

Encyclopaedia of Prudential Solvency

Chapter 9: Solvency II and Solvency UK – Key Concepts and Recent Developments

Introduction

This chapter discusses the European Union’s (EU’s) Solvency II (Solvency II) and the gradual divergence between that regime and what has come to be known as Solvency UK following the end of the Brexit transition period in the UK, in 2020.

The UK is the third-largest insurance market in the world and ranked second in the top 15 centres of the insurance sector.¹ It holds a global market share of more than 5% in the insurance space in 2024, with total insurance premium volumes of US\$375 billion. The insurance market in the UK is also the fastest-growing amongst the top 10 insurance markets in the world, recording a 11% year-on-year increase on total insurance premium in 2024. The UK’s insurance and reinsurance industry is supervised by the “twin peak” regulators: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The UK is home to more than 400 authorised insurance firms.²

Some members of the EU are key players in the global insurance market. France, Germany and Italy are amongst the top 10 insurance markets in the world in terms of total premium in 2024. In the same year, the Netherlands and Spain demonstrated growth potential, reaching respective 11% and 22% year-on-year increases in total insurance premiums. The EU’s insurance and reinsurance industry is supervised by the European Insurance and Occupational Pensions Authority (EIOPA). EIOPA is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. It plays an important role in shaping the policies and laws of the EU insurance and reinsurance industry, including the Solvency II Directive.

In November 2024, we published our first edition of *A Guide to Solvency II*, in which we dissected various important topics in the EU and UK prudential solvency regimes. This chapter recaps some of the key themes and elaborates on recent developments.

1. Solvency II and Solvency UK

Historical Development of Solvency II

In 2009, the European Parliament and Council of the European Union first published the Solvency II Directive,³ which is the framework of Solvency II. The Solvency II Directive replaced the previously in force insurance and reinsurance directives in the EU, coming into effect on 1 January 2016. Solvency II serves as the prudential solvency regime for almost all insurance and reinsurance companies in the EU, and fundamentally reformed the capital requirements for insurers and reinsurers to a more risk-based approach.

Like the approach introduced for the banking sector in the form of Basel II, Solvency II is built on three pillars:

- *Pillar 1*: The quantitative requirements, detailed through, amongst others:
 - capital requirements (the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR)), internal models, matching adjustments;
 - “prudent person” approach instead of quantitative restrictions with respect to investments; and
 - harmonised calculations of technical provisions.

¹ Z/Yen, “[The Global Financial Centres Index 36](#),” September 2024.

² The Bank of England, “[Insurance Aggregate Data Annual Report](#),” last updated 4 August 2025.

³ The final text of the Directive was published in the Official Journal of 17 December 2009 (Directive 2009/138/EC of the European Parliament and Council of 25 November 2009).

- *Pillar 2*: The qualitative requirements to cover risks not captured by the SCR, addressing internal governance and risk management.
- *Pillar 3*: The supervisory reporting and public disclosure requirements (the Solvency and Financial Condition Report (SFCR)) ensuring transparency.

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 (the Level 2 Delegated Regulation) supplemented the Solvency II Directive, and its publication was timed in order to give stakeholders time to review its provisions ahead of the 1 January 2016 implementation date of the Solvency II Directive. The Solvency II Directive was intended to be a principles-based document and many of the provisions within the directive are further developed in the Level 2 Delegated Regulation. As indicated in the explanatory memorandum to the Level 2 Delegated Regulation, the regulation was based on over 4,000 pages of technical advice provided to EIOPA in 2009 and 2010. Some key matters covered by the Level 2 Delegated Regulation include:

- External credit assessments.
- Market consistent valuation of assets and liabilities including technical provisions.
- The eligibility of insurance own-fund items.
- The methodology and calibration of the MCR and the standard formula for the calculation the SCR.
- The use and approval of internal models.
- Governance and the role of key governance functions.
- Capital add-ons.
- Supervisory review processes and the elements to consider in deciding an extension of the recovery period for undertakings that are in breach of the SCR.
- Supervisory reporting and public disclosure.
- Criteria for the supervisory approval of SPVs taking on reinsurance risk and requirements related to their operations.
- Group supervision, the calculation of group SCR, group internal models, the operation of branches and the coordination between supervisory authorities.
- The criteria for assessing whether the solvency or prudential regime of a third country is equivalent.

On 18 July 2025, the European Commission published a draft delegated act for stakeholder feedback, proposing revisions to the Level 2 Delegated Regulation.⁴ The draft aims to update technical rules for valuing insurers' liabilities, calculating solvency requirements, and streamlining reporting, disclosure and group supervision. These changes are part of broader efforts to enhance the EU financial system's support for investment and competitiveness.

Key proposals include:

- Dedicated treatment for long term equity investments by insurers that aims to encourage equity financing of European firms and facilitating their access to stable, long term capital.
- Measures to reduce the impact of short-term market volatility on insurers' solvency positions.
- Lowering barriers to insurer investments in securitisation by reducing risk factors on both simple, transparent and standardised (STS) and non-STs securitisation.
- Simplifying and making supervisory reporting more proportionate, especially for smaller, low-risk insurers.

⁴ European Commission, "[Commission seeks feedback on the review of the Solvency II Delegated Regulation](#)," July 2025.

- Recalibrating capital requirements for natural catastrophe risks to reflect the latest scientific insights related to climate change.
- Recognising the role of insurers in mobilising private capital to support key EU objectives, including investments made in the real economy alongside public funds, particularly when public guarantees or subsidies are involved.

The consultation closed on 5 September 2025, with adoption by the European Commission planned for the fourth quarter of 2025.

