

PRA RULEBOOK: SOLVENCY II FIRMS: MATCHING ADJUSTMENT INSTRUMENT 2024**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);
- (2) section 137T (General supplementary powers).

The PRA also makes this instrument in the exercise of its powers under regulation 7 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 (2023/1347).

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

PRA Rulebook: Solvency II Firms: Matching Adjustment Instrument 2024

C. The PRA makes the rules in the Annexes to this instrument.

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Commencement

D. This instrument comes into force on 30 June 2024.

Citation

E. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Matching Adjustment Instrument 2024.

By order of the Prudential Regulation Committee

4 June 2024

Annex A

Amendments to the Glossary Part

In this Annex new text is underlined and deleted text is struck through.

...

asset type

means a category of assets that have similar features and/or similar methodologies for the purposes of determining the *credit rating* or internal credit assessment for that type of asset.

assigned asset

means an asset contained in the *relevant portfolio of assets*, that falls within the scope of Matching Adjustment 4.4(1).

...

basic relevant risk-free interest rate term structure

means the *relevant risk-free interest rate term structure* without:

- (1) a *matching adjustment*,
- (2) a *volatility adjustment*, or
- (3) a *risk-free interest rate transitional measure*.

...

cash-flows that are not fixed

means any cash-flows that are not fixed or that are capable of being changed by *issuers* of the assets or any third parties, but excluding any cash-flows that fall within the scope of regulation 4(9)(b) or (c) of the *IRPR regulations*.

...

credit quality step

means the credit quality steps 0 to 6 set out in the Annex to Commission Implementing Regulation 2016/1800.

credit quality step pair

means a sequential pair of *credit quality steps*, paired in the order in which they are set out in the Annex to Commission Implementing Regulation 2016/1800.

credit rating

has the meaning given to that term in regulation 2(1) of the *IRPR regulations*.

credit rating agency

has the meaning given to that term in Regulation 2(1) of the *IRPR regulations*.

...

default

has the meaning given to that term in Article 4(4) of Commission Implementing Regulation 2016/1799.

...

expense risk

means the risk of loss, or of adverse change, in the value of insurance obligations, resulting from changes in the level, trend or volatility of the expenses incurred in servicing contracts of insurance or reinsurance contracts.

...

group death in service dependants' annuity

means a contract of insurance covering a specified group of persons which provides benefits in the form of regular payments to nominated dependant(s) upon the death of a person in that group, to the extent of and in accordance with the terms of that contract of insurance.

...

health revision risk

means the risk of loss, or of adverse change, in the value of insurance obligations, resulting from changes in the level, trend or volatility of the revision rates applied to annuities, due to changes in inflation, the legal environment or in the state of health of the person insured.

...

income protection policy

means a contract of insurance covering a person or specified group of persons that provides benefits in the form of regular payments to that person or those persons if they are unable, or have reduced capacity, to work because of illness or injury, to the extent of and in accordance with the terms of that contract of insurance.

...

IRPR regulations

means the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 (2023/1347).

...

life revision risk

means the risk of loss, or of adverse change, in the value of insurance obligations, resulting from changes in the level, trend or volatility of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured.

line of business

means a line of business as set out in Annex I of Commission Delegated Regulation (Solvency II) 2015/35.

...

long-term insurance or reinsurance obligations

means insurance or reinsurance obligations falling within lines of business 29 to 36.

...

longevity risk

means the risk of loss, or of adverse change, in the value of insurance obligations, resulting from changes in the level, trend or volatility of mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance obligations.

...

matching adjustment

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate of a relevant portfolio of insurance or reinsurance obligations* in accordance with:

- (1) ~~Technical Provisions 6 and 7~~ the Matching Adjustment Part; and
- (2) ~~the Solvency II Regulations adopted under Article 86(1)(h) — (i) of the Solvency II Directive; [deleted]~~
- (3) ~~for the purposes of calculating technical provisions as at a point in time falling before IP completion day, the relevant technical information made by EIOPA under Article 77e(1)(b) of the Solvency II Directive and adopted in the Solvency II Regulations under Article 77e(2) of the Solvency II Directive; and [deleted]~~
- (4) ~~for the purposes of calculating technical provisions as at a point in time falling on or after IP completion day, the relevant technical information published by the PRA in accordance with regulation 4B(1) of the Solvency 2 Regulations~~ regulation 3(1) of the IRPR regulations.

matching adjustment approval

~~means the approval granted to a firm by the PRA to permit it to apply a matching adjustment for the purposes of calculating the best estimate in relation to a relevant portfolio of insurance and reinsurance obligations.~~

matching adjustment eligibility conditions

means:

- (1) the conditions contained in regulation 4(3) to (9) and (11) of the IRPR regulations; and
- (2) the conditions contained in 2.2 to 2.4 (inclusive) of the Matching Adjustment Part.

matching adjustment permission

means the permission granted to a firm by the PRA pursuant to section 138BA of FSMA to apply a matching adjustment for the purposes of calculating the best estimate in relation to a relevant portfolio of insurance or reinsurance obligations.

matching adjustment permission application

means an application by a firm for a matching adjustment permission.

matching adjustment portfolio

means a relevant portfolio of insurance or reinsurance obligations and the corresponding relevant portfolio of assets.

