MILLIMAN BRIEFING NOTE

Amendments to the Solvency II Directive

In January 2024 the European Council and the European Parliament published their agreed amendments to the Solvency II Directive. This briefing note summarises these amendments.

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The review of the Solvency II Directive has been underway since 2020. Agreement on the proposed updates to the Directive has now been reached representing a significant milestone in the process.

The implementation date is still uncertain. Early 2026 is the soonest, with further delays still possible.

Background

In December 2020 the European Insurance and Occupational Pensions Authority (EIOPA) published its opinion on the review. In September 2021, the European Commission published its proposals. In June 2022 the European Council shared its views on the proposals. In July 2023 the European Parliament's Committee on Economic and Monetary Affairs (ECON) approved its amendments to the Directive. Negotiations between the European Parliament, European Council and European Commission then resulted in the provisional amendments to the Directive now agreed. These cover the following areas:

- Risk Margin
- Solvency Capital Requirement (SCR)
  - Interest rate risk
  - Symmetric adjustment
  - Long-term equities
- Long-term guarantee (LTG) measures
  - Extrapolation
  - Volatility Adjustment
  - Matching Adjustment
- Pillar 2 requirements:
  - General governance
  - Cyber, liquidity and sustainability risk management
  - Macroprudential considerations
  - Climate change
- Pillar 3 requirements
  - Deadlines
  - Solvency and Financial Condition Report (SFCR)
- Proportionality measures

The texts of the provisional agreements will now be finalised and presented to member states' representatives and the European Parliament for approval. If approved, the Council and the Parliament will have to formally adopt the texts. This will need to be completed by the end of April 2024, when the last European Parliament sessions will be held before the June 2024 elections.

In this briefing note we also include a comparison to the Solvency II reforms proposed by the Prudential Regulation Authority (PRA) in the UK.

Risk Margin

In the revised framework for the risk margin, the cost of capital parameter has been set at 4.75% (reduced from the current 6%). This number appears to be an exact compromise between the 5% proposed by the European Commission and the 4.5% proposed by the European Parliament. The cost of capital parameter shall be periodically reviewed by the Commission, but not for at least five years after this update is implemented. It could potentially be amended through the Delegated Acts within a 4% to 5% corridor.

In line with EIOPA's earlier advice, an exponential and time-dependent element is introduced to account for the time dependency of risks and reduce the amount of the risk margin, the "lambda factor." The detailed requirements for the implementation of this element are to be specified in the Delegated Acts. We know from the Commission's proposals in 2021 that it had largely followed EIOPA's proposal. However, EIOPA had proposed a floor on the lambda factor of 50% (which would apply from year 2028) and the Commission had removed this floor to allow for more effective mitigation of volatility. We might expect therefore that the Commission will

implement its previous proposal in the Delegated Acts (but perhaps not, given that a lower cost of capital factor now applies).

Overall, the level and interest rate sensitivity of the risk margin are expected to be significantly reduced. These developments will be welcomed in particular by insurers with long-term liabilities.

SCR

INTEREST RATE RISK

Regarding the interest rate risk sub-module of the SCR, the proposals are in line with EIOPA's original recommendations.

The parameters for determining shocked interest rates for interest rate up and down scenarios will be based on a combination of absolute and relative shocks. A downward shock will be applied even to initially negative interest rates, with the introduction of a floor rate.

It is mentioned that the methodology used should not result in unrealistically large decreases in the liquid part of the curve. The text states that, in line with interest rates dynamics, the European Commission should aim to introduce a floor that is term-dependent rather than flat, to the extent that the available market data allows for a robust risk-based calibration of such term dependency.

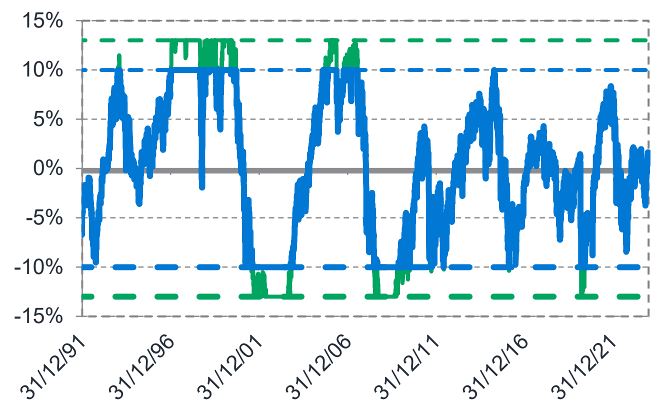
The adjustments to the interest rate risk sub-module may be phased in over a transitional period of up to five years. Such phasing-in shall be mandatory and apply to all insurance or reinsurance undertakings.