Divergence Between Solvency II and Solvency UK

Following the end of the Brexit transition period in 2020, there has been gradual divergence between Solvency II and Solvency UK. The UK's reform of Solvency II has continued apace, resulting in additional rounds of reforms and consultation designed to adapt Solvency II to more closely meet the needs of the UK market. Areas of reform include the matching adjustment, reporting obligations on liquidity and solvency exit planning.

2. Key Solvency II and Solvency UK Concepts

A. The Capital Requirements

The capital requirements under Solvency II and Solvency UK comprise two pillars: the SCR and the MCR. The SCR is designed to protect policyholders by helping ensure that insurers can survive difficult periods and pay claims as they fall due. It prescribes a specific level of capital that an insurer is expected to hold, calculated after taking into account a diverse range of risks. Operating alongside the SCR, the MCR is a significantly lower threshold than the SCR.

It follows that different degrees of outcomes may arise in an event when an insurer fails to meet its SCR and MCR. If an insurer's capital falls below the SCR, the PRA, or relevant EU supervisory authority, is able to intervene in the running of the insurer. If the level of capital falls below the MCR, the PRA, or relevant EU supervisory authority, may have the right to withdraw authorisation and close the insurer to new business.

The SCR may be calculated either by using the standard formula, prescribed by the PRA Rulebook and Solvency II, or by using a PRA⁵-approved internal model bespoke to the company concerned. The SCR calculated using the standard formula is made up of:

- The basic SCR — an aggregation of capital charges arising from the different risk modules set out in the Solvency II Directive:
 - underwriting risks, which is further split into:
 - non-life underwriting risks.
 - life underwriting risks.
 - health underwriting risks.
 - market risks.
 - counterparty default risks.
- The capital requirement for operational risks.

⁵ or relevant EU supervisory authority.

- An adjustment for the loss-absorbing capacity of technical provisions and deferred taxes.
- A capital requirement for intangible asset risks.⁶

Solvency II requires that the SCR is calculated at a “value-at-risk” that is subject to a 99.5% confidence level. In other words, the SCR should allow the insurer to be able to withstand, without its entire depletion, all but the most extreme risks that occur less than once every 200 years. The SCR must be calculated at least annually, and the result should be reported to the PRA or relevant EU supervisory authority. Insurers must continue to monitor their amount of capital and their SCR on an ongoing basis. If there is a significant change in an insurer’s risk profile, it must recalculate its SCR as soon as possible and report the new result to the PRA or relevant EU supervisory authority.⁷

In addition to the SCR, (re)insurers must fulfil obligations in connection with the MCR.⁸

The MCR must be calibrated to a confidence level of 85% over a one-year period (in contrast to the 99.5% value-at-risk calibration for the SCR).

The MCR is subject to a cap and two separate floors:

- The MCR must not exceed 40% of the (re)insurer’s SCR, including any capital add-on.
- The MCR must not be less than 25% of the (re)insurer’s SCR, including any capital add-on.
- The MCR has an absolute floor, set at a different amount for each of general insurers, long-term insurers, pure reinsurers and composite insurers.

(Re)insurers must calculate the MCR and report the results to the PRA or relevant EU supervisory authority at least quarterly.

We mentioned the gradual divergence between Solvency II and Solvency UK. However, to date, these changes have not touched directly on the capital requirements. We expect the PRA to continue to develop the application of capital requirements in the UK in the coming years.

An insurer regulated under Solvency II or Solvency UK must hold own funds at least equal to the sum of its capital requirements. In practice, insurers usually hold more own funds than required to match their internal risk appetite level.

B. Own Funds

Own funds is the term employed in the Solvency II Directive (or the Own Funds Part of the PRA Rulebook) for the items that constitute a (re)insurer’s regulatory capital. These are principally balance sheet items, with limited allowance for off-balance-sheet items.

Own funds are items that are most available to absorb losses, such as retained earnings, the proceeds of paid-in ordinary share capital and/or types of long-term debt instruments. Allowance is also made for certain assets that are less available to absorb losses and, subject to eligibility criteria, may extend to uncalled share capital and to other items such as deferred tax assets.

A (re)insurer must make a pre-issuance notification (PIN) to the PRA before issuing or amending certain capital instruments that it intends to classify as own-fund items, 30 days before doing so.

⁶ Article 87 of the Level 2 Delegated Regulation.

⁷ Article 102, *ibid.* (transposed in Paragraphs 4.1 to 4.5, Solvency Capital Requirement - General Provisions Part of the PRA Rulebook).

⁸ (1) Article 129 of the Solvency II Directive (transposed in Paragraphs 3.1 to 3.13, Minimum Capital Requirement Part of the PRA Rulebook); and (2) Articles 248 to 254 of the Level 2 Delegated Regulation.

Insurers are required to classify own funds into three categories, with varying degrees of availability and subordination. Own-fund items are further classified as either basic own funds (BOF) or ancillary own funds (AOF). The former are on-balance-sheet items and qualify automatically and have a higher eligibility ranking. The latter are off-balance-sheet items that cannot qualify as Tier 1 own funds and require supervisory approval.