...

mortality risk

means the risk of loss, or of adverse change, in the value of insurance obligations, resulting from changes in the level, trend or volatility of mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance obligations.

...

rating notch

means, in respect of each *credit quality step*, the additional sub-categories (if relevant) which differentiate the relative credit quality of assets within that *credit quality step*.

...

recovery time risk

means the risk of loss, or of adverse change in the value of insurance obligations, resulting from changes in the expected time until the cessation of payments to those currently unable to work due to illness, injury or disability.

...

relevant portfolio of assets

means, in respect of a *relevant portfolio of insurance or reinsurance obligations*, the portfolio of assets, referred to in regulation 4(3) of the *IRPR regulations*, which is assigned to cover the *best estimate* of those insurance or *reinsurance obligations*.

relevant portfolio of insurance or reinsurance obligations

means a portfolio of ~~*long-term insurance or reinsurance obligations*~~~~insurance or reinsurance obligations falling within any *long-term insurance business class*, including annuities stemming from a *contract of general insurance*~~, in respect of which:

- (1) a *firm* has been granted a ~~*matching adjustment approval*~~*matching adjustment permission*; and
- (2) for the purposes of the Matching Adjustment Part only, a *firm* is applying for a *matching adjustment permission*.

relevant risk-free interest rate term structure

means the relevant risk-free interest rate term structure, in accordance with:

- (1) Technical Provisions 5 and 8.3 to 8.4; and
- (2) ~~the *Solvency II Regulations* adopted under Article 86 of the *Solvency II Directive*; and~~~~[deleted]~~
- (3) ~~for the purposes of calculating technical provisions as at a point in time falling before *IP completion day*, the relevant technical information made by *EIOPA* under Article 77e(1)(a) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*;~~~~[deleted]~~
- (4) ~~for the purposes of calculating technical provisions as at a point in time falling on or after *IP completion day*, the relevant technical information made~~published by the *PRA* in accordance with ~~regulation 4B(1) of the *Solvency 2 Regulations*~~regulation 3(1) of the *IRPR regulations*.

...

revision risk

means *life revision risk* and/or *health revision risk*, as the context requires.

...

underwriting risk

means the risk of loss or of adverse change in the value of insurance ~~obligations~~liabilities, due to inadequate pricing and provisioning assumptions.

...

volatility adjustment

means the adjustment to the *relevant risk-free interest rate term structure* to calculate the *best estimate* in accordance with:

- (1) the *Solvency II Regulations* adopted under Article 86(1)(j) of the *Solvency II Directive*; and
- (2) ~~for the purposes of calculating technical provisions as at a point in time falling before *IP completion day*, in accordance with the relevant technical information made by EIOPA under Article 77e(1)(c) of the *Solvency II Directive* and adopted in *Solvency II Regulations* under Article 77e(2) of the *Solvency II Directive*; or [deleted]~~
- (3) ~~for the purposes of calculating technical provisions as at a point in time on or after *IP completion day*, in accordance with the relevant technical information published by the PRA in accordance with regulation 4B(1) of the *Solvency 2 Regulations*~~ regulation 3(1) of the *IRPR regulations*.

...

Annex B**Matching Adjustment Part**

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

Part**MATCHING ADJUSTMENT**

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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 3.1, the *Society*; and
- (3) in accordance with Insurance General Application 3.2, *managing agents*.

1.2 In this part, the following definitions shall apply:

attestation reference date

means:

- (1) where 9.1(2)(a) applies, the effective date of the *firm's SFCR*; or
- (2) where 9.1(2)(b) applies, a date no later than three *months* after the material change in risk profile.

eligible element

means a portion of insurance or *reinsurance* obligations forming part of a wider *contract of insurance* or *reinsurance contract* and which:

- (1) comprises:
 - (a) the guaranteed element of a *with-profits policy* that is either an immediate annuity or a deferred annuity; or
 - (b) the in-payment element of a *group death in service dependants' annuity* or an *income protection policy*,

in each case, where the element can be organised and managed separately in accordance with regulation 4(6) of the *IRPR regulations*; and
- (2) would otherwise meet the *matching adjustment eligibility conditions*, but for the fact that it forms part of a *contract of insurance* or *reinsurance contract* which does not so comply, when taken as a whole.

exposure limit

means any limit that forms part of the *firm's matching adjustment permission* in respect of the inclusion of a particular asset or assets in the *relevant portfolio of assets*.

highly predictable

has the meaning given to that term in Matching Adjustment 5.3.

