropriate, diversification effects shall be taken into account in the design of each risk module.

5.5.22 The same design and specifications for the risk modules shall be used for all authorised undertakings, both with respect to the Basic Solvency Capital Requirement and to any simplified calculations as laid down in paragraphs 5.5.51 and 5.5.52.

5.5.23 With regard to risks arising from catastrophes, geographical specifications may, where appropriate, be used for the calculation of the life, non-life and health underwriting risk modules.

5.5.24 The authorised undertaking may, subject to approval by the competent authority, replace a subset of its parameters, within the design of the standard formula, by parameters specific to the authorised undertaking when calculating the life, non-life and health underwriting risk modules.

5.5.25 The parameters referred in paragraph 5.5.24 above, shall be calibrated on the basis of either the internal data of the authorised undertaking, or of data which is directly relevant for the operations of that undertaking using standardised methods.

5.5.26 The competent authority shall verify the completeness, accuracy and appropriateness of the data used, when granting approval.

Calculation of the Basic Solvency Capital Requirement

5.5.27 The Basic Solvency Capital Requirement shall be calculated in accordance with paragraphs 5.5.28 to 5.5.38 below.

5.5.28 For the purposes of the Basic Solvency Capital Requirement, an authorised undertaking shall calculate the capital requirement for the non-life underwriting risk module so that it:

- (a) reflects the risk arising from non-life insurance obligations, in relation to the perils covered and the processes used in the conduct of business; and
- (b) take account of the uncertainty in the results of an authorised undertaking related to the existing insurance and reinsurance obligations as well as to the new business expected to be written over the following 12 months.

5.5.29 The non-life underwriting risk module shall be calculated in accordance with the following formula:

$$SCR_{\text{non-life}} = \sqrt{\sum_{i,j} \text{Corr}_{i,j} \times SCR_i \times SCR_j}$$

where:

- (a) 'SCR_i' and 'SCR_j' denote the non-life premium and reserve risk sub-module and the non-life catastrophe risk sub-module; and
- (b) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'.

5.5.30 For the purposes of the non-life underwriting risk module referred to in paragraph 5.5.17(a)(i) and in accordance with paragraph 5.5.28, the non-life underwriting risk module is a combination of the capital requirements for at least the following sub-modules:

- (a) 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 (non-life premium and reserve risk);
- (b) 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 (non-life catastrophe risk).

5.5.31 For the purposes the life underwriting risk module referred to in paragraph 5.5.17(a)(ii), and in accordance with paragraph 5.5.32, an authorised undertaking shall calculate the capital requirement for the life underwriting risk module so as to reflect the risk arising from life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.

5.5.32 The life underwriting risk module shall be calculated as:

(a) a combination of the capital requirements for the following risk sub-modules:

- (i) mortality risk;
- (ii) longevity risk;
- (iii) disability-morbidity risk;
- (iv) life expense risk;
- (v) revision risk;
- (vi) lapse risk; and
- (vii) life catastrophe risk;
- (viii) aggregated in accordance with the following formula:

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

where:

- (i) 'SCR_i' and 'SCR_j' 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
- (ii) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'.

5.5.33 The life underwriting risk is a combination of at least the following risk sub-modules:

- (a) 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 (mortality risk);

- (b) 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 (longevity risk); 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 (disability – morbidity risk);
- (c) 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 insurance or reinsurance contracts (life-expense risk);
- (d) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations 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 (revision risk);
- (e) 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 (lapse risk);
- (f) 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 (life-catastrophe risk).

5.5.34 For the purposes of the health underwriting risk module referred to in paragraph 5.5.17(a)(iii):

- (a) an authorised undertaking shall reflect the risk arising from the 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
- (b) the health underwriting risk module shall cover at least the risk of loss, or of adverse change in the value of insurance liabilities, resulting from:
 - (i) changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts;

- (ii) fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of claim settlements at the time of provisioning; and
- (iii) 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.

5.5.35 For the purposes of the market risk module referred to in paragraph 5.5.17(a)(iv), the capital requirement for the market risk module should reflect 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 undertaking and properly reflect the structural mismatch between assets and liabilities, in particular with respect to the duration thereof.

5.5.36 The market risk module shall be calculated in accordance with the following formula:

$$SCR_{\text{market}} = \sqrt{\sum_{i,j} \text{Corr}_{i,j} \times SCR_i \times SCR_j}$$

where:

- (a) 'SCR_i' and 'SCR_j' denote the interest rate risk sub-module, equity risk sub-module, property risk sub-module, spread risk sub-module, market risk concentrations sub-module and currency risk sub-module; and
- (b) 'i,j' means that the sum of the different terms should cover all possible combinations of 'i' and 'j'.

5.5.37 For the purposes of paragraph 5.5.35, the capital requirements for the market risk module is a combination of the capital requirements for at least the following sub-modules:

- (a) 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 (interest rate risk);
- (b) 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 (equity risk);

- (c) 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 (property risk);
- (d) 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 (spread risk);
- (e) the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of currency exchange rates (currency risk);
- (f) additional risks to an insurance or reinsurance undertaking 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 (market risk concentrations).

5.5.38 For the purposes of the counterparty default risk module referred to in paragraph 5.5.17(a)(v), the counterparty default risk module shall:

- (a) reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of the authorised undertaking over the following 12 months;
- (b) 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;
- (c) take appropriate account of collateral or other security held by or for the account of the authorised undertaking and the associated risks;
- (d) for each counterparty, the counterparty default risk module shall take account of the overall counterparty risk exposure of the undertaking concerned to that counterparty, irrespective of the legal form of its contractual obligations to that undertaking.

Calculation of the equity risk sub-module and the application of the symmetric adjustment mechanism

5.5.39 For the purposes of calculating the equity risk sub-module referred to in paragraph 5.5.37(b) in accordance with the standard formula, an authorised undertaking shall include a symmetric adjustment to the equity capital charge to cover the risk arising from changes in the level of equity prices.