Basic Own Funds

Tier 1 items are considered of the highest quality and must dominate the portfolio. They should constitute at least half of the total eligible own funds contributing towards the calculation of the SCR and 80% of such contributing towards the MCR.⁹ Preference shares, subordinated debt and certain other items are limited to less than 20% of the total amount of Tier 1.¹⁰ Tier 1 items share certain non-exhaustive features, which include:

1. **Readily callable:** Tier 1 items must be readily accessible or callable on demand to comprehensively offset losses, both in ongoing operations and during liquidation. This ensures that the capital is permanently available to absorb losses.¹¹
2. **Loss absorption ability:** The total amount of the Tier 1 item must be available to absorb losses, and repayment to the holder is refused until all other obligations, including insurance and reinsurance obligations to policyholders, have been met.
3. **Undated and redeemable at (re)insurer's option:** Tier 1 items must be undated¹² and repayable or redeemable only at the option of the (re)insurer, subject to prior supervisory approval.¹³
4. **No incentives to redeem:** Tier 1 capital instruments may not include any incentives to redeem.¹⁴
5. **Dividend/coupon restrictions:** Tier 1 capital instruments may not allow for payment of a dividend, distribution or coupon in the event of a breach of the SCR or where such payment would lead to a breach, save where all of the following conditions are met:
 - the supervisory authority has exceptionally waived the cancellation of distributions;
 - the distribution does not further weaken the solvency position of the firm; and
 - the MCR is complied with after the distribution.¹⁵
6. **Full flexibility over distributions:** Tier 1 capital instruments must provide for full flexibility by the (re)insurer over any dividend or coupon.¹⁶
7. **Tier 1 capital components:** Tier 1 items include:
 - paid-in ordinary share capital (or equivalent);
 - surplus funds, which are effectively profit;

⁹ Article 82(1) and (2) of the Level 2 Delegated Regulation (transposed in Rule 4A.1(1) and 4A.2(1), Own Funds Part of the PRA Rulebook).

¹⁰ (1) *ibid.* and (2) Rule 4A.3, Own Funds Part of the PRA Rulebook.

¹¹ Article 93(1)(a) of the Solvency II Directive (transposed in Rule 3.5(1), Own Funds Part of the PRA Rulebook).

¹² Article 71(1)(f)(i) of the Level 2 Delegated Regulation (transposed in Rule 3B.1(6), Own Funds Part of the PRA Rulebook).

¹³ Article 71(1)(h), *ibid.* (transposed in Rule 3B.1(8)), *ibid.*

¹⁴ Article 71(1)(f)(iii), *ibid.* (transposed in Rule 3B.1(9)) *ibid.*

¹⁵ Article 71(1)(m), *ibid.* (transposed in Rule 3B.1(13)) *ibid.*

¹⁶ Article 71(1)(n) of the Level 2 Delegated Regulation (transposed in Rule 3B.1(14), Own Funds Part of the PRA Rulebook).

- reconciliation reserves which allow for foreseeable dividends and expected profits in future premiums;¹⁷ and
 - paid-in preference share capital and subordinated debt which includes restricted Tier 1 (**RT1**) instruments.
8. **RT1 redemption restrictions:** RT1 instruments must not be redeemable before five years after issuance and may only be redeemable between five and 10 years after issuance provided the SCR is exceeded by an appropriate margin.
 9. **RT1 distribution flexibility:** RT1 instruments should contain further conditions regarding flexibility, including unrestricted authority for (re)insurers to indefinitely cancel distributions on a noncumulative basis.¹⁸
 10. **Principal loss absorption mechanism:** RT1 instruments must feature a mechanism that, upon a significant breach of the SCR or the MCR, aims to act as a principal loss absorption mechanism and sets out the trigger events for that principal loss absorption mechanism.¹⁹

Tier 2 BOF items have less stringent requirements than Tier 1 items. They shall not exceed 20% of the MCR. Tier 2 items share certain non-exhaustive features, which include:

1. **Undated and redeemable at (re)insurer's option no earlier than five years:** Tier 2 items must be undated or have an original maturity of no less than 10 years.²⁰ They must be repayable or redeemable only at the option of the firm, subject to prior supervisory approval.²¹ Tier 2 instruments must not be redeemable before five years after issuance.²²
2. **Subordination:** Tier 2 items rank after policyholders and non subordinated creditors.
3. **Incentives to redeem:** Unlike Tier 1, Tier 2 items feature limited incentives to redeem (such as interest step-ups), which can only apply after 10 years from the date of issuance. They are subject to strict quantitative limits.²³
4. **Distributions:** Distributions may be fixed/cumulative; and must be deferrable on a SCR breach.²⁴

Tier 3 BOF items are effectively the remainder of the balance sheet items subordinated after policyholder and beneficiaries' claims and which are ineligible to constitute Tier 1 or 2.²⁵ Tier 3 items must be undated or have a minimum maturity of five years.²⁶ They include a wider pool of assets, including deferred tax assets. Tier 3 items must be minimised, contributing less than 15% of the SCR.²⁷

In addition, the sum of Tier 2 and Tier 3 items shall not exceed 50% of the SCR.²⁸

¹⁷ Article 70(1), *ibid.* (transposed in Rule 3C) *ibid.*

¹⁸ Article 71(4), *ibid.* (transposed in Rule 3B.4) *ibid.*

¹⁹ Article 71(1)(e), *ibid.* (transposed in Rule 3B.1(5)) *ibid.*

²⁰ Article 73(1)(c), *ibid.* (transposed in Rule 3E.1(3)) *ibid.*

²¹ Article 73(1)(d), *ibid.* (transposed in Rule 3E.1(4)) *ibid.*

²² Article 73(1)(c), *ibid.* (transposed in Rule 3E.1(3)) *ibid.*

²³ Article 73(1)(e), *ibid.* (transposed in Rule 3E.1(5), 3E.4) *ibid.*

²⁴ Article 73(1)(g), *ibid.* (transposed in Rule 3E.1(8)) *ibid.*

²⁵ Article 77(1)(a), *ibid.* (transposed in Rule 3F) *ibid.*

²⁶ Article 77(1)(c), *ibid.* (transposed in Rule 3G.1(3)) *ibid.*

²⁷ Article 82(1), *ibid.* (transposed in Rule 4A.1(2)) *ibid.*

²⁸ Article 82(1), *ibid.* (transposed in Rule 4A.1(2)) *ibid.*

Ancillary Own Funds

Inclusion of AOF requires regulatory approval. In our experience, such inclusions have typically been heavily scrutinised by the PRA. A (re)insurer seeking approval must scrupulously demonstrate to a high standard that the proposed AOF meet the regulatory criteria, including its legally binding nature, availability and reliability for absorbing losses. The PRA and EU supervisory authorities will provide approval for a specified monetary amount or a method to determine the amount of AOF for a predefined period.²⁹