2 ELIGIBILITY TO APPLY A MATCHING ADJUSTMENT

2.1 A *firm* must not apply a *matching adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless it has a *matching adjustment permission*.

2.2 The conditions referred to in regulation 4(11) of the *IRPR regulations* are:

- (1) except as set out in 2.5, the contracts underlying the *relevant portfolio of insurance* or *reinsurance obligations* do not give rise to future premium payments;

- (2) the only *underwriting risks* connected to the *relevant portfolio of insurance or reinsurance obligations* are *longevity risk, expense risk, revision risk, mortality risk* or *recovery time risk*;
- (3) where the *underwriting risk* connected to the *relevant portfolio of insurance or reinsurance obligations* includes *mortality risk*, the *best estimate* of the *relevant portfolio of insurance or reinsurance obligations* does not increase by more than 5% under a *mortality risk* stress that is calibrated in accordance with Chapter 3 of the Solvency Capital Requirement – General Provisions Part and otherwise complies with 2.4;
- (4) the contracts underlying the *relevant portfolio of insurance or reinsurance obligations* include:
 - (a) no options for the *policyholder*; or
 - (b) only a surrender option with a *surrender value* not exceeding the value of the assets, valued in accordance with Valuation 2.1 and 2.2, covering the insurance or *reinsurance* obligations at the time the surrender option is exercised;
- (5) the *relevant portfolio of assets* cannot be used to cover losses arising from the other activities of the *firm*; and
- (6) the *relevant portfolio of assets* and each individual asset contained in it meets the requirements of the prudent person principle contained in Chapters 2 and 3 of the Investments Part.

2.3 For the purposes of this Part, the insurance or *reinsurance* obligations of an insurance or *reinsurance* contract must not be split into different parts when composing the *relevant portfolio of insurance or reinsurance obligations*, other than in the case of an *eligible element*.

2.4

- (1) The *mortality risk* stress referred to in 2.2(3) shall be the more adverse of the following two scenarios in terms of its impact on *basic own funds*:
 - (a) an instantaneous permanent increase of 15% in the mortality rates used for the calculation of the *best estimate*; or
 - (b) an instantaneous increase of 0.15 percentage points in the mortality rates (expressed as percentages) which are used in the calculation of *technical provisions* to reflect the mortality experience in the following 12 *months*.
- (2) For the purpose of (1) the increase in mortality rates shall only apply to those *policies* for which the increase in mortality rates leads to an increase in *technical provisions*, taking into account the following:
 - (a) multiple *policies* in respect of the same insured *person* may be treated as if they were one *policy*; and
 - (b) where the calculation of *technical provisions* is based on groups of *policies* as referred to in Article 35 of Commission Delegated Regulation (Solvency II) 2015/35, the identification of the *policies* for which *technical provisions* increase under an increase of mortality rates may also be based on those groups of *policies* instead of single *policies*, provided that it yields a result which is not materially different.
- (3) With regard to *reinsurance* obligations, the identification of the *policies* for which *technical provisions* increase under an increase of mortality rates shall apply to the underlying insurance *policies* only and shall be carried out in accordance with (2).

2.5 The condition set out in 2.2(1) does not apply in respect of an *eligible element* specified in 1.2 *eligible element* (1)(b).

[Note: In accordance with regulation 4(11) of the *IRPR regulations*, this Chapter sets out *matching adjustment eligibility conditions* in addition to those set out in regulation 4(3) to (9) and (11) of the *IRPR regulations*, under which a *firm* is eligible to apply a *matching adjustment*]

3 MATCHING ADJUSTMENT PERMISSIONS

- 3.1 A *firm* making a *matching adjustment permission application* must confirm to the *PRA* in writing and submit, as a minimum, documentary evidence that demonstrates that the *relevant portfolio of assets* and *relevant portfolio of insurance or reinsurance obligations*, and, if the context requires, the *firm*, satisfies the *matching adjustment eligibility conditions*.
- 3.2 A *firm* that applies the *matching adjustment* to a *relevant portfolio of insurance or reinsurance obligations* must not revert back to the approach that does not include a *matching adjustment*.