5.5.40 The symmetric adjustment made to the standard equity capital charge, calibrated in accordance with paragraphs 5.5.20 and 5.5.21 covering the risk arising from changes in the level of equity prices shall be based on a function of the current level of an appropriate equity index and a weighted average level of that index. The weighted average shall be calculated over an appropriate period of time which shall be the same for all authorised undertakings.

5.5.41 The symmetric adjustment made to the standard equity capital charge covering the risk arising from changes in the level of equity prices shall not result in an equity capital charge being applied that is more than 10 percentage points lower or 10 percentage points higher than the standard equity capital charge.

5.5.42 An authorised insurance undertaking carrying on long term business providing:

- (a) occupational retirement provision business in accordance with Article 4 of Directive 2003/41/EC,
- (b) retirement benefits paid by reference to reaching, or the expectation of reaching retirement where the premiums paid for those benefits provide a tax deduction to policyholders in accordance with Maltese law,

where:

- (i) all assets and liabilities corresponding to the business are ring-fenced, managed and organised separately from the other activities of the undertaking, without any possibility of transfer;
- (ii) the activities of the undertaking referred to in paragraphs 5.5.42(a) and 5.5.42(b) are only carried out in Malta; and
- (iii) the average duration of the liabilities corresponding to the business held by the undertaking exceeds an average of 12 years,

shall, subject to the prior approval of the competent authority, apply an equity risk sub-module of the Solvency Capital Requirement.

5.5.43 Pursuant to paragraph 5.5.42, an authorised undertaking which applies an equity risk sub-module of a Solvency Capital Requirement is to be calibrated by using a Value-at-Risk measure over a time period, which is consistent with the typical holding period of equity investments for the undertaking concerned, with a confidence level providing the policy holders and beneficiaries with a level of protection equivalent to that set out in paragraphs 5.5.3 to 5.5.6, where the approach provided for in paragraphs 5.5.42 to 5.5.44 is used only in respect of those assets and liabilities referred to in paragraph 5.5.42(i). In the calculation of the Solvency Capital Requirement those assets and liabilities shall be fully considered for the purpose of assessing the diversification effects, without prejudice to the need to safeguard the interests of policyholders and beneficiaries in other Member States.

5.5.44 The competent authority shall approve that an authorised insurance undertaking referred to in paragraph 5.5.42 uses the approach referred to in paragraph 5.5.43 only where the solvency and liquidity position as well as the strategies, processes and reporting procedures of the undertaking concerned with respect to asset-liability management are such as to ensure, on an ongoing basis, that it is able to hold equity investments for a period which is consistent with the typical holding period of equity investments for the undertaking concerned. The undertaking shall be able to demonstrate to the competent authority that the condition is verified with the level of confidence necessary to provide policyholders and beneficiaries with a level of protection equivalent to that set out in paragraphs 5.5.3 to 5.5.6.

5.5.45 An authorised insurance undertaking referred to in paragraph 5.5.42 which has applied the equity risk sub-module of the Solvency Capital Requirement shall only revert to applying the approach set out in paragraphs 5.5.27 to 5.5.38 in duly exceptional circumstances after obtaining the approval of the competent authority.

Capital requirement for operational risk

5.5.46 The capital requirement for operational risk shall:

- (a) reflect the operational risks of the undertaking to the extent they are not already reflected in the risk modules comprising the Basic Solvency Capital Requirement; and
- (b) be calibrated in accordance with paragraphs 5.5.4 and 5.5.5.

5.5.47 With respect to long term insurance contracts, where the investment risk is borne by the policy holders, the calculation of the capital requirement for operational

risk shall take account of the amount of annual expenses incurred in respect of those insurance obligations.

5.5.48 With respect to insurance and reinsurance operations, other than those referred to in paragraph 5.5.47, when calculating the capital requirement for operational risk an authorised undertaking shall:

- (a) take account of the volume of those operations, in terms of earned premiums and technical provisions which are held in respect of those insurance and reinsurance obligations; and
- (b) not exceed 30 % of the Basic Solvency Capital Requirement relating to those insurance and reinsurance operations.

Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes

5.5.49 The adjustment for the loss-absorbing capacity of technical provisions and deferred taxes referred to in paragraph 5.5.16(c) shall:

- (a) reflect potential compensation of unexpected losses through a simultaneous decrease in technical provisions or deferred taxes, or a combination of the two; and
- (b) take account of the risk mitigating effect provided by future discretionary benefits of insurance contracts.

5.5.50 For the purposes of paragraph 5.5.49:

- (a) an authorised undertaking shall 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;
- (b) the risk mitigating effect provided by future discretionary benefits shall be no higher than the sum of technical provisions and deferred taxes relating to those future discretionary benefits; and
- (c) the value of future discretionary benefits under adverse circumstances shall be compared to the value of such benefits under the underlying assumptions of the best estimate calculation.

Simplifications in the standard formula

5.5.51 An authorised undertaking may use a simplified calculation for a specific risk sub-module or risk module where the nature, scale and complexity of the risks it faces justifies it and where it would be disproportionate to require an authorised undertaking to apply the standardised calculation.

5.5.52 An authorised undertaking shall calibrate its simplified calculation in accordance with paragraphs 5.5.4 and 5.5.5.

Significant deviations from the assumptions underlying the standard formula calculation

5.5.53 The competent authority may, where it is inappropriate for an authorised undertaking to calculate the Solvency Capital Requirement in accordance with the standard formula as set out in paragraphs 5.5.17 to 5.5.52, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 111 of the Solvency II Directive because the risk profile of the authorised undertaking deviates significantly from the assumptions underlying the standard formula calculation and by means of a decision stating the authority's reasons, require the undertaking concerned to replace a subset of the parameters used in the standard formula calculation by parameters specific to that undertaking when calculating the life, non-life and health underwriting risk modules, as set out in paragraphs 5.5.24 and 5.5.25. Those specific parameters shall be calculated in such a way to ensure that the undertaking complies with paragraphs 5.5.4(a), 5.5.4(c) and 5.5.5.