Tier 2 AOF must be callable on demand.³⁰ Once the Tier 2 AOF item has been called up and paid in, it must display the features of a Tier 1 instrument (as discussed above).³¹ Tier 2 AOF items include:

- Unpaid/uncalled ordinary or preference share capital.
- Unpaid subordinated debt.
- Letters of credit and guarantees.
- Other legally binding commitments provided that the item can be called up on demand and is clear of encumbrances.³²

Tier 3 AOF are effectively AOF that do not meet all of the requirements for Tier 2 AOF.³³

Similar to capital requirements, the ongoing divergence between Solvency II and Solvency UK has not yet touched directly on the own-funds requirements. We expect the PRA to continue to follow current Solvency II requirements on own funds in the foreseeable future.

C. Investment Rules

Since the introduction of Solvency II, insurers have greater investment freedom and flexibility to determine how to invest their assets. They must invest in accordance with the Prudent Person Principal (PPP), an objective which ensures that this flexibility is exercised responsibly. Different categories of investment engaged by the insurers will attract different capital charges when calculating the SCR.

The Prudent Person Principle

The PPP is developed under Solvency II and is adopted in the PRA Rulebook for Solvency UK. This principle requires an insurer to invest its assets in accordance with the following requirements:

- The firm must only invest in assets and instruments the risks of which it can properly identify, measure, monitor, manage, control and report and appropriately take into account in the assessment of its overall solvency needs.
- All of the assets of the firm must be:
 - invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio of assets of the firm as a whole; and
 - localised such as to ensure their availability.
- In the case of a conflict of interest, the firm, or any third party which manages its assets, must ensure that the investment of assets is made in the best interest of policyholders or other specified beneficiaries.³⁴

²⁹ Article 90(1) of the Solvency II Directive (transposed in Rule 2.5, Own Funds Part of the PRA Rulebook).

³⁰ Article 74 of the Level 2 Delegated Regulation (transposed in Rule 3H, Own Funds Part of the PRA Rulebook).

³¹ Article 75, *ibid.* (transposed in Rule 3I) *ibid.*

³² Article 89(1) of the Solvency II Directive (transposed in Rule 2.3, Own Funds, Part of the PRA Rulebook); and (2) Article 74 of the Level 2 Delegated Regulation (transposed in Rule 3H, Own Funds Part of the PRA Rulebook).

³³ Article 78 of the Level 2 Delegated Regulation (transposed in Rule 3J, Own Funds Part of the PRA Rulebook).

³⁴ Article 132(1)-(2) of the Solvency II Directive (transposed in Paragraph 2.1, Investments Part of the PRA Rulebook).

For all assets other than those held in respect of life insurance contracts where the investment risk is borne by policyholders, there are additional requirements that the insurers are required to comply with. These include:

- Investments in derivative or quasiderivative instruments shall only be permitted to the extent that they contribute to a reduction of risks or facilitate efficient portfolio management. As such, a hedging derivative is more likely to be compliant in contrast to a purely speculative derivative.
- Investments in unlisted securities must be kept to prudent levels.
- Assets must be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer, group of undertakings or geographical area and excessive accumulation of risk in the portfolio as a whole.
- Investments in assets issued by the same issuer, or issuers belonging to the same group, must not expose the insurer to excessive risk concentration.³⁵

The PRA and the EIOPA have published guidelines on the investment activities of their respective regulated insurers or reinsurers.

PRA Guidance

In the UK, the PRA requires that an insurer's investment strategies should be aligned with its investment objectives and asset allocation, the board's risk appetite, risk tolerance limits and investment risk return objectives, as well as alignment of the investment strategy with its business model, the nature and duration of its liabilities and obligations and the best interest of policyholders.³⁶

There is also a wide range of requirements regarding the content of insurers' risk management policies and monitoring frameworks. For instance, investments should be aligned with the insurer's risk appetite, risk management policies, risk tolerance limits and investment strategy alongside its overall business model.³⁷

Additionally, where an insurer or reinsurer chooses to outsource its investment activities to an external party, it must be subject to appropriate due diligence and the outsourced entity must equally be able to comply with the requirements of the supervisory statement.³⁸

EIOPA Guidance

In the EU, EIOPA has published guidance on the system of governance (EIOPA BoS-14/253 EN) (Governance Guidelines). It continues to apply in the UK as confirmed by the Bank of England and PRA.³⁹ It provides that there should be regular reviews of a firm's investment portfolio, which includes, for example, considering the relevant liability constraints and the level and nature of risk that the insurer is willing to accept. The guidance is reflective of what Solvency II requires, namely that the entire portfolio is monitored on a continuing basis for compliance with the prudency requirements.

Where an investment is of a nonroutine nature, EIOPA also requires additional due diligence to be conducted, including an assessment of the associated risks of the investment, the insurer's internal liability constraints and its ability to manage the investment properly.⁴⁰ The insurer should require

³⁵ Article 132(4), *ibid.* (transposed in Paragraph 5, *ibid.*).

³⁶ PRA SS1/20.

³⁷ *Ibid.*

³⁸ *Ibid.*

³⁹ Appendix 1 of the Bank of England and PRA Statement of Policy, "[Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU](#)," first published 18 April 2019.