4 CALCULATION OF THE MATCHING ADJUSTMENT

- 4.1 This Chapter applies to a *firm* that has been granted a *matching adjustment permission*.
- 4.2 A *firm* with a *matching adjustment permission* must calculate the *matching adjustment* in accordance with 4.3 to 4.8.
- 4.3 For each currency the *matching adjustment* must be equal to the difference of:
- (1) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value of the portfolio of *assigned assets*; and
 - (2) the annual effective rate, calculated as the single discount rate that, where applied to the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, results in a value that is equal to the value of the *best estimate* of the *relevant portfolio of insurance or reinsurance obligations* where the time value of money is taken into account using the *basic relevant risk-free interest rate term structure*.
- 4.4 For the purpose of the calculation referred to in 4.3:
- (1) *assigned assets* only includes assets whose expected cash-flows are required to replicate the cash-flows of the *relevant portfolio of insurance or reinsurance obligations*, excluding any assets in excess of that;
 - (2) valuations must be calculated in accordance with the Valuation Part.
- 4.5 In 4.4(1), the 'expected cash-flow' of an asset means the cash-flow of the asset adjusted to allow for the probability of default of the asset that corresponds to the element of the fundamental spread set out in 4.10(1) or, where no reliable credit spread can be derived from the default statistics, the portion of the long term average of the spread over the *basic relevant risk-free interest rate term structure* (as provided in 4.11 and 4.12).
- 4.6 The *matching adjustment* must not include the fundamental spread (as calculated in accordance with 4.10 to 4.17) reflecting the risks retained by the *firm*.
- 4.7 The deduction of the fundamental spread under 4.6 from the result of the calculation set out in 4.3 must include only the portion of the fundamental spread that has not already been reflected in the adjustment to the cash-flows of the assigned portfolio of assets in accordance with 4.3 to 4.5.
- 4.8 The fundamental spread referred to in 4.6 and 4.7 must be calculated in a transparent, prudent, reliable and objective manner that is consistent over time and based on relevant indices where available.

- 4.9 The fundamental spread must be calculated in accordance with 4.10 to 4.17.
- 4.10 The fundamental spread must be equal to the sum of the following:
- (1) the credit spread corresponding to the probability of default of the assets; and
 - (2) the credit spread corresponding to the expected loss resulting from downgrading of the assets.
- 4.11 For exposures to the central government of the *United Kingdom* and the *Bank of England*, where the fundamental spread would otherwise be lower than 30% of the long-term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets (the 'average spread'), the fundamental spread must be 30% of the average spread.
- 4.12 For assets other than exposures to the central government of the *United Kingdom* and the *Bank of England*, where the fundamental spread would otherwise be lower than 35% of the long-term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets (the 'average spread'), the fundamental spread must be 35% of the average spread.
- 4.13 For the purposes of 4.10 to 4.12:
- (1) the calculation of the 'credit spread' must be based on the assumption that in case of default 30% of the market value of the assets can be recovered;
 - (2) the 'probability of default' must be based on long-term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class;
 - (3) the 'expected loss' must be based on long-term statistics that are relevant to changes in the credit quality of the asset and correspond to the probability-weighted loss the *firm* incurs where the asset is downgraded to a lower credit quality and is replaced immediately afterwards, and the calculation of the expected loss must be based on the assumption that the replacing asset meets all of the following criteria:
 - (a) the replacing asset has the same cash-flow pattern as the replaced asset before downgrade;
 - (b) the replacing asset belongs to the same asset class as the replaced asset; and
 - (c) the replacing asset has the same credit quality as the replaced asset before downgrade or a higher one;
 - (4) the 'long-term average of the spread over the risk-free interest rate' must be based on data relating to the previous 30 years;
 - (5) the methods to derive the fundamental spread of a bond must be the same for each currency and each country and may be different for government bonds and for other bonds.
- 4.14 For the purposes of 4.13(2) and (3), where no reliable credit spread can be derived from the default statistics, the fundamental spread must be equal to the portion of the long-term average of the spread over the risk-free interest rate set out in 4.11 or 4.12.
- 4.15 Where part of the data referred to in 4.13(4) is not available or where the available data is not reliable, constructed data based on prudent assumptions may be used; and the constructed data must be based on available and reliable data relating to the previous 30 years.
- 4.16 A *firm* must increase the fundamental spread calculated under 4.10 to 4.15 in accordance with 8.2.

4.17 A *firm* may increase the fundamental spread calculated under 4.10 to 4.16 where necessary to ensure it covers all risks retained by the *firm*.