Solvency capital requirement full and partial internal models

General Provisions for the approval of full and partial internal models

5.5.54 An authorised undertaking shall apply to the competent authority for the approval of:

- (a) the calculation of the Solvency Capital Requirement using a full or partial internal model;
- (b) major changes to an approved internal model, in accordance with the Commission Implementing Regulation (EU) 2015/460¹; or

¹ Commission Implementing Regulation (EU) 2015/460 of 19 March 2015 laying down implementing technical standards with regard to the procedure concerning the approval of an internal model in accordance with Directive 2009/138/EC of the European Parliament and of the Council.

- (c) the policy for changing an approved internal model in accordance with the Commission Implementing Regulation (EU) 2015/460.

5.5.55 An authorised undertaking which has been granted internal model approval shall calculate its Solvency Capital Requirement using the internal model for which an internal model approval has been granted.

5.5.56 An authorised undertaking shall apply to the competent authority pursuant to paragraph 5.5.54 to use a partial internal model, which may be applied to the whole or to only one or more major business units, for the calculation of one or more of the following:

- (a) one or more risk modules, or sub-modules, of the Basic Solvency Capital Requirement, as set out in paragraphs 5.5.17 to 5.5.38;
- (b) the capital requirement for operational risk as set out in paragraphs 5.5.46 to 5.5.48;
- (c) the adjustment referred to in paragraphs 5.5.49 to 5.5.50.

5.5.57 Where an authorised undertaking applies to the competent authority pursuant to paragraph 5.5.54, such undertaking shall submit as a minimum:

- (a) documentary evidence that the internal model fulfils the requirements set out in paragraphs 5.5.72 to 5.5.92;
- (b) the requirements set out in paragraphs 5.5.72 to 5.5.92, where the application relates to a partial internal model, adapted to take account of the limited scope of the application of the model.

5.5.58 Where an authorised undertaking submits an application in accordance with paragraph 5.5.54, the competent authority shall:

- (a) only approve such application where it is satisfied that:
 - (i) the systems of the undertaking for identifying, measuring, monitoring, managing and reporting risk are adequate; and
 - (ii) in particular that the internal model fulfils the requirements referred to in paragraph 5.5.57;
- (b) give a decision on an application within six months of receiving a completed application;

- (c) where it decides to reject that application, state the reasons on which it is based;
- (d) after having approved such application, require the authorised undertaking to provide an estimate of the Solvency Capital Requirement determined in accordance with the standard formula, as set out in paragraphs 5.5.16 to 5.5.52, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 111 of the Solvency II Directive.

5.5.59 Where the competent authority receives an application from an authorised undertaking to use or change an internal model, the competent authority shall inform EIOPA in accordance with Article 35(1) of Regulation (EU) No 1094/2010. The competent authority may request EIOPA to provide further technical assistance with respect to the decision on the application, in accordance with Article 8(1)(b) of Regulation (EU) No 1094/2010.

Applications for the approval of partial internal models

5.5.60 An authorised undertaking submitting an application to use a partial internal model shall, in addition to the requirements set out in paragraph 5.5.57(b):

- (a) explain and properly justify, the reason for the limited scope of application of the internal model;
- (b) explain how the resulting Solvency Capital Requirement reflects more appropriately the risk profile of the undertaking and in particular complies with the principles set out in paragraphs 5.5.1 to 5.5.12;
- (c) demonstrate that the design of its partial internal model is consistent with the principles set out in paragraphs 5.5.1 to 5.5.12, so as to fully integrate the partial internal model into the standard formula.

5.5.61 The competent authority may when assessing an application of an authorised undertaking 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 an undertaking with respect to a specific risk module, or parts of both, require the undertaking concerned to submit a realistic transitional plan to extend the scope of the proposed partial internal model.

² Regulation (EU) no 1094/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision no 716/2009/EC and repealing Commission Decision 2009/79/EC

5.5.62 The realistic transitional plan referred to in paragraph 5.5.60 shall set out the manner in which an authorised undertaking plans to extend the scope of the proposed partial internal model to other sub-modules or business units of the undertaking, in order to ensure that the model covers a predominant part of the insurance operations of an authorised undertaking with respect to that specific risk module.

Policy for changing the full and partial internal models

5.5.63 As part of the initial approval process of an internal model, the competent authority shall approve the policy for changing the model of an authorised undertaking. An authorised undertaking which has received approval for its internal model shall not change its internal model other than in accordance with the undertaking's internal model change policy.

5.5.64 The internal model change policy of an authorised undertaking shall include a specification of minor and major changes to the internal model.

5.5.65 An authorised undertaking which has received an approval for an internal model shall not:

- (a) make any major change to its internal model; or
- (b) make any change to its internal model change policy;

without obtaining the prior approval of the competent authority, as laid down in paragraphs 5.5.54 to 5.5.58.

5.5.66 For the avoidance of doubt, minor changes to the internal model shall not be subject to the prior approval of the competent authority, insofar as they are developed in accordance with that policy.

Responsibilities of the Board of Directors

5.5.67 The Board of Directors of an authorised undertaking shall approve the application for approval:

- (a) of the internal model referred to in paragraphs 5.5.54 to 5.5.58; and
- (b) for a major change to its internal model, which is the subject of an internal model approval, prior to submission to the competent authority.

5.5.68 The Board of Directors of an authorised undertaking shall be responsible for putting in place systems which ensure that the internal model of the undertaking operates properly on a continuous basis.

Reversion to the standard formula

5.5.69 An authorised undertaking with an approved internal model shall not revert to calculating the whole or any part of the Solvency Capital Requirement in accordance with the standard formula, except in duly justified circumstances and subject to the approval of the competent authority.