⁴⁰ Guideline 28 of the Governance Guidelines.

that an investment or investment activity entailing a significant risk or change in the risk profile must be communicated in the risk profile to the firm's administrative, management or supervisory body.⁴¹

Similarly, where an investment is complex, not admitted to trading on a regulated market or otherwise difficult to value, insurers should implement, manage, monitor and control procedures in relation to such investments. Equally, an insurance firm should treat assets which are admitted to trading, but not traded or not frequently traded, in a similar manner to assets not admitted to trading on a regulated financial market.⁴²

D. Matching Adjustment

Long-term insurance products that may not generally be lapsed, such as annuities, are typically backed by (re)insurers with long-term assets that match the cash flows closely (such as long-dated bonds) and are expected to be held to maturity.

The Matching Adjustment (MA) is a mechanism that allows insurers to recognise upfront as capital resources a proportion of the investment return that they project to earn over the future lifetime on the assets matching their insurance and reinsurance liabilities.

More technically speaking, the MA is an adjustment to the discount rate that can be applied to the valuation of insurance and reinsurance obligations in certain specific conditions. It is designed to allow writers of certain types of long-term business (principally annuities) who are able to hold backing assets to maturity to use a discount rate closer to the credited-adjusted market rate of return for the relevant liabilities, instead of the risk-free rate prescribed by Solvency II or Solvency UK.

Leveraging the MA, the insurer is able to benefit from the higher discount rate which in turn lowers the present value of its liabilities and, consequently, lowers its technical provisions, which in turn lowers the insurer's capital requirement.

In June 2024, the PRA introduced reforms to the MA and published PRA PS10/24, which further amended PRA SS7/18 (as discussed in [Chapter 5 of our *Guide to Solvency II*](#)). Reforms included eligibility for assets that are highly predictable, increased allowance of sub-investment-grade assets, extension of the categories of insurance liabilities, efficiencies in the application process, a more balanced approach to condition breaches, the introduction of an attestation requirement and the formalising of a new reporting requirement. A summary of the reforms is included in the table in the Annex. Full details are provided in Chapter 5 of our *Guide to Solvency II*.

Eligible Liabilities

Solvency II Framework

Only certain liabilities are eligible for MA treatment:

- They must be life (re)insurance obligations, including annuities.
- The portfolio of (re)insurance obligations to which the MA is applied must be identified, organised and managed separately from the other obligations of the undertaking.
- The contracts underlying the (re)insurance obligations must not give rise to future premium payments.
- The only underwriting risks connected to the portfolio of (re)insurance obligations are longevity risk, expense risk, revision risk and mortality risk.

⁴¹ *Ibid.*

⁴² Guideline 33, *ibid.*

- The contracts underlying the portfolio of (re)insurance obligations include no surrender options for the policyholder or only a surrender option where the surrender value does not exceed the value of the assets, valued in accordance with Article 75 of the Solvency II Directive (transposed in the Valuation Part of the PRA Rulebook), covering the (re)insurance obligations at the time the surrender option is exercised.
- The (re)insurance obligations of a (re)insurance contract must not be split into different parts when composing the portfolio of (re)insurance obligations.⁴³

These eligibility requirements under Solvency II were adopted by the PRA when it formulated Solvency UK.

PRA Approach

The PRA further set out its expectation regarding the liability eligibility conditions under the Solvency II Directive in PRA SS7/18. This supervisory statement addresses some of the key aspects such as future premium payments and surrender options. In June 2024, the PRA introduced reforms to the MA and published PRA PS10/24, which further amended PRA SS7/18.

The PRA's reforms expand the scope of liability portfolios that may benefit from the MA. These now include in-payment income protection claims, including recovery time risk (*i.e.*, the risk that income protection policyholders take longer to recover from sickness than the (re)insurer's best estimate projection). This is a significant extension of the MA to a new business line, which may produce significant capital benefits in the relevant market. The extension also now permits the guaranteed components of with-profits annuities to be included in an MA portfolio (but with the nonguaranteed elements remaining outside). Although unlikely to have a significant impact on the market overall, this will likely assist the limited number of providers of these specialised products.

Eligible Assets

Solvency II Framework

The assets backing the relevant insurance or reinsurance liabilities must meet the following conditions under Solvency II:

- The portfolio of assets assigned by the (re)insurer to cover the best estimate of the portfolio of (re)insurance obligations must consist of bonds and other assets with similar cash flow characteristics over the lifetime of the obligations (except where the cash flows have materially changed).
- The assigned portfolio of assets must be identified, organised and managed separately from other assets of the undertaking.
- The expected cash flows of the assigned portfolio of assets must replicate each of the expected cash flows of the portfolio of (re)insurance obligations in the same currency and any mismatch must not give rise to risks that are material in relation to the risks inherent in the (re)insurance business to which the MA is applied.
- The cash flows of the assigned portfolio of assets must be fixed and cannot be changed by the issuers of the assets or any third parties, save that:
 - inflation-linked assets are permitted provided that the assets replicate the cash flows of (re)insurance obligations which depend on inflation; and

⁴³ Article 77b of the Solvency II Directive (transposed in Rules 6.1 to 6.4, Technical Provisions Part of the PRA Rulebook).

- a right of the issuer or a third party to change the cash flows of an asset is permitted provided that the (re)insurer will receive sufficient compensation to allow it to obtain the same cash flows by reinvesting in assets of an equivalent or better credit quality.⁴⁴

These eligibility requirements under Solvency II were adopted by the PRA when it formulated Solvency UK.