[Note: This Chapter replicates the provisions for the calculation of the *matching adjustment* and fundamental spread contained in regulations 5 and 6 of the *IRPR regulations*]

[Note: The *IRPR regulations* refer to the 'assigned portfolio of assets'. This has the same meaning as the *relevant portfolio of assets*, except for regulation 5(5) which is replicated in 4.7 where the 'assigned portfolio of assets' is referring to *assigned assets* as set out at 4.3 and 4.4]

5 ASSETS WITH CASH-FLOWS THAT ARE NOT FIXED

- 5.1 For the purpose, and without limiting the generality, of the condition in regulation 4(9) of the *IRPR regulations*, assets with *cash-flows that are not fixed* are only capable of being included in a *firm's relevant portfolio of assets* without giving rise to material risks to the quality of matching if the *cash-flows that are not fixed* are *highly predictable*.
- 5.2 For the purposes of the condition in regulation 4(9)(a)(ii) of the *IRPR regulations*, the proportion of a *firm's relevant portfolio of assets* that comprises assets with *highly predictable* cash-flows is subject to the following limits:
- (1) no more than 10% of the *matching adjustment* benefit is attributable to an asset with *highly predictable* cash-flows, either on its own or when taken together with other assets with *highly predictable* cash-flows in the *relevant portfolio of assets*; and
 - (2) any applicable *exposure limit*.
- 5.3 The cash-flows of an asset are *highly predictable* for the purposes of 5.1 where:
- (1) the contractual terms of the asset provide for a bounded range of variability in respect of the timing and amount of the cash-flows; and
 - (2) failure to meet such contractual terms is a *default*.
- 5.4 In assessing asset cash-flows for the purposes of 5.3, a *firm* must:
- (1) base the best estimate of the cash-flows on the contractual payments of the asset;
 - (2) use assumptions consistent with the economics of the asset; and
 - (3) where expert judgment is used in determining the cash-flows, ensure that it is subject to the level of controls specified in Article 2 of Commission Delegated Regulation (Solvency II) 2015/35.
- 5.5 For the purposes of 5.2(1), the *matching adjustment* benefit means, where a *firm* has a *matching adjustment permission*, an amount equal to the impact on its *best estimate* of the scenario set out in Conditions Governing Business 3.2(2)(c) (and for the purposes of this calculation, ignoring any impact of rule 13.5).

6 REQUIREMENT FOR THE FUNDAMENTAL SPREAD TO REFLECT DIFFERENCES IN QUALITY BY RATING NOTCH

- 6.1 Where an *assigned asset* has a *credit rating* or internal credit assessment of a comparable standard (within the meaning of 7.1(1)) mapping to *credit quality steps* 1 to 5 (inclusive), a *firm* with a *matching adjustment permission* must make an adjustment to the fundamental spread derived from the *credit quality step* attributed to that asset in order to reflect the corresponding *rating notch*, in accordance with 6.3 and 6.4.
- 6.2 The obligation in 6.1 does not apply in the circumstances described in 6.5.
- 6.3 A *firm* must derive the adjustment referred to in 6.1 for at least:

- (1) the probability of default referred to in 4.5; and
 - (2) the overall fundamental spread,
- in each case, applicable to the cash-flows of that asset.

6.4 A *firm* must:

- (1) derive the adjustments referred to in 6.3 using linear interpolation of the information published by the *PRA* under regulation 3(1) of the *IRPR regulations*;
- (2) use linear interpolation for each consecutive *credit quality step pair*; and
- (3) assume for the purposes of this Chapter that each intermediate *rating notch* is evenly spread between each consecutive *credit quality step pair*.

6.5 Where there is no *rating notch* available for a particular asset falling within the scope of 6.1:

- (1) a *firm* must not adjust the fundamental spread, or component thereof, applied to the cash-flows of that asset, other than to account for additions to the fundamental spread in accordance with 4.16 and/or 4.17, as applicable; and
- (2) a *firm* must consider the appropriateness of the fundamental spread and *matching adjustment* in respect of that asset as part of its analysis and verification process and policy under Chapter 10, in relation to the attestation made under Chapter 9.

6.6 By way of derogation, during the period from, and including, 30 June 2024 to, and excluding, 31 December 2024, a *firm* may, but will not be required, to comply with the obligation in 6.1.

7 INTERNAL CREDIT ASSESSMENTS AND CREDIT RATINGS

7.1 Where a *firm* uses any internal credit assessment of assets within the *relevant portfolio of assets*, the *firm* must ensure on an ongoing basis:

- (1) that, as required by regulation 4(4) of the *IRPR regulations*, such internal credit assessment is of a comparable standard to a *credit rating*; and
- (2) the appropriateness of:
 - (a) its process to produce such internal credit assessments; and
 - (b) the outcomes of such internal credit assessments.