Non-compliance of the internal model

5.5.70 Where an authorised undertaking with an internal model, approved by the competent authority, ceases to comply with the requirements set out in paragraphs 5.5.72 to 5.5.92 such undertaking shall, without delay, either submit to the competent authority a plan to restore compliance within a reasonable period of time, or demonstrate to the competent authority that the effect of non-compliance is immaterial.

5.5.71 Where an authorised undertaking fails to implement the plan to restore compliance referred to in paragraph 5.5.69, the competent authority may require the undertaking to revert to calculating the Solvency Capital Requirement in accordance with the standard formula as set out in paragraphs 5.5.16 to 5.5.52, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 111 of the Solvency II Directive.

Significant deviations from the assumptions underlying the standard formula calculation

5.5.72 Where it is inappropriate for an authorised undertaking to calculate the Solvency Capital Requirement in accordance with the standard formula because the risk profile of the undertaking concerned deviates significantly from the assumptions underlying the standard formula calculation, the competent authority may, by means of a decision stating the reasons, require the undertaking concerned to use an internal model to calculate the Solvency Capital Requirement, or the relevant risk modules of the Solvency Capital Requirement.

Use test

5.5.73 An authorised undertaking shall demonstrate that its internal model is widely used in and plays an important role in its system of governance, referred to in

article 18I of the Act and Chapter 6 in Part B of these Insurance Rules in particular in the undertaking's:

- (a) risk-management system as laid down in paragraphs 6.3.1 to 6.3.9 of Chapter 6 in Part B of these Insurance Rules, and their decision-making processes;
- (b) economic and solvency capital assessment and allocation processes, including the assessment referred to in paragraphs 6.4.1 to 6.4.7 of Chapter 6 in Part B of these Insurance Rules.

5.5.74 An authorised undertaking shall also demonstrate that the frequency of calculation of its Solvency Capital Requirement using the internal model is consistent with the frequency with which it uses its internal model for the purposes set out in paragraph 5.5.72.

5.5.75 The Board of Directors shall be responsible for ensuring the ongoing appropriateness of the design and operations of the internal model of the authorised undertaking, and that the internal model continues to appropriately reflect the risk profile of the undertaking concerned.

Statistical quality standards

5.5.76 An authorised undertaking shall ensure that its internal model, and in particular, the calculation of the probability distribution forecast underlying it, complies with the criteria set out in paragraphs 5.5.76 to 5.5.82.

5.5.77 The methods used to calculate the probability distribution forecast shall be:

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

5.5.78 An authorised undertaking shall be able to justify the assumptions underlying its internal model to the competent authority.

5.5.79 The data used for the internal model shall be accurate, complete and appropriate. An authorised undertaking shall update the data sets used in the calculation of the probability distribution forecast at least annually.

5.5.80 No particular method for the calculation of the probability distribution forecast shall be determined by this Chapter. Irrespective of the method chosen by the authorised undertaking to calculate the probability distribution forecast, the ability of the internal model to rank risk shall be sufficient to ensure that it is widely used in and plays an important role in the system of governance of an authorised undertaking, in particular its risk-management system and decision-making processes, and capital allocation in accordance with paragraphs 5.5.72 to 5.5.74.

5.5.81 The internal model shall cover all of the material risks to which an authorised undertaking is exposed, including at least, the risks set out in paragraph 5.5.4(b).

5.5.82 An authorised undertaking's internal model may take into account:

- (a) the dependencies within and across risk categories when calculating the diversification effects within the internal model, provided that the competent authority is satisfied that the undertaking's system used for measuring those diversification effects is adequate;
- (b) 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 internal model; and
- (c) future management actions that the undertaking would reasonably expect to carry out in specific circumstances and make allowance for this in its internal model for the time necessary to implement such actions.

5.5.83 In its internal model, an authorised undertaking shall:

- (a) accurately assess:
 - (i) the particular risks associated with financial guarantees and any contractual options where material; and
 - (ii) the risks associated with both policyholder options and the undertaking'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;

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

Calibration standards

- 5.5.84 An authorised undertaking may use for internal modelling purposes, a different time period or risk measure than that set out in paragraphs 5.5.4(a), 5.5.4(c) and 5.5.5 only where the outputs of the internal model can be used by the undertaking to calculate the Solvency Capital Requirement in a manner that provides policyholders and insureds with a level of protection equivalent to that set out in paragraphs 5.5.3 to 5.5.6.
- 5.5.85 An authorised undertaking shall, whenever practicable, derive the Solvency Capital Requirement directly from the probability distribution forecast generated by the internal model of that undertaking, using the Value-at-Risk measure set out in paragraph 5.5.5.
- 5.5.86 Where an authorised undertaking cannot derive the Solvency Capital Requirement directly from the probability distribution forecast generated by its internal model, the competent authority may allow approximations to be used in the process to calculate the Solvency Capital Requirement.
- 5.5.87 In considering such an application, an authorised undertaking shall demonstrate to the competent authority that it can provide its policyholders with a level of protection equivalent to that provided for in the Solvency Capital Requirement in accordance with paragraphs 5.5.3 to 5.5.6.
- 5.5.88 When required to do so by the competent authority, an authorised undertaking shall run its internal model on relevant benchmark portfolios and 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.

Profit and loss attribution

- 5.5.89 An authorised undertaking which has an internal model shall:
- (a) review, at least annually, the causes and sources of profits and losses for each major business unit;
 - (b) demonstrate how the categorisation of risk chosen in its internal model explains the causes and sources of profits and losses; and

- (c) that its categorisation of risk and attribution of profits and losses reflect the risk profile of the undertaking.

Validation standards

5.5.90 An authorised undertaking shall 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 undertaking to demonstrate to the competent authority 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.

5.5.91 The statistical methods applied for the purposes of paragraph 5.5.89(b) shall test the appropriateness of the probability distribution forecast compared to loss experience and to all material new data and information relating thereto.