SYMMETRIC ADJUSTMENT

The symmetric adjustment, often referred to as the equity dampener, will see its corridor expanded from 10 percentage points around the standard equity shock to 13 percentage points.

This will allow a wider range for the adjustment. In recent years the lower bound was reached during the initial outbreak of COVID-19.

FIGURE 1: HISTORICAL VALUES OF SYMMETRIC ADJUSTMENT AS OF DECEMBER 2023 WITH THE PREVIOUS CORRIDOR AND THE NEW CORRIDOR



LONG-TERM EQUITIES

The principle of long-term equity (LTE) investments was introduced in Solvency II in 2019 with a new article 171a in the Delegated Acts.

The LTE module is now included in the Directive with some amendments to the criteria.

OTHER SCR CHANGES

Some other changes are proposed in relation to the calculation of the SCR, including:

- The duration-based equity sub-module will be removed with a grandfathering clause provided for those currently applying it.
- For companies using full or partial internal models, an estimate of the SCR calculated using the standard formula will be required at least every two years.
- The European Commission is empowered to adopt delegated acts to reflect the credit and market risks involved in crypto assets. No additional information is provided at this stage, but it can be noted that crypto assets are part of the latest Quantitative Reporting Template (QRT) taxonomy 2.8.
- EIOPA is asked to assess the potential effects of dedicated prudential treatment of exposures which are associated substantially with harm to environmental and/or social objectives or on the protection of policyholders and financial stability in the EU, including fossil fuel-related assets. EIOPA has already launched a consultation paper on the prudential treatment of sustainability risks.[1]
- EIOPA is encouraged to reassess the standard parameters for natural catastrophe risk to take into account the effect of the ongoing climate change on the frequency and severity of the natural catastrophes.

[1] EIOPA (13 December 2023). EIOPA consults on the prudential treatment of sustainability risks. Retrieved 26 February 2024 from https://www.eiopa.europa.eu/eiopa-consults-prudential-treatment-sustainability-risks-2023-12-13_en.

LTG measures

The proposed updates to the Solvency II Directive contain significant amendments for the following LTG measures:

- Extrapolation
- Volatility Adjustment
- Matching Adjustment

These amendments largely echo EIOPA's opinion on the Solvency II review, but in certain areas there are some notable deviations.

Besides quantitative impacts, there are also changes to the disclosure requirements and risk management provisions related to these LTG measures.

EXTRAPOLATION

A new methodology has been agreed for the extrapolation of risk-free interest rates. The extrapolation will start from the first smoothing point (FSP), i.e., the duration at which bond markets are no longer considered deep, liquid or transparent. The extrapolation from that point will be based on forward rates converging smoothly from the applicable forward rate at the FSP to an ultimate forward rate (UFR). The extrapolated forward rates shall be equal to a maturity-dependent weighted average of the UFR and a liquid forward rate, which takes into account information on longer-term interest rates from multiple financial instruments other than bonds that can be observed in a deep, liquid and transparent market.

While the detailed parameters, including exact formulae and weightings, are yet to be clarified in the Delegated Acts, two important parameters have already been agreed upon in the Directive:

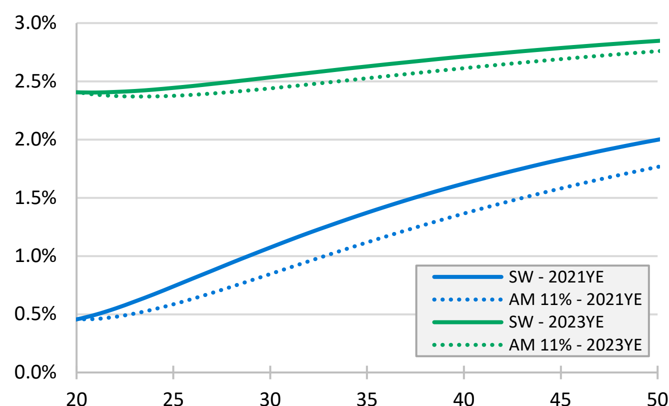
- At application date, the FSP for the euro shall be at a maturity of 20 years.
- At 40 years past the FSP, the UFR weight should have increased to at least 77.5%. This condition effectively floors the convergence parameter (alpha) at roughly 11% in the extrapolation formula proposed earlier by EIOPA.