7.2 For the purposes of 7.1, the *firm* must ensure at a minimum that:

- (1) the internal credit assessments have considered all possible sources of *credit risk*, both qualitative and quantitative, and how these types of *credit risk* may interact;
- (2) the internal credit assessment outcomes lie within a plausible range of issue ratings that could have resulted from a *credit rating agency*;
- (3) both at the level of the *relevant portfolio of assets* and of each *asset type*, there is broad consistency and no bias between:
 - (a) internal credit assessment outcomes; and
 - (b) issue ratings that could have resulted from a *credit rating agency*;
- (4) the internal credit assessment process is subject to appropriate validation, and appropriate assessment of its on-going appropriateness;
- (5) the *firm* has obtained proportionate independent external assurance in respect of 7.2(2); and

(6) the *firm's* internal credit assessment function is independent and there are effective controls to manage any potential conflicts of interest.

7.3 Upon request, the *firm* must be able to demonstrate its compliance with 7.1 to the *PRA*.

7.4 The use of *credit ratings* in the calculation of the *matching adjustment* shall be in line with the specifications set out in Articles 4 - 6 of the Commission Delegated Regulation (EU) 2015/35 and Commission Implementing Regulation 2016/1800.

8 ADDITIONS TO THE FUNDAMENTAL SPREAD IN RESPECT OF ASSETS WITH CASH-FLOWS THAT ARE HIGHLY PREDICTABLE

8.1 A *firm* with a *matching adjustment permission* must identify all sources of uncertainty regarding the timing and amount of cash-flows from any asset in the *relevant portfolio of assets* with cash-flows that are *highly predictable*.

8.2 A *firm* must add to the fundamental spread an amount that reflects the risks arising from the uncertainties identified in accordance with 8.1 to ensure that the fundamental spread reflects risks retained by the *firm* in accordance with 4.6.

9 ATTESTATION REQUIREMENTS

9.1 A *firm* with a *matching adjustment permission* must provide to the *PRA* the attestation set out at (1) at the time set out in (2) by a *person* in (3) in the form set out in 12.1 in respect of each *relevant portfolio of assets* as a whole held by the *firm*.

(1) The attestation is that, as at the applicable *attestation reference date*:

- (a) the fundamental spread used by the *firm* in calculating the *matching adjustment* reflects compensation for all retained risks in accordance with 4.6; and
- (b) the *matching adjustment* can be earned with a high degree of confidence from the assets held in the *relevant portfolio of assets*.

(2) Subject to 9.2, the attestation must be provided:

- (a) annually, no later than 14 weeks after the *firm's* financial year-end, commencing with its first financial year-end after the *matching adjustment permission* took effect; and
- (b) where there is a material change in risk profile of the *firm*, as soon as reasonably practicable after the applicable *attestation reference date*.

(3) The attestation must be provided by the *PRA senior management function holder* in the *firm* responsible for the prescribed responsibility of the production and integrity of the *firm's* financial information and its regulatory reporting (PR Q), as provided for in Insurance – Allocation of Responsibilities 3.1(4).

9.2 In respect of a *firm* with a *matching adjustment permission* that took effect prior to 31 December 2024, that *firm* will not be required, but may nevertheless elect, to provide the attestation set out at 9.1(1) in respect of any financial year-end or material change in risk profile for which the applicable *attestation reference date* would fall within the period commencing on 30 June 2024, up to, and excluding, 31 December 2024.

10 INTERNAL GOVERNANCE FOR THE ATTESTATION

10.1 Before providing any attestation in accordance with 9.1, a *firm* must analyse and justify that the fundamental spread used by the *firm* reflects compensation for all retained risks, and that the *matching adjustment* can be earned with a high degree of confidence from the assets held in the *relevant portfolio of assets*.

- 10.2 A *firm* must have in place appropriate internal processes, systems and controls to allow it to produce the analysis and justification required by 10.1.
- 10.3 A *firm* must put in place and maintain a policy on providing the attestation at 9.1 and the analysis and justification required in 10.1 and must ensure that its *governing body* has approved that policy.

11 DISCLOSURE OF THE ATTESTATION

- 11.1 A *firm* with a *matching adjustment permission* must disclose in its *SFCR* whether it has or has not provided the attestation in accordance with 9.1 in respect of the financial year to which that *SFCR* relates.