Documentation standards

5.5.92 An authorised undertaking shall document the design and operational details of its internal model.

5.5.93 The documentation referred to in paragraph 5.5.91 shall:

- (a) demonstrate compliance with paragraphs 5.5.72 to 5.5.90 provide a detailed outline of the theory, assumptions, and mathematical and empirical bases underlying the internal model;
- (b) indicate any circumstances under which the internal model does not work effectively; and

- (c) include all major changes to their internal model, as set out in paragraphs 5.5.62 to 5.5.65.

External models and data

5.5.94 The internal model requirements apply regardless of whether an authorised undertaking uses in its internal model, a model or data obtained from a third party.

Risk mitigation techniques

5.5.95 An authorised insurance undertaking shall not take into account risk mitigation clauses and/or techniques in relation to the obligation to pay a claim where a reinsurance undertaking defaults, which disproportionately reduces the counterparty default risk on the exposure of a reinsurance undertaking, for the purposes of calculating the Solvency Capital Requirement.

5.6. Minimum Capital Requirement

General provisions

5.6.1 Pursuant to article 17 of the Act, an authorised undertaking shall hold eligible basic own funds, to cover the Minimum Capital Requirement.

Calculation of the Minimum Capital Requirement

5.6.2 The Minimum Capital Requirement of an authorised undertaking shall:

- (a) be calculated in a clear and simple manner, and in such a way as to ensure that the calculation can be audited; and
- (b) correspond to an amount of eligible basic own funds below which policy holders and insureds are exposed to an unacceptable level of risk where such undertaking is allowed to continue its operations.

5.6.3 The linear function referred to in paragraph 5.6.5 used to calculate the Minimum Capital Requirement of an authorised undertaking shall be calibrated to the Value-at-Risk of its basic own funds subject to a confidence level of 85 % over a one-year period.

5.6.4 The Minimum Capital Requirement of an authorised undertaking shall have an absolute floor of:

- (a) € 2,700,000* for an authorised undertaking carrying on direct general business, including a captive insurance undertaking, except in the case where all or some of the risks included in one of the classes 10 to 15 specified in Part I of the Third Schedule to the Act are covered, in which case it shall be no less than € 4,000,000*,
- (b) € 4,000,000* for an authorised undertaking carrying on direct long term business, including a captive insurance undertaking,
- (c) € 3,900,000* for an authorised undertaking carrying on business restricted to reinsurance, except in the case of a captive reinsurance undertaking in which case the Minimum Capital Requirement shall be no less than € 1,300,000*,
- (d) the sum of the amounts set out in points paragraphs 5.6.4(a) and (b) for an authorised insurance undertaking authorised to carry on both long term and general business as referred to in article 9 of the Act.

5.6.5 Subject to paragraph 5.6.6, the Minimum Capital Requirement of an authorised undertaking shall be calculated as a linear function of a set or sub-set of the following variables: the undertaking's technical provisions, written premiums, capital-at-risk, deferred tax and administrative expenses. The variables used shall be measured net of reinsurance.

5.6.6 Without prejudice to the requirements on the absolute floor set out in paragraph 5.6.4, the Minimum Capital Requirement shall neither fall below 25 % nor exceed 45 % of the Solvency Capital Requirement of an authorised undertaking, calculated in accordance with paragraphs 5.5.16 to 5.5.52, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 111 of the Solvency II Directive, or paragraphs 5.5.54 to 5.5.68 and including any capital add-on imposed in accordance with article 31C of the Act.

5.6.7 Pursuant to regulation 4 of the Insurance Business (Solvency II Transitional Provisions) Regulations, 2015, an authorised insurance undertaking or an authorised reinsurance undertaking shall apply a floor of 25% and a cap of 45% exclusively to the undertaking's Solvency Capital Requirement, calculated in accordance with the standard formula as set out in this Chapter for a transitional period ending no later than 31 December 2017.

Frequency and reporting in relation to the Minimum Capital Requirement

- 5.6.8 An authorised undertaking shall calculate the Minimum Capital Requirement and report the results of that calculation to the competent authority, at least quarterly.
- 5.6.9 For the purposes of calculating the limits referred to in paragraphs 5.6.6 and 5.6.7, an authorised undertaking shall not be required to calculate the Solvency Capital Requirement on a quarterly basis.
- 5.6.10 Where either of the limits referred to in paragraphs 5.6.6 and 5.6.7 determines the Minimum Capital Requirement of an authorised undertaking, such undertaking shall provide to the competent authority information allowing a proper understanding of the reasons therefor.

5.7. Investments

Prudent person principle: General Principles

- 5.7.1 An authorised undertaking shall invest all its assets in accordance with the prudent person principle as specified hereunder:
- (a) an authorised undertaking shall only invest in assets and instruments the risks of which the undertaking 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 paragraphs 6.4.2(a) of Chapter 6 in Part B of these Insurance Rules;
 - (b) all assets in particular those covering the Minimum Capital Requirement and the Solvency Capital Requirement of an authorised undertaking shall be:
 - (i) invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio of assets of the undertaking as a whole; and
 - (ii) localised such as to ensure their availability.
- 5.7.2 In the case of a conflict of interest, an authorised insurance undertaking, or any third party which manages the asset portfolio of the undertaking, shall ensure that the investment is made in the best interest of policyholders and insureds.

Prudent Person Principle: Assets covering technical provisions

- 5.7.3 In addition to meeting the requirements set out in paragraph 5.7.1 and 5.7.2, an authorised undertaking shall ensure that assets held to cover its technical provisions are invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities, and in the best interest of all policyholders and insureds taking into account any disclosed policy objectives.