In addition, a phasing-in mechanism is introduced for the new extrapolation method, subject to prior supervisory approval. Under this phasing-in mechanism, insurers are allowed to implement the new extrapolation method through yearly (linear) changes in extrapolation parameters between the implementation date and 1 January 2032.[2] If the phasing-in mechanism is applied, insurers need to publicly disclose the use of this transitional measure and its impact on their financial position in the Solvency and Financial Condition Report (SFCR).

In relation to the details to be clarified in the Delegated Acts, this will be the responsibility of the European Commission. Previously, the European Commission had indicated that it would build on the formulae and parameters proposed by EIOPA.

In Figure 2, the risk-free rates at year-end (YE) 2021 and YE 2023 are shown for the new alternative extrapolation method (AM) under the expected parametrisation, compared against the current Smith-Wilson methodology (SW). With the recent increases in long-term swap rates, the differences between the new and current extrapolation methodology are substantially smaller than the differences before 2022.

FIGURE 2: EXTRAPOLATED RISK-FREE RATES 2021YE AND 2023YE INCLUDING CREDIT RISK ADJUSTMENT AND EXCLUDING VOLATILITY ADJUSTMENT



Source: Refinitv, Tooling for Inter- and Extrapolation by Milliman.

In Figure 3, the impacts of the expected changes in extrapolation method on liability valuation are illustrated for the years 2021 and 2023. For this example, we have used a proxy cash flow, internally constructed, representing a typical life insurance company with long-term liabilities. The cash flow is calibrated to represent a life insurance best estimate liability with duration 16 when applying the Solvency II curve, excluding the Volatility Adjustment (VA), and the last liquid point (LLP) is at the same maturity as proposed for the FSP.

The impact of the expected change in extrapolation methodology has decreased substantially with the recent rate increases. If rates remain at current levels, the need for the phasing-in mechanism will most likely not be as high as it was before 2022. Moreover, the condition for the UFR weight has created more certainty on the expected range for the transition impacts and its sensitivity towards movements in long-term swap rates. This provides an opportunity for insurers to already consider how to treat the transition impact in their interest rate hedging policy.

[2] The phasing-in mechanism has been discussed in a previous briefing note, which can be found at https://www.milliman.com/en/insight/the-transitional-mechanism-for-the-alternative-extrapolation.

FIGURE 3: PROXY INSURER LIABILITY VALUATION FOR DIFFERENT LIABILITY DISCOUNT CURVES (SW LLP 20 AT 2021 YE = 100), AS OF 2021YE AND 2023YE

	2021 YE SW LLP 20	2021 YE AM 11%	2023 YE SW LLP 20	2023 YE AM 11%
Liability value	100,0	101,9	76,9	77,4
Impact (abs.)		1,9		0,5
Impact (%)		1,9%		0,7%

VOLATILITY ADJUSTMENT

The VA framework has also been significantly revised. Supervisory approval will now be required in all countries before applying the VA.

Additionally, the mechanism underlying the VA is subject to a substantial overhaul:

- The general application ratio has increased from 65% to 85%.
- The country component of the VA is replaced with a macroeconomic VA for euro countries, based on the country-specific reference portfolio and with a gradual and smooth activation to avoid a “cliff-edge” effect.
- Introduction of an undertaking-specific credit spread sensitivity ratio (CSSR) with a value between 0 and 1 to account for volume and duration mismatches between fixed income investments and insurance liabilities.
- Insurance and reinsurance undertakings may, subject to prior supervisory approval, apply an additional undertaking-specific adjustment on the risk-corrected spread of the currency, to account for the undertaking’s fixed income portfolio composition. This additional adjustment is capped at 105% and may not be higher than 100% for two consecutive quarters.
- The weights used to weigh the spreads for government bonds and for bonds other than government bonds should sum up to 100%.
- The risk-correction deducted from spreads shall be calculated as a percentage of spreads, where the treatment of long-term average spreads is in line with the principles as advised earlier by EIOPA.
- In the extrapolation of risk-free interest rates, the VA also applies to the last liquid forward rate.