12 FORM OF THE ATTESTATION

- 12.1 The attestation must be:
- (1) provided in the form of an attestation document and which must include the information set out at 12.2; and
 - (2) accompanied by a supporting attestation report as set out at 12.3.
- 12.2 The attestation document must include:
- (1) the attestation in 9.1;
 - (2) the name and role of the *PRA senior management function holder* giving the attestation;
 - (3) the *relevant portfolio of assets* to which the attestation applies; and
 - (4) the date of the attestation.
- 12.3 The supporting attestation report must include the following information:
- (1) either:
 - (a) a copy of the latest version of the policy referred to in 10.3; or
 - (b) confirmation that such policy has not been updated since it was last provided to the *PRA*;
 - (2) confirmation that the *firm* and attestor complied with the terms of the policy referred to in 10.3 in making the attestation, or if not:
 - (a) details of the alternative approach followed by the *firm* and the attestor; and
 - (b) an explanation as to why this occurred;
 - (3) a list detailing the evidence the attestor relied on in making the attestation; and
 - (4) in relation to any increase(s) in the fundamental spread that the *firm* has elected to use in accordance with 4.17, a list of:
 - (a) all assets in each *relevant portfolio of assets* to which these apply;
 - (b) the reasons for the increase(s); and
 - (c) the amount of the increase(s) and the *matching adjustment* resulting from those assets,as at the applicable *attestation reference date*.

13 ON-GOING COMPLIANCE WITH ELIGIBILITY CONDITIONS

- 13.1 This Chapter applies to a *firm* that has been granted a *matching adjustment permission*.

- 13.2 A firm with a *matching adjustment permission* must comply with the *matching adjustment eligibility conditions* and the terms of its *matching adjustment permission*, including any applicable *exposure limits*, at all times.
- 13.3 A firm that applies the *matching adjustment* to a *relevant portfolio of insurance or reinsurance obligations* must not apply a *risk-free interest rate transitional measure* or *volatility adjustment* in respect of those obligations.
- 13.4 Where a firm that applies the *matching adjustment* is no longer able to comply with the *matching adjustment eligibility conditions*, it must immediately:
- (1) inform the PRA; and
 - (2) take the necessary measures to restore compliance with these conditions as soon as possible.
- 13.5 Where a firm is not able to restore compliance with the *matching adjustment eligibility conditions* within two *months* of the date of non-compliance it must then, on a *monthly* basis and for the duration of the period of non-compliance, adjust the *matching adjustment* it applies in respect of the *relevant portfolio of insurance or reinsurance obligations* according to the following formula:

$$MA^* = MA - (n - 1) \times p \times \max \{MA, 0\}$$

where:

MA^* is the reduced *matching adjustment* applied to the *relevant portfolio of insurance or reinsurance obligations*;

MA is the *matching adjustment*, where the *matching adjustment* is calculated assuming no restrictions relating to the breach of *matching adjustment eligibility conditions*;

n is the whole number of *months* since the date of non-compliance, and shall not be greater than 11; and

p is 10%.

Annex C

Amendments to the Technical Provisions Part

In this Annex new text is underlined and deleted text is struck through

1 APPLICATION AND DEFINITIONS

...

1.2 In this Part, the following definitions shall apply:

~~basic relevant risk-free interest rate term structure~~

~~means the relevant risk-free interest rate term structure without:~~

~~(1) a matching adjustment;~~

~~(2) a volatility adjustment; or~~

~~(3) a risk-free interest rate transitional measure.~~

...

~~relevant portfolio of assets~~

~~means the assigned portfolio of assets, consisting of bonds and other assets with similar cash-flow characteristics, to cover the best estimate of the relevant portfolio of insurance or reinsurance obligations, referred to in regulation 42(4)(a) and (b) of the Solvency 2 Regulations 2015.~~

...

6 MATCHING ADJUSTMENT TO THE RELEVANT RISK FREE INTEREST RATE TERM STRUCTURE [DELETED]

6.1 ~~A firm must not apply a matching adjustment to the relevant risk-free interest rate term structure to calculate the best estimate of its insurance or reinsurance obligations unless it has a matching adjustment approval.~~[Deleted]

6.2 ~~Firms that apply the matching adjustment to a relevant portfolio of insurance or reinsurance obligations shall not revert back to the approach that does not include a matching adjustment.~~[Deleted]

6.3 ~~Where a firm that applies the matching adjustment is no longer able to comply with the conditions specified in regulation 42(4) to (6) of the Solvency 2 Regulations 2015, it shall immediately:~~

~~(1) inform the PRA; and~~

~~(2) take the necessary measures to restore compliance with these conditions as soon as possible.~~[Deleted]