Prudent Person Principle: Additional Requirements for Assets covering linked long-term liabilities

- 5.7.4 In addition to the requirements set out in paragraphs 5.7.1 and 5.7.3, in relation to assets held in respect of life insurance contracts of insurance, where the investment risk is borne by the policyholders, the authorised insurance undertaking shall also satisfy the following requirements:

- (a) where the benefits provided by a contract are directly linked to the value of units in an UCITS as defined in Directive 2009/65/EC, or
- (b) where the benefits provided by a contract are directly linked to the value of assets contained in an internal fund held by an authorised insurance undertaking, in the case where the internal fund is divided into notional units, the technical provisions in respect of those benefits must be represented as closely as possible by those units or, in the case where notional units are not established by those assets;
- (c) where the benefits provided by the contract are directly linked to a share index or some other reference value, not mentioned in paragraph 5.7.4 (a) or 5.7.4 (b), the technical provisions in respect of those benefits must be represented as closely as possible either by the units deemed to represent the reference value or, in the case where units are not established, by assets of appropriate security and marketability which correspond as closely as possible with those on which the particular reference value is based; and
- (d) where the benefits referred to in the paragraphs 5.7.4 (a) and 5.7.4 (b), include a guarantee of investment performance or some other guaranteed benefit, the assets held to cover the corresponding additional technical provisions shall be subject to paragraph 5.7.5.

Prudent person principle: Additional requirements where the investment risk is not borne by the policyholder

- 5.7.5 Without prejudice to paragraphs 5.7.1 to 5.7.3, with respect to assets other than those referred to in paragraph 5.7.4, an authorised undertaking shall invest its assets in accordance with the following requirements:
- (a) an undertaking shall not invest in a derivative or quasi-derivative instrument, unless and to the extent as it contributes to a reduction of risks or facilitates efficient portfolio management;
 - (b) investments and assets which are not admitted to trading on a regulated market shall be kept to prudent levels;
 - (c) assets shall be properly diversified in such a way as to avoid:
 - (i) excessive reliance on any particular asset, issuer or group of undertakings, or geographical area; and
 - (ii) excessive accumulation of risk in the portfolio as a whole;
 - (d) investments in assets issued by the same issuer, or issuers belonging to the same group, shall not expose the authorised insurance undertaking to excessive risk concentration.

Freedom of investment

- 5.7.6 Subject to paragraph 5.7.8, an authorised undertaking shall invest in any category of assets.
- 5.7.7 Any investment decisions taken by an authorised undertaking or any third party appointed by the undertaking shall not be subject to any kind of prior approval or systematic notification of the competent authority.
- 5.7.8 Where the assets or reference values to which policy benefits may be linked, an authorised undertaking shall comply with the requirements of the Insurance Business (Linked Long Term Contracts) Regulations, 2000.

Localisation of assets and prohibition of pledging of assets

- 5.7.9 An authorised undertaking shall not be required by the competent authority, with respect to insurance risks situated in the Union, to localise the assets held to

cover the technical provisions related to those risks in any particular Member States or EEA States, including Malta.

5.7.10 An authorised undertaking shall not be required by the competent authority with respect to recoverables from reinsurance contracts against undertakings authorised under the Solvency II Directive, or an undertaking which has its head office in a third country, whose solvency regime is deemed to be equivalent in accordance with Article 172 of the Solvency II Directive, to localise its recoverables within the Union, of the assets representing those recoverables;

5.7.11 For the purposes of the establishment of technical provisions, the competent authority does not require the pledging of assets to cover unearned premiums and outstanding claims provisions where the reinsurer is an undertaking authorised under the Solvency II Directive.

[Intra-company loans within a group \(Intra-group Loans\)](#)

5.7.12 An authorised undertaking which is part of a group and which intends to grant an intra-group loan to any undertaking or a company within its group, shall comply with the requirements set out in the Annex to this Chapter.

5.8. Authorised undertakings in difficulty

[Non-compliance with the Solvency Capital Requirement](#)

5.8.1 Pursuant to article 16 of the Act, an authorised undertaking shall:

- (a) immediately inform the competent authority as soon as it observes that the Solvency Capital Requirement is no longer complied with, or where there is a risk of non-compliance within the next three months;
- (b) within two months from the observation of non-compliance with the Solvency Capital Requirement, submit a realistic recovery plan for approval by the competent authority; and
- (c) take the measures necessary to achieve, within six months from the observation of non-compliance with the Solvency Capital Requirement, the re-establishment of the level of eligible own funds covering the Solvency Capital Requirement or the reduction of its risk profile to ensure compliance with the Solvency Capital Requirement.

- 5.8.2 The competent authority may extend the period referred to in paragraph 5.8.1(c) by a further period not exceeding three months.
- 5.8.3 In the event of exceptional adverse situations affecting an authorised undertaking representing a significant share of the market or of the affected lines of business, as declared by EIOPA, the competent authority may, after consulting the European Systemic Risk Board where it deems appropriate, extend for the undertakings concerned, the period set out in paragraph 5.8.2 by a maximum period of seven years, taking into account all relevant factors including the average duration of the technical provisions.
- 5.8.4 Where an authorised undertaking representing a significant share of the market or of the affected lines of business is unlikely to meet one of the requirements set out in paragraph 5.8.1(c), the competent authority may request EIOPA to declare the existence of exceptional adverse situations.
- 5.8.5 For the purposes of paragraph 5.8.4, exceptional adverse situations exist where the financial situation of an authorised undertaking representing a significant share of the market or of the affected lines of business are seriously or adversely affected by one of more of the following conditions:
- (a) a fall in the financial markets which is unforeseen, sharp and steep;
 - (b) a persistent low interest rate environment;
 - (c) a high-impact catastrophic event.
- 5.8.6 The competent authority shall cooperate with EIOPA to assess on a regular basis, whether the conditions referred to in paragraph 5.8.5 continue to apply.
- 5.8.7 Where the competent authority has extended the period referred to in paragraph 5.8.1(c), by reason of a declaration by EIOPA of exceptional adverse circumstances affecting an authorised undertaking, such undertaking shall submit a progress report to the competent authority every three months setting out the measures taken and the progress made to re-establish the level of eligible own funds covering the Solvency Capital Requirement or the reduction of its risk profile to ensure compliance with the Solvency Capital Requirement.
- 5.8.8 The competent authority shall withdraw the extension referred to in paragraph 5.8.3 where the progress report shows that there was no significant progress in achieving the re-establishment of the level of eligible own funds covering the Solvency Capital Requirement or the reduction of the risk profile to ensure compliance with the Solvency Capital Requirement between the date of the

observation of non-compliance of the Solvency Capital Requirement and the date of submission of the progress report.