PRA Approach

Similar to the liabilities eligibility criteria, the PRA further set out its expectation into the asset eligibility conditions under the Solvency II Directive in PRA SS7/18.

The PRA took the view that, amongst others:

- Assets can be grouped into a MA asset portfolio, which in aggregate satisfies the requirement for “bonds or other assets with similar cash flow characteristics.” In this case, the PRA expects the relevant (re)insurer to indicate clearly where groups of assets need to be considered in aggregate to demonstrate these qualities.
- Even if an individual asset in a MA asset portfolio is denominated in a currency different to the currency of the expected liability cash flows, this does not necessarily mean that such an asset would fall short of the eligibility condition, provided that the MA asset portfolio in aggregate replicates the expected liability cash flows in the relevant currency.
- (Re)insurers may potentially take into account an asset with both fixed and nonfixed cash flows (provided that the bond also meets the rest of the MA asset eligibility criteria). For instance, (re)insurers may be able to demonstrate that the cash flows from callable bonds up to the first call date are fixed.⁴⁵

In June 2024, the PRA introduced further reforms through PRA PS10/24. The new framework moves away from a requirement for the MA to be applied only to fixed-income assets to allow for the limited inclusion within an MA portfolio of assets with HP cash flows (*i.e.*, with cash flows that are capable of being changed by the issuers of the assets or third parties), provided such assets do not represent more than 10% of the total MA benefit claimed by the relevant (re)insurer. Such HP assets must comply with certain conditions. Full details are provided in Chapter 5 of our *Guide to Solvency II*.

In addition the PRA increased the allowance of sub-investment grade (SIG) assets in an MA portfolio by removing the previous current cap and modifying expectations around the management and modelling of SIG assets. These adjustments aim to promote investments that hover around the threshold between IG and SIG assets. That said, the PRA expects that any investment in SIG assets will remain limited given that annuity policyholders do not necessarily benefit from the higher yield on these products, and states that these should remain at prudent levels. (Re)insurers will be required to account for the risk of market conditions downgrading investment asset holdings from IG to SIG. In line with the PPP, the PRA also considers that (re)insurers should only invest in SIG assets to the extent that they have an effective risk management system for the risks particular to these assets.

3. Key Recent Solvency UK Developments

Following Brexit, the UK continues to pursue a managed divergence from EU-derived legislation, including a targeted liberalisation of the Solvency II regime. In 2025, the PRA has published policy statements and consultation papers which set out the proposed framework for the reform in certain key areas of Solvency UK. Some key proposals applicable to UK (re)insurers are selected for this chapter.

⁴⁴ *Ibid.*

⁴⁵ PRA SS7/18 (as amended by the PRA PS10/24).

A. Matching Adjustment Investment Accelerator⁴⁶

In April 2025, the PRA published consultation paper CP7/25 which introduced the proposal for the launching of the Matching Adjustment Accelerator (MAIA). The consultation closed on 4 June 2025 and the PRA expects to publish and implement the final proposal in Q4 2025.

The aim of the MAIA is to shorten the application process for the MA permission, which at present can lead to missed investment opportunities for insurers.

Currently, UK insurers must apply to the PRA to include specific assets in a MA portfolio to benefit from MA capital treatment. This process can take up to six months to secure approval.⁴⁷

The proposed MAIA framework would allow those insurers that hold MA permission to apply for MAIA permission. If granted, MAIA permission would allow firms to self-assess and include certain assets in their MA portfolio that they consider to be MA-eligible without first requesting a variation to their existing MA permission.

Insurers then have two years to apply to the PRA to formally include these assets in the MA portfolio. In the meantime, they would continue to benefit from the MA capital treatment in the interim period. Once the application is approved, the MAIA assets are integrated into the firm's MA portfolio and no longer count against the MAIA exposure limit.

Applying for MAIA Permissions

Insurers applying for MAIA permissions must propose an MAIA exposure limit. The PRA has suggested a general MAIA exposure limit, which is the lower of (a) 5% of the Best Estimate of Liabilities of the MA portfolio (net of reinsurance), or (b) any amount less than £2 billion, as proposed by the insurer.⁴⁸

As part of the MAIA framework, the PRA has proposed requiring any firm that holds MAIA permissions to maintain an MAIA policy. Amongst other things, the policy should outline:

- Any governance or oversight processes in connection with how assets are assessed for inclusion in a firm's MA portfolio.
- The firm's intended use of its MAIA permission, which may include a description of assets that would or would not be appropriate for inclusion in the MA portfolio.
- A description of a firm's MAIA risk appetite framework.⁴⁹

The PRA has also proposed that firms maintain contingency plans for each MAIA asset for circumstances where MAIA assets were determined to not be MA eligible and therefore had to be removed from the MA portfolio.⁵⁰

MAIA Reporting Requirements

The PRA also proposes the introduction of an annual "MAIA use" report. The MAIA use report would assist firms in:

- Managing their MAIA permissions.

⁴⁶ PRA CP7/25.

⁴⁷ Bank of England, "[Overseeing BPA growth safely - Speech by Gareth Truran](#)," April 2025.

⁴⁸ Paragraph 3.33, PRA CP7/25.

⁴⁹ Paragraph 3.16, *ibid.*

⁵⁰ Paragraphs 3.19 – 3.21, *ibid.*

- Identifying risk management weaknesses.
- Supporting internal operations and governance.⁵¹

Additionally, the PRA plans to make changes to the Matching Adjustment Asset and Liability Information Return (MALIR) reporting template. This change is necessary in order for the PRA to identify which assets are placed in MA portfolios using MAIA permissions, and to identify when an MA application has not been made on time. The updated reporting template will help the PRA assess the effectiveness of MAIA permissions in achieving its objectives and identifying emerging risks.⁵²

B. Closing Liquidity Reporting Gaps

The PRA considers that UK life insurers are increasingly using derivatives and other financial instruments to manage various risks to their business, citing that the gross notional derivatives exposure of UK life firms has more than doubled to £1.4 trillion since 2018.⁵³

The PRA considers that such instruments can be a significant source of liquidity risk because they can require firms to increase margin or collateral payments when market conditions change, resulting in rapid and substantial outflows.