Some of the detailed parameters, formulae and definitions regarding the VA remain to be outlined in the Delegated Acts, but the Commission had previously indicated it would consider EIOPA’s advice. In line with EIOPA’s objectives, overall spread mismatches are expected to be reduced. The redesign is in particular expected to address the VA overshooting in times of high stress, as observed during the beginning of the COVID-19 pandemic.[3]

DYNAMIC VOLATILITY ADJUSTMENT

For the Dynamic VA (DVA), only applicable for undertakings with an internal model, a DVA prudency principle is to be introduced, in line with EIOPA’s earlier advice.

The SCR after DVA should be at least as high as:

(i) the SCR with EIOPA VA and

(ii) the SCR with a VA based on the EIOPA methodology applied to the undertaking’s investment portfolio.

Moreover, changes to the macroeconomic VA should be excluded from the DVA, as well as the undertaking-specific adjustment for the portfolio composition.

Together with the other proposed VA changes a reduction of the VA offset (currently benefiting insurers) is expected.

MATCHING ADJUSTMENT

The updated Solvency II Directive does not introduce substantial changes to the Matching Adjustment (MA) or its calculation, apart from a few clarifications.

The European Commission has been asked to introduce Delegated Acts to set out criteria for eligibility of assets where diverging practices could arise with respect to the MA.

The description of the bases and methods behind the MA calculation should be in the part of SFCR that is to be targeted at market professionals, rather than policyholders.

Pillar 2

Pillar 2 sets the qualitative requirements, including governance and risk management of the undertakings and the Own Risk and Solvency Assessment (ORSA). There are a number of new requirements, including requirements to consider sustainability risks within the risk management system, and to consider macroeconomic factors and climate change scenarios within the ORSA. The new requirements and changes are outlined below.

GENERAL GOVERNANCE REQUIREMENTS

There is a new requirement for undertakings to put in place a policy promoting diversity on the board, including setting individual quantitative objectives related to gender balance. EIOPA will issue guidelines in relation to diversity to be taken into account.

A new requirement was added for undertakings to appoint different people to carry out the key functions of risk management, actuarial, compliance and internal audit. Each function should be carried out in an independent manner from the others, to avoid conflicts of interest. One person may carry out more than one key function only when the undertaking has been classified as “small and non-complex” under the proportionality criteria below and supervisory approval has been obtained and the following conditions are met:

- Potential conflicts of interests are properly managed

[3] An earlier briefing note has discussed the redesign of the VA as proposed by EIOPA and its effectiveness, which can be found at: https://www.milliman.com/-/media/milliman/pdfs/articles/briefing-note-va.ashx.

- The combination of functions or the combination of a function with the condition of membership of the board does not compromise the person's ability to carry out their responsibilities

An additional written policy on remuneration is also required.

Undertakings will be required to notify the supervisory authority of any changes to the identity of the people who run the undertaking or are responsible for other key functions, along with the reasons for the changes and all information needed to assess whether any new people appointed are fit and proper.

Where a person who runs the undertaking or is responsible for other key functions does not fulfil the requirements, the supervisory authorities will have the power to remove the person from that position.

RISK MANAGEMENT

Cybersecurity

The risk management system is to include cybersecurity within operational risk management.

Liquidity risk management

Undertakings should prepare and keep up to date a liquidity risk management plan covering liquidity analysis in the short term. Undertakings should develop liquidity risk indicators to identify, monitor and address potential liquidity stress.

The liquidity risk management of undertakings should ensure they maintain adequate liquidity to settle obligations as they fall due, even under stressed conditions.

Where undertakings apply the VA, their liquidity plans should take into account the use of the volatility adjustment.

Sustainability risks

Undertakings will need to develop and monitor the implementation of specific plans, quantifiable targets and processes to monitor and address the financial risks arising in the short, medium and long term from sustainability factors, including those arising from regulatory objectives and legal acts in relation to sustainability.