5.8.9 Where the competent authority is of the opinion that the financial situation of the authorised undertaking will deteriorate further, it may, in exceptional circumstances, also restrict or prohibit the free disposal of the assets of that undertaking.

5.8.10 Where the competent authority restricts or prohibits the free disposal of the assets of the undertaking pursuant to paragraph 5.8.9, the authority:

- (a) shall inform the European regulatory authorities of the host Member State or the overseas regulatory authorities of any measures it has taken;
- (b) request those authorities concerned to take the same measures; and
- (c) designate the assets to be covered by such measures.

[Recovery plan and finance scheme](#)

5.8.11 The recovery plan and the finance scheme of an authorised undertaking referred to in article 18A of the Act, shall at least include the particulars or evidence concerning the following:

- (a) estimates of management expenses, in particular current general expenses and commissions;
- (b) estimates of income and expenditure in respect of direct business, reinsurance acceptances and reinsurance cessions;
- (c) a forecast balance sheet;
- (d) estimates of the financial resources intended to cover the technical provisions and the Solvency Capital Requirement and the Minimum Capital Requirement;
- (e) the overall reinsurance policy.

5.9. Authorised undertakings which are part of a group

5.9.1 An authorised undertaking which is part of a group shall calculate its group solvency in accordance with the applicable provisions found in Part II of the Insurance Business (Supervision of Insurance and Reinsurance Undertakings in a Group) Regulations, 2015 and the applicable provisions of the EU Commission Delegated Regulation and shall also be guided by the [Guidelines on group solvency](#).

5.10. Third country insurance undertakings and third country reinsurance undertakings

5.10.1 This Section of this Chapter applies to a third country insurance undertaking and a third country reinsurance undertaking carrying on business in Malta by means of a branch.

Technical provisions and own funds

5.10.2 Pursuant to article 11(3)(a) of the Act, a third country insurance undertaking and a third country reinsurance undertaking shall establish adequate technical provisions to cover the insurance and reinsurance obligations arising from the business carried out by the branch in Malta calculated in accordance with paragraphs 5.3.1 to 5.3.49, the EU Commission Delegated Regulation and any regulatory and implementing technical standards issued pursuant to Article 86 of the Solvency II Directive.

5.10.3 Pursuant to article 11(3)(b) of the Act, a third country insurance undertaking and a third country reinsurance undertaking shall value its assets and liabilities arising from such business in accordance with paragraphs 5.2.1 and 5.2.2 of this Chapter for the purposes of establishing its technical provisions.

5.10.4 Pursuant to article 11(3)(b) of the Act a third country insurance undertaking and a third country reinsurance undertaking shall determine its own funds in accordance with paragraphs 5.4.1 to 5.4.24 of this Chapter and the EU Commission Delegated Regulation.

5.10.5 A third country insurance undertaking and a third country reinsurance undertaking shall maintain an amount of eligible own funds consisting of the items referred to in paragraph 5.4.23.

Solvency Capital Requirement and Minimum Capital Requirement

5.10.6 A third country insurance undertaking and a third country reinsurance undertaking shall:

- (a) calculate the Solvency Capital Requirement and the Minimum Capital Requirement, both for general and long term insurance, taking into account the operations effected by the branch in Malta;
- (b) constitute the eligible amount of basic own funds required to cover the Minimum Capital Requirement and the absolute floor of that Minimum Capital Requirement in accordance with paragraph 5.4.24;
- (c) ensure that the eligible amount of basic own funds shall not be less than half of the absolute floor required under paragraph 5.6.4;
- (d) count the deposit lodged in accordance with article 11(1)(d) of the Act towards such eligible basic own funds to cover the Minimum Capital Requirement; and
- (e) maintain the assets representing the Solvency Capital Requirement, where the activities are pursued in Malta up to the amount of the Minimum Capital Requirement, and the excess within the Union.

Advantages to undertakings authorised in more than one Member State or EEA State

5.10.7 A third country insurance undertaking or third country reinsurance undertaking may apply to the competent authority to make use of the advantages set out in regulation 15 of the Insurance Business (General Provisions of Supervision) Regulations, 2015.

5.11. Additional requirements and obligations

5.11.1 In complying with the provisions of articles 14, 15, 16, 17 18A, 18D and 18E of the Act and with this Chapter, an authorised undertaking shall also refer to and comply with the following:

- (a) Chapters II, III, IV, V, VI, VII, VIII, X, XI and XI of Title I of the EU Commission Delegated Regulation;

(b) the following implementing technical standards:

- (i) [Commission Implementing Regulation \(EU\) 2015/500 of 24 March 2015 laying down implementing technical standards with regard to the procedures to be followed for the supervisory approval of the application of a matching adjustment in accordance with Directive 2009/138/EC of the European Parliament and of the Council;](#)
- (ii) [Commission Implementing Regulation \(EU\) 2015/499 of 24 March 2015 laying down implementing technical standards with regard to the procedures to be used for granting supervisory approval for the use of ancillary own-fund items in accordance with Directive 2009/138/EC of the European Parliament and of the Council;](#)
- (iii) [Commission Implementing Regulation \(EU\) 2015/498 of 24 March 2015 laying down implementing technical standards with regard to the supervisory approval procedure to use undertaking-specific parameters in accordance with Directive 2009/138/EC of the European Parliament and of the Council;](#)
- (iv) [Commission Implementing Regulation \(EU\) 2015/460 of 19 March 2015 laying down implementing technical standards with regard to the procedure concerning the approval of an internal model in accordance with Directive 2009/138/EC of the European Parliament and of the Council;](#)
- (v) [Commission Implementing Regulation \(EU\) 2015/2012 of 11 November 2015 laying down implementing technical standards with regard to the procedures for decisions to set, calculate and remove capital add-ons in accordance with Directive 2009/138/EC of the European Parliament and of the Council;](#)
- (vi) [Commission Implementing Regulation \(EU\) 2015/2011 of 11 November 2015 laying down implementing technical standards with regard to the lists of regional governments and local authorities, exposures to whom are to be treated as](#)

exposures to the central government in accordance with Directive 2009/138/EC of the European Parliament and of the Council;