As such, in December 2024, the PRA issued consultation paper CP19/24 proposing to close liquidity reporting gaps for large insurance firms with significant exposure to derivatives or securities involved in lending and repurchase agreements.

The consultation closed on 31 March 2025, and in September 2025 the PRA considered the responses to CP19/24 when they issued policy statement PS15/25. The proposed implementation date for the reforms in CP19/24 will be 30 September 2026.⁵⁴ However, the PRA proposes to apply the proposed liquidity reporting thresholds retrospectively. Firms would be subject to the requirements if they meet the thresholds at the proposed implementation date of 30 September 2026, based on their balance sheet over the three quarterly reporting periods prior to implementation.⁵⁵

Liquidity Risk Conditions

The requirements under the CP19/24 are only applicable to firms that meet the liquidity risk conditions. These include:

- The value of the institution's total assets (with some exclusions) exceeds £20 billion over three consecutive quarterly reporting periods on average.
- The total notional value of all the institution's derivative contracts not held in unit-linked and index-linked contracts exceeds £10 billion at any time.
- The total value of the underlying security on- and off-balance sheet, excluding assets held for index-linked and unit-linked contracts, involving the lending or repurchase agreements exceeds £1 billion at any time.⁵⁶

⁵¹ Paragraphs 3.23 – 3.24, *ibid.*

⁵² Paragraph 3.26, *ibid.*

⁵³ Paragraph 2.6, PRA CP19/24.

⁵⁴ Paragraph 1.20, PRA PS15/25.

⁵⁵ *Ibid.*

⁵⁶ Paragraphs 3.35 – 3.36, PRA CP19/24.

If firms meet any of these conditions, they must commence liquidity risk reporting on the first reporting reference date after these conditions have been met. However, the enhanced reporting requirements would not apply to the Society of Lloyd's and its managing agents, third-country branches or non-Solvency II firms.⁵⁷

When a firm falls below the thresholds on three consecutive annual reporting dates, it must cease to report.

Reporting Format

In CP19/24, the PRA introduced proposed amendments to the Reporting Part of the PRA Rulebook as well as new proposed liquidity templates and introductions which were then confirmed in PS15/25. They are:

- Cash flow mismatch template (long- and short-form versions).
- Committed facilities template.
- Liquidity market risk sensitivities template.

C. Removal of the Expectation for Life Insurers With Internal Model Permissions To Annually Submit the SF.01 Template

The proposals update supervisory statement SS15/16–Solvency II: Monitoring Model Drift and Standard Formula SCR Reporting for Firms With an Approved Internal Model.

The PRA acknowledges that the template may be less effective in detecting model drift in internal models (IM) for life insurance firms. For example, Standard Formula treatment of non-vanilla assets, particularly internally securitised and internally rated assets such as equity release mortgages commonly invested in by life insurers, can lead to significant changes in the Standard Formula SCR year-on-year while the IM SCR remains more stable.⁵⁸

As such, the Standard Formula SCR is less informative of model drift for life insurance firms with such investments, and the PRA is proposing not to require it in the future. Following a deadline extension in CP19/24 for life insurers to submit this template for year-end 2024 to 15 September 2025, in PS15/25 it was confirmed that in-scope IM firms will not be expected to submit a year-end 2024 SF.01 report to the PRA.⁵⁹ Non-life and composite IM firms, however, will be expected to continue submitting the template.⁶⁰

D. Solvent Exit Planning

In December 2024, the PRA issued the policy statement PS20/24 which focuses on solvent exit planning for insurers, which is designed to ensure that insurers can “exit” the market in an orderly manner without causing significant disruption to policyholders or the financial system, with changes to come into effect from 30 June 2026.⁶¹

PS20/24 finalises the proposed policy and rules set out under consultation paper CP2/24, published in January 2024. There are new rules in the form of new a “Preparations for Solvent Exit” Part of the PRA Rulebook, as well as expectations in the form of supervisory statement (SS11/24).

This new solvent exit planning regime is two-fold:

⁵⁷ Paragraph 1.8, *ibid.*

⁵⁸ Paragraph 5.4, *ibid.*

⁵⁹ Paragraph 1.22, PRA SS15/25.

⁶⁰ Paragraph 5.4, PRA CP19/24.

⁶¹ Paragraph 1.15, PRA PS20/24.

- **BAU planning:** There are new rules on planning for a solvent exit as part of its “business as usual” (BAU) basis. Insurers must document those activities in a Solvent Exit Analysis (SEA).
- **Expectations when solvent exit becomes a prospect:** These new expectations, set out in SS11/24, only apply where a solvent exit becomes a reasonable prospect for a firm. In this case a firm must produce a Solvent Exit Execution Plan (SEEP) when a solvent exit becomes a reasonable prospect for an insurer.

BAU Planning – Solvent Exit Analysis

BAU planning is applicable to all insurers supervised by the PRA. Insurers must produce an SEA and update it whenever a material change has taken place that may affect its preparations for a solvent exit, and/or at least once every three years.