In order to ensure consistent application of requirements in relation to sustainability risks, EIOPA will develop draft regulatory technical standards which will specify elements to be covered in plans, quantifiable targets, processes etc.

Undertakings will be required to disclose on an annual basis the quantifiable targets included in the plan.

Undertakings will also be required to take account of the impact of sustainability risks on their investments and the potential long-term impact of investment decisions on sustainability factors when deciding on investment strategy.

MACROPRUDENTIAL CONSIDERATIONS

The ORSA is required to include:

- Consideration and analysis of the macroeconomic situation and possible macroeconomic and financial markets' developments.
- Upon request of the supervisory authority, consideration and analysis of:
  - Macroprudential concerns that may affect the risk profile, risk tolerance limits, business strategy, underwriting activities or investment decisions, and the overall solvency needs of the undertaking
  - Activities of the undertaking that may affect the macroeconomic and financial markets developments and have the potential to turn into sources of systemic risk
- The overall capacity of the undertaking to settle its financial obligations to policyholders and counterparties, even under stressed conditions.

Further details on what needs to be included for each of these points are also outlined in the updated text.

Undertakings will be required to take account of possible macroeconomic and financial markets developments when deciding on investment strategy.

Undertakings may also be requested by the supervisor to take account of macroprudential concerns when deciding on investment strategy.

CLIMATE CHANGE

Undertakings will be required to assess whether they have any material exposure to climate change risks. Where a material exposure is identified, the undertaking should specify at least two long-term climate change scenarios, including:

- A long-term climate change scenario where the global temperature increase remains below 2 degrees Celsius
- A long-term climate change scenario where the global temperature increase is significantly higher than 2 degrees Celsius

The long-term climate change scenarios are required to be reviewed at least every three years and updated where necessary.

Pillar 3

DEADLINES

Deadline periods for annual reporting are proposed to increase as follows:

- Annual QRTs from 14 weeks to 16 weeks
- Regular Supervisory Report (RSR) and SFCR from 14 weeks to 18 weeks
- Group SFCR from 20 weeks to 22 weeks

Quarterly reporting deadlines are unchanged (5 weeks for solo QRTs and 11 weeks for group QRTs).

SFCR

The content of the Solvency and Financial Condition Report (SFCR) is proposed to be divided into two parts.

- The first part, addressed mainly to policyholders and beneficiaries, should contain the key information on business, performance, capital management and risk profile. This part should only contain the information that is

expected to be relevant to the decision-making of an average policyholder.

- The second part, addressed to market professionals, should contain detailed information on the business and on the system of governance, specific information on technical provisions and other liabilities and the solvency position as well as other data relevant for specialised analysts.

While insurance and reinsurance undertakings should publicly disclose the impact of not applying the MA, the VA and the transitional measures on risk-free interest rates and on technical provisions on their financial positions, such disclosures should not be assumed to be relevant to the decision-making of an average policyholder. The impact of such measures should therefore be disclosed in the part of the SFCR targeted to market professionals and not in the part targeted to policyholders.

The public part of the SFCR should be subject to audit covering at least the balance sheet.

Proportionality

The updated Solvency II Directive introduces rules for "small and non-complex" insurance companies, which will reduce the administrative burden on these companies.

CRITERIA

For two consecutive years directly prior to classification, the following criteria must be met:

For life undertakings:

- The interest rate risk sub-module is not higher than 5% of technical provisions, gross of reinsurance and special purpose vehicles (SPVs).
- Annual gross written premium income from business written in Member States other than the home Member State is either;
  - Lower than €20 million
  - Lower than 10% of total annual gross written premium
- Technical provisions from life activities, gross of reinsurance and SPVs, are not higher than €1 billion.
- The sum of the following is not higher than 20% of total investments:
  - The gross market risk module
  - The part of the counterparty risk module that corresponds to exposures to securitisations, derivatives, receivables from intermediaries and other investment assets which are not covered in the spread risk sub-module
  - Any capital requirement that is applicable to investments in intangible assets that are not covered by the market risk and counterparty default risk modules
- The reinsurance accepted does not exceed 50% of total annual gross written premium.
- The Solvency Capital Requirement is complied with.

