PRA RULEBOOK: SOLVENCY II FIRMS: INVESTMENTS INSTRUMENT 2015

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Investments Instrument 2015

D. The PRA makes the rules in the Annex to this instrument.

Commencement

E. This instrument comes into force on 1 January 2016.

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Investments Instrument 2015.

By order of the Board of the Prudential Regulation Authority
17 March 2015

Annex

In this Annex, the text is all new and is not underlined.

Part

INVESTMENTS

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *UK Solvency II firm*;

(2) in accordance with Insurance General Application 3, the *Society*; and

(3) in accordance with Insurance General Application 3, *managing agents*.

1.2 In this Part, the following definitions shall apply:

alternative investment fund

means (in accordance with Article 4(1)(a) of Directive 2011/61/EU) a collective investment undertaking, including investment compartments thereof, which:

(1) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and

(2) does not require authorisation pursuant to Article 5 of the Directive 2009/65/EC.

authorised contractual scheme

means a *co-ownership scheme* or a *partnership scheme*.

ICVC

means a body incorporated under the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

linked benefit

means a benefit payable under a *linked long-term contract of insurance* or a *regulated collective investment scheme* the amount of which is determined by reference to:

(1) the value of the property of any description (whether specified or not);

(2) fluctuations in the value of any such property;

(3) income from such property; or

(4) fluctuations in an index of the value of such property.

linked long-term liabilities

means the insurance obligations in respect of *linked benefits* under a *linked long-term contract of insurance*.

recognised scheme

means a scheme recognised under:

(1) section 264 of *FSMA* (Schemes constituted in other EEA States);

(2) section 270 of *FSMA* (Schemes authorised in designated countries or territories); or

(3) section 272 of *FSMA* (Individually recognised overseas schemes).

regulated collective investment scheme

means:

(1) an *ICVC*;

(2) an *authorised unit trust scheme*;

(3) an *authorised contractual scheme*; or

(4) a *recognised scheme*;

regulated market

means:

(1) a regulated market as defined in point (14) of Article 4 of Directive 2004/39/EC; or

(2) a market situated outside the *EEA States* which is characterised by the fact that:

(a) it meets comparable requirements to those set out in (1); and

(b) the financial instruments dealt in are of a quality comparable to those in a regulated market in the *UK*.

unit

means:

(1) (in relation to a *collective investment scheme*) the investment, specified in article 81 of the *Regulated Activities Order* (Units in a collective investment scheme) and defined in section 237(2) of *FSMA* (Other definitions); and

(2) (in relation to an *alternative investment fund*) the right or interest (however described) of an investor in an *alternative investment fund*.

2 PRUDENT PERSON PRINCIPLE: GENERAL PRINCIPLES

2.1 A *firm* must invest its assets in accordance with the following requirements:

(1) 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 in accordance with Conditions Governing Business 3.8(2)(a);

(2) all the assets of the *firm* must be:

(a) 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

(b) localised such as to ensure their availability; and

(3) in the case of a conflict of interest, the *firm* must, or must procure that any third party which manages its assets will ensure that the investment of assets is made in the best interest of *policyholders*.

[Note: Art. 132(1) – (2) of the *Solvency II Directive*]

3 PRUDENT PERSON PRINCIPLE: ASSETS COVERING TECHNICAL PROVISIONS

3.1 In addition to meeting the requirements set out in 2.1*,* a *firm* must ensure that assets held to cover its *technical provisions* are invested in a manner appropriate to the nature and duration of the *firm's* insurance and *reinsurance* liabilities and in the best interests of all *policyholders*, taking into account any disclosed *policy* objectives.

[Note: Art. 132(2) of the *Solvency II Directive*]

4 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS FOR ASSETS COVERING LINKED LONG-TERM LIABILITIES

4.1 This Chapter does not apply to a *pure reinsurer.*

4.2 In addition to the requirements set out in 2.1 and 3.1*,* where a *firm* carries out *linked long-term contracts of insurance*, it must also satisfy the requirements in 4.3.

4.3 Where 4.2 applies, the *firm* must cover its *technical provisions* in respect of its *linked long-term liabilities* as closely as possible with:

(1) where the *linked benefits* are linked to the value of *units*, those *units*;

(2) where the *linked benefits* are linked to the value of assets contained in an internal fund of the *firm*:

(a) in a case where the internal fund is divided into notional units, the assets represented by those notional units; or

(b) in a case where notional units are not established, those assets; and

(3) where the *linked benefits* are linked to a *share* index or other reference value not mentioned in (1) or (2), assets of appropriate security and marketability which correspond as closely as possible to the assets on which the reference value is based.

[Note: Art. 132(3) of the *Solvency II Directive*]

5 PRUDENT PERSON PRINCIPLE: ADDITIONAL REQUIREMENTS WHERE THE INVESTMENT RISK IS NOT BORNE BY THE POLICYHOLDER

5.1 This Chapter does not apply in respect of assets covering *technical provisions* for *linked long-term contracts of insurance* unless, and to the extent that, the assets are held to cover the *technical provisions* in respect of any guarantee of investment performance or other guaranteed benefit provided under those *linked long-term contracts of insurance*.

[Note: Art. 132(3) – (4) of the *Solvency II Directive*]

5.2 Subject to 5.1, and without prejudice to 2, 3 and 4, a *firm* must invest its assets in accordance with the following requirements:

(1) the *firm* must not invest in a *derivative* or *quasi-derivative* unless, and to the extent that, it contributes to a reduction of risks or facilitates efficient portfolio management;

(2) investments and assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;

(3) assets must be properly diversified in such a way as to avoid:

(a) excessive reliance on any particular asset, issuer, *group* of *undertakings* or geographical area; and

(b) excessive accumulation of risk in the portfolio as a whole;

(4) investments in assets issued by the same issuer, or issuers belonging to the same *group*, must not expose the *firm* to excessive risk concentration.

[Note: Art. 132(4) of the *Solvency II Directive*]

6 REPACKAGED LOANS

6.1 A *firm* must ensure that the requirements set out in the *Solvency II Regulations,* that need to be met by *undertakings* that repackage loans into tradable securities and other financial instruments in order for a *firm* to be allowed to invest in such securities or instruments, are met in respect of securities or instruments held by the *firm* that were:

(1) issued after 1 January 2011; or

(2) issued before 1 January 2011 where new underlying exposures were added or substituted after 31 December 2014.

[Note: Art. 135(2)(a) and Art. 308b (11) of the *Solvency II Directive*]