The level of detail in the SEA should be proportionate to the nature, scale and complexity of the firm. The SEA must include the following, amongst others:⁶²

- **Solvent exit actions:** These are main options that a firm considers appropriate for a solvent exit such as a run-off, sale or partial sale, a merger with another insurer, a transfer of all or part of its business, a solvent scheme of arrangement and/or restructuring plan, or a combination of these. For each option, a firm should set out in its SEA the actions that would be needed to cease its PRA-regulated activities while remaining solvent.
- **Solvent exit indicators:** A firm should identify and monitor indicators that would inform it about when it may need to initiate a solvent exit and whether the execution of a solvent exit is likely to be successful.
- **Potential barriers and risks:** The PRA lists internal and external potential barriers and risks to a firm’s execution of a solvent exit, of a financial and nonfinancial nature.
- **Resources and costs:** A firm should set out in its SEA the financial resources, including capital, reinsurance, funding and liquidity, needed to execute a solvent exit.
- **Communications:** A firm should set out in its SEA the internal and external stakeholders that may be impacted by a solvent exit.
- **Governance and decision-making:** A firm should set up clear governance arrangements, with a senior manager accountable, for BAU preparations for a solvent exit.
- **Assurance:** A firm should undertake adequate assurance activities for its solvent exit preparations. This assurance can be conducted internally, or externally as the firm considers appropriate.

Reasonable Prospect of a Solvent Exit – Solvent Exit Execution Plan⁶³

A firm will be expected to produce an SEEP when there is a reasonable prospect that the firm may need to execute a solvent exit, which could be informed by its solvent exit indicators, or when the firm is requested by the PRA to produce an SEEP.

The SEEP should contain a non-exhaustive list of contents which mirrors some of the content headings applicable to the SEA. In addition, the SEEP should provide the PRA with a detailed execution plan for the proposed solvent exit and how the firm will stop its regulated activities. The SEEP should also come with a clear and detailed communication plan for stakeholders impacted by the solvent exit.

⁶² PRA SS20/24.

⁶³ *Ibid.*

In preparation of the SEEP, the firm’s board of directors (or equivalent) should provide sufficient challenge on it, and should review and approve the SEEP. The SEEP should be supported by:

- Projections over the period of the solvent exit of future premiums and claims cash flows, gross and net of reinsurance, expenses, and SCR and MCR.
- Analyses of risk factors and how these would be managed. For example, the composition of assets and liabilities by maturity and currency, currency risk, reinvestment risk, concentration risk, lapse risk and contractual risk in respect of derivative or reinsurance contracts.
- Realistic exit valuations of assets and liabilities, including appropriate adjustments to their value.

4. Conclusion

In 2025, the PRA continues to focus on implementation of reforms on the Solvency UK to achieve objectives to: (i) spur a vibrant, innovative, and internationally competitive insurance sector; (ii) protect policyholders and ensure the safety and soundness of firms; and (iii) support firms to make long-term investments to support growth.⁶⁴

The European Commission and the EIOPA also make effort in reviewing the Level 2 Delegated Regulation to remove deterrents for EU insurers to support the long-term financing of the European economy, while preserving financial stability and ensuring policyholder protection. The regulators ultimately aim to improve the way the EU financial system works to better support investments and enhance the EU’s competitiveness.⁶⁵

It is evident that Solvency II and Solvency UK will continue to be reviewed and fine-tuned amid the ever-changing global economy to ensure that they are best placed to facilitate the growth and security of the EU and the UK insurance industries.

For more details of Solvency II and Solvency UK, please refer to our first edition of *A Guide to Solvency II*, published in November 2024.

⁶⁴The PRA, “[Insurance Supervision: 2025 priorities](#),” 9 January 2025.

⁶⁵The European Commission, “[Commission seeks feedback on the review of the Solvency II Delegated Regulation](#),” July 2025.

Annex – Summary of Changes to the MA Further to PS10/24

Reform Area	Summary
Matching Adjustment Asset Eligibility for Assets That Are Highly Predictable	The new framework allows for the inclusion of assets with highly predictable (HP) cash flows within an MA portfolio, provided they do not exceed 10% of the total MA benefit. These assets must be contractually bound as to timing and amount of cash flows, be bonds or similar assets, and have a credit quality capable of assessment. Where it is not clear if an asset has HP or fixed cash flows, the PRA prohibits decomposing assets into fixed and HP components and expects insurers to manage these assets with appropriate governance.
Sub-Investment Grade Assets	The PRA has removed the cap on sub-investment grade (SIG) assets in an MA portfolio and modified expectations around their management and modelling. Investments in SIG assets should remain limited and prudent, with effective risk management systems in place.
Extension of the Categories of Insurance Liabilities Eligible for Matching Adjustment	The scope of liability portfolios eligible for the MA has been expanded to include in-payment income protection claims and the guaranteed components of with-profits annuities. This extension aims to provide significant capital benefits in relevant markets.
Implementing a More Efficient Matching Adjustment Application Procedure Tailored to Specific Assets	The PRA has optimised its MA application processes, setting a target of six months for decisions on MA applications and developing a timeline for streamlined reviews expected to be shorter than six months.
A More Balanced Approach to Matching Adjustment Condition Breaches	The PRA has retained the two-month compliance restoration period but allows for a staggered reduction of the MA if compliance is not restored within this window. The reduction starts at 10% of the unadjusted MA, increasing by 10% each month until compliance is restored or the MA is reduced to zero.
Matching Adjustment Attestation	An annual formal statement by the chief financial officer or relevant senior manager is required, attesting that the fundamental spread reflects compensation for all retained risks and that the MA can be earned with a high degree of confidence. A new senior management function holder will be responsible for this attestation, supported by appropriate internal processes.
Matching Adjustment Asset and Liability Information Return	A new annual reporting requirement mandates insurers to provide detailed information on the assets and liabilities held in their MA portfolios, standardizing data provided to the PRA concerning these portfolios.

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