For non-life undertakings:

- The average combined ratio for non-life activities net of reinsurance of the last three years is less than 100%.
- Annual gross written premium income from business written in Member States other than the home Member State is either;
  - Lower than €20 million
  - Lower than 10% of total annual gross written premium
- Annual gross written premium for non-life activities is not higher than €100 million.
- The sum of annual gross written premium in classes 5 to 7, 11, 12, 14 and 15 of Section A of Annex 1 is not higher than 30% of total annual written premiums of non-life business.
- The sum of the following is not higher than 20% of total investments:
  - The gross market risk module
  - The part of the counterparty risk module that corresponds to exposures to securitisations, derivatives, receivables from intermediaries and other investment assets which are not covered in the spread risk sub-module
  - Any capital requirement that is applicable to investments in intangible assets that are not covered by the market risk and counterparty default risk modules
- The reinsurance accepted does not exceed 50% of total annual gross written premium.
- The Solvency Capital Requirement is complied with.

Captives can also be classified as "small and non-complex" provided they comply with additional specific criteria relevant for captives.

There are certain undertakings which will never be classified as "small and non-complex" undertakings. They include those that use a partial or full internal model to calculate the Solvency Capital Requirement.

USE OF PROPORTIONALITY MEASURES

Undertakings classified as "small and non-complex" may use all proportionality measures, except where the supervisory authority has serious concerns in relation to the risk profile, provided this concern is duly justified in writing.

Undertakings that are not classified as "small and non-complex" may use some of the proportionality measures outlined below, subject to prior approval from the supervisory authority. Such firms are not allowed to use the measures related to the SFCR, or related to the climate change scenarios in the ORSA.

Once classified as "small and non-complex," undertakings should benefit from proportionality measures on reporting, disclosure, governance, revision of written policies, calculation of technical provisions, the ORSA and the liquidity risk management plan.

Details of the proportionality measures provided are as follows:

- **RSR**

  The frequency of the RSR may be up to five years for “small and non-complex” undertakings, where permitted by the supervisory authority. (For all other undertakings the RSR is required every three years.)

- **SFCR**

  “Small and non-complex” undertakings may disclose only the quantitative data in the part of the SFCR consisting of information targeted to other market professionals, provided they disclose a full report containing all the required information every three years.

  The balance sheet disclosed as part of the SFCR is not subject to audit for “small and non-complex” undertakings (however, Member States may opt to extend this obligation to include “small and non-complex” undertakings).

- **General governance requirements**

  When an undertaking has been classified as “small and non-complex,” the people responsible for the key functions of risk management, actuarial and compliance may also perform: any other key function (other than internal audit); any other function; or be a member of the board, provided certain conditions are met.

  “Small and non-complex” undertakings may perform a less frequent review of their written policies in relation to risk management, internal control, internal audit, remuneration and, where relevant, outsourcing. These policies should be reviewed at least every five years, instead of at least annually, unless the supervisory authority concludes that a more frequent review is needed.

- **ORSA**

  “Small and non-complex” undertakings are not obliged to provide consideration and analysis of macroprudential concerns that may affect the undertaking, or activities that may affect the macroeconomic and financial markets’ development and have the potential to turn into systemic risk.

  “Small and non-complex” undertakings may perform the ORSA at least every two years, instead of annually.

  They are also not required to specify climate change scenarios or to assess their impact on the business.

- **Technical provisions**

  “Small and non-complex” undertakings may use a prudent deterministic valuation of the best estimate for life obligations with options and guarantees that are not deemed material, instead of using a scenario-based approach.

- **Liquidity risk management**

  “Small and non-complex” undertakings are not obliged to draw up a liquidity risk management plan.

- **Solvency Capital Requirement**

  “Small and non-complex” undertakings may use a simplified calculation for a specific risk module or risk sub-module without having to comply with the general conditions for using a simplified approach, where they can demonstrate that at least every five years the following conditions are met:

  - Each individual risk module or risk sub-module, for which a simplified calculation is intended to be used, represents, without applying the simplification, less than 2% of the basic Solvency Capital Requirement.
  - The sum of all risk modules or sub-modules, for which a simplified calculation is intended to be used, represents, without applying the simplification, less than 10% of the basic Solvency Capital Requirement.