- (vii) Commission Implementing Regulation (EU) 2015/2016 of 11 November 2015 laying down the implementing technical standards with regard to the equity index for the symmetric adjustment of the standard equity capital charge in accordance with Directive 2009/138/EC of the European Parliament and of the Council;
- (viii) Commission Implementing Regulation (EU) 2015/2017 of 11 November 2015 laying down implementing technical standards with regard to the adjusted factors to calculate the capital requirement for currency risk for currencies pegged to the euro in accordance with Directive 2009/138/EC of the European Parliament and of the Council;
- (ix) Commission Implementing Regulation (EU) 2015/2013 of 11 November 2015 laying down implementing technical standards with regard to standard deviations in relation to health risk equalisation systems in accordance with Directive 2009/138/EC of the European Parliament and of the Council;
- (x) any other regulatory or implementing technical standards issued by the EU Commission or EIOPA in terms of Articles 75(2), 75(3), 77e, 86, 92, 97, 99, 109a, 111, 114, 127, 130, 135 and 143 of the Solvency II Directive; and

(c) the following guidelines issued by EIOPA:

- (i) [Guidelines on recognition and valuation of assets and liabilities other than technical provisions relating to Article 75 of the Solvency II Regulation and to Articles 7 to 16 of the EU Commission Delegated Regulation;](#)
- (ii) [*Revised Guidelines on Valuation of Technical Provisions;](#)
- (iii) [Guidelines on contract boundaries relating to Articles 76 \(1\) and 78 of the Solvency II Directive and Articles 17 and 18 of the EU Commission Delegated Regulation;](#)
- (iv) [*Revised Guidelines on Contract Boundaries;](#)
- (iii) [Guidelines on valuation of technical provisions relating to Articles 76 to 86 and Article 48 of the Solvency II Directive and Articles 17 to 42 of the EU Commission Delegated Regulation;](#)
- (iv) [Guidelines on the implementation of the long-term guarantee measures on the implementation of the measures set out in Articles 77b, 77d, 308c and 308d of the Solvency II Directive;](#)
- (v) [Guidelines on ancillary own funds relating to Articles 89, 90, 93 to 96, 226 and 235 of the Solvency II Directive and to Articles 62 to 67, 74, 75, 78 and 79 of the EU Commission Delegated Regulation;](#)
- (vi) [Guidelines on treatment of related undertakings, including participations referred to in Articles 92\(1\)\(b\) and 111\(1\)\(m\) of the Solvency II Directive and Articles 68, 168 and 171, without prejudice to Article 84 of the EU Commission Delegated Regulation;](#)
- (vii) [Guidelines on classification of own funds relating to Articles 93 to 95 of the Solvency II Directive and Articles 69 to 73, 76, 77, 79 and 82 of the EU Commission Delegated Regulation;](#)
- (viii) [Guidelines on ring-fenced funds relating to Articles 99\(b\) and 111\(1\)\(h\) of the Solvency II Directive 2009/138/EC and Articles 80, 81, 216 and 217 of the EU Commission Delegated Regulation;](#)

- (ix) [Guidelines on the loss-absorbing capacity of technical provisions and deferred taxes relating to Articles 103\(c\) and 108 of the Solvency II Directive and Article 83 and Articles 205 to 207 of the EU Commission Delegated Regulation;](#)
- (x) [Guidelines on basis risk related to Article 104 and 105 of the Solvency II Directive;](#)
- (xi) [Guidelines on look-through approach relating to Article 104 and 105 of the Solvency II Directive;](#)
- (xii) [Guidelines on the treatment of market and counterparty risk exposures in the standard formula relating to Article 104 and 105 of the Solvency II Directive 2009/138/EU and to Articles 164 to 202 of the EU Commission Delegated Regulation;](#)
- (xiii) [Guidelines on undertaking-specific parameters relating to Article 104\(7\), 110, 111, 230, 248\(2\) of the Solvency II Directive and Articles 218, 219, 220, 338 and 356 of the EU Commission Delegated Regulation; and](#)
- (xiv) [Guidelines on application of outwards reinsurance arrangements to the non-life underwriting risk sub-module relating to Article 105\(2\) of the Solvency II Directive and Article 119 to Article 135, Article 209 and Article 214 of the EU Commission Delegated Regulation;](#)
- (xv) [Guidelines on health catastrophe risk sub-module relating to Article 105 \(4\) of the Solvency II Directive and Articles 160 to 163 and Annex VI of the EU Commission Delegated Regulation;](#)
- (xvi) [Guidelines on the use of internal models related to the use of Internal Models in applying the Solvency II Directive and Articles 112, 113, 115, 116, 120 to 126 and 231 of the EU Commission Delegated Regulation;](#)
- (xvii) [Guidelines on the application of life underwriting risk module relating to Article 105\(3\) of the Solvency II Directive and Articles 137, 138 and 139 of the EU Commission Delegated Regulation;](#)

- (xviii) [Guidelines on the Extension of the Recovery Period in exceptional adverse situations, which are based on which supplement Article 138\(4\) of the Solvency II Directive;](#)
- (xix) [Guidelines on the supervision of branches of third-country insurance undertakings, which relate to Articles 162 to 171 of the Solvency II Directive.](#)

Malta Financial Services Authority

Triq L-Imdina, Zone 1

Central Business District, Birkirkara, CBD 1010, Malta

communications@mfsa.mt

www.mfsa.mt