Other

Some other items included in the revised text are described in this section.

SCOPE

The limits for exclusion from the scope of the Solvency II requirements have been increased. The Directive will not apply to undertakings fulfilling the following conditions:

- Annual gross written premium income does not exceed €15 million (increased from €5 million)
- Total technical provisions, gross of reinsurance and special purpose vehicles, does not exceed €50 million (increased from €25 million)
- Where the undertaking belongs to a group, total technical provisions of the group, gross of reinsurance and special purpose vehicles, does not exceed €50 million (increased from €25 million)

INTRA-GROUP TRANSACTIONS

The definition of “intra-group transactions” was updated to mean:

“any transaction by which a (re)insurance undertaking, a third-country (re)insurance undertaking, an insurance holding company or a mixed financial holding company relies, either directly or indirectly, on other undertakings within the same group or on any natural or legal person linked to the undertakings within that group by close links, for the fulfilment of an obligation, whether or not contractual, and whether or not for payment.”

The Solvency II text was also updated so that, in addition to intra-group transactions within this meaning, supervisory authorities may also require groups to report intra-group transactions that involve undertakings other than (re)insurance undertakings, third-country (re)insurance undertakings, insurance holding companies and mixed financial holding companies.

SIGNIFICANT CROSS-BORDER ACTIVITIES

Measures have been introduced to allow for enhanced supervisory cooperation and information exchange between home and host supervisory authorities in relation to significant cross-border activities.

Significant cross-border activities are defined as (re)insurance activities carried out under the freedom of establishment or freedom to provide services by an undertaking, which meet any of the following criteria:

- Total annual gross written premium income exceeds €15 million
- The activities carried out are considered by the supervisory authority of the host Member State as being of relevance to the host Member State's market

There are new requirements aiming to provide enhanced supervisory cooperation and information exchange between home and host supervisory authorities in relation to significant cross-border activities.

Comparison to UK reforms

In the UK, the Prudential Regulation Authority (PRA) has published a Consultation Paper, with a set of proposed Solvency II reforms. All currently proposed reforms are expected to be in force by 31 December 2024 subject to final versions being published. The focus of these reforms is on simplification, improving flexibility and encouraging entry into the UK markets. Although the goals may not align completely with those of EIOPA, there are similarities to be found in both sets of proposals.

Among these, the PRA has a comparable proposal for a reduction in the cost of capital (which came into force as at 31 December 2023), but set to 4% instead of 4.75%. In addition, a new formula for the calculation of the Risk Margin has been introduced, with a tapering factor for the "runoff" factors.

The PRA is also advocating for more streamlining and simplifications in the reporting and disclosure requirements. One change is the complete retirement of the RSR, as the PRA is of the view that it is no longer needed for supervisory purposes. Others include:

- Allowing greater flexibility in the calculation of group SCR
- Increasing the threshold at which Solvency II applies
- The removal of capital requirements applicable to third-country branches

The PRA is also considering a number of changes to the calculation and application of the MA, covering the following:

1. Investment flexibility: Widening the range of assets which may be held in MA portfolios.
2. Liability eligibility: Allowing the MA to be applied to a wider range of insurance products.
3. Credit ratings under the MA: This covers the removal of the limit on the MA arising from sub-investment grade (SIG) assets, clarification on risk management requirements for SIG assets and formalising requirements on internal credit assessments with respect to MA portfolios.
4. MA Permissions, Breaches and Consequential Rule changes: Including streamlining the MA application process for certain assets and increased proportionality for breaches of MA conditions.
5. Attestation: Introducing a formal requirement for senior management to attest that the fundamental spread compensates for all retained risks and the MA can be earned with a high degree of confidence.
6. Assumptions underlying the MA: Introducing technical and conceptual assumptions to explicitly identify the assumptions underlying the MA.
7. Matching Adjustment Asset and Liability Information Return: Formalising regulatory data requests on the MA through a new template.
8. Notching of credit ratings to differentiate between credit ratings at a more granular level, e.g., between AA+, AA and AA-: Including notching in the fundamental spread. This will act to reduce the size of the step changes between credit ratings.

Further details on the PRA's proposal on the MA can be found in the Milliman summary here.

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