6.4 ~~Where a firm is not able to restore compliance with the conditions referred to in 6.3 within two months of the date of non-compliance, it shall cease to apply the matching adjustment to any of its insurance or reinsurance obligations.~~[Deleted]

~~[Note: Art. 77b of the Solvency II Directive]~~

7 CALCULATION OF THE MATCHING ADJUSTMENT ~~[DELETED]~~

- 7.1 ~~This Chapter applies to a firm that has been granted a matching adjustment approval.~~~~[Deleted]~~
- 7.2 ~~The matching adjustment shall be calculated for each currency in accordance with the following principles:~~
- ~~(1) the matching adjustment shall be equal to the difference of the following:

 - ~~(a) the annual effective rate, calculated as the single discount rate that, where applied to the cash flows of the relevant portfolio of insurance or reinsurance obligations, results in a value that is equal to the value (in accordance with the Valuation Part of the PRA Rulebook) of the relevant portfolio of assets;~~
 - ~~(b) the annual effective rate, calculated as the single discount rate that, where applied to the cash flows of the relevant portfolio of insurance or reinsurance obligations, results in a value that is equal to the value of the best estimate of the relevant portfolio of insurance or reinsurance obligations, where the time value is taken into account using the basic relevant risk-free interest rate term structure;~~~~
 - ~~(2) the matching adjustment shall not include the fundamental spread reflecting the risks retained by the firm;~~
 - ~~(3) notwithstanding (1), the fundamental spread shall be increased where necessary to ensure that the matching adjustment for assets with sub-investment grade credit quality does not exceed the matching adjustment for assets of investment grade quality, of the same duration and asset class; and~~
 - ~~(4) the use of external credit assessments in the calculation of the matching adjustment shall be in line with the specifications set out in the Solvency II Regulations.~~~~[Deleted]~~
- 7.3 ~~For the purposes of 7.2(2) and subject to 7.5, the fundamental spread shall be:~~
- ~~(1) equal to the sum of the following:

 - ~~(a) the credit spread corresponding to the probability of default of the assets; and~~
 - ~~(b) the credit spread corresponding to the expected loss resulting from downgrading of the assets;~~~~
 - ~~(2) for exposures to the UK's central government and central bank, no lower than 30% of the long term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;~~
 - ~~(3) for assets other than exposures to the UK's central government and central bank, no lower than 35% of the long term average of the spread over the risk-free interest rate of assets of the same duration, credit quality and asset class, as observed in financial markets;~~~~[Deleted]~~
- 7.4 ~~The probability of default referred to in 7.3(1)(a) shall be based on long term default statistics that are relevant for the asset in relation to its duration, credit quality and asset class.~~~~[Deleted]~~
- 7.5 ~~Where no reliable credit spread can be derived from the default statistics referred to in 7.3, the fundamental spread shall be equal to the portion of the long term average of the spread over the risk-free interest rate set out in 7.3(2) and 7.3(3).~~~~[Deleted]~~
- ~~[Note: Art. 77c and Art. 77e(3) of the Solvency II Directive]~~

8 VOLATILITY ADJUSTMENT

8.1 A firm must not apply a *volatility adjustment* to the *relevant risk-free interest rate term structure* to calculate the *best estimate* of its insurance or *reinsurance* obligations unless:

- (1) it has been granted a *volatility adjustment approval*; and
- (2) the *volatility adjustment* has been set out in *Solvency II Regulations* or published by the PRA under ~~regulation 4B of the *Solvency 2 Regulations*~~regulation 3 of the *IRPR regulations*.

...

8.4 A firm must only apply a *volatility adjustment* that includes a relevant country increase ~~referred to in regulation 4B(6) of the *Solvency 2 Regulations*~~ to calculate the *best estimate* of its insurance or *reinsurance* obligations of products sold in the insurance market of that country, respectively.

...

Annex D

Amendments to the Conditions Governing Business Part

In this Annex new text is underlined and deleted text is struck through.

...

3 RISK MANAGEMENT

3.1 ...

(4) Where a firm applies the *matching adjustment*, the firm must manage any risks that are identified in the analysis undertaken in accordance with Matching Adjustment 10.1.

~~[Note: Art. 44(1)-(2) of the Solvency II Directive]~~

3.2 As regards asset-liability management, a firm must:

...

(2) where the *matching adjustment* is applied, regularly assess:

- (a) the sensitivity of its *technical provisions* and *eligible own funds* to the assumptions underlying the calculation of the *matching adjustment*, including the calculation of the fundamental spread referred to in ~~Technical Provisions 7.2(2)~~Matching Adjustment 4, and the possible effect of a forced sale of assets on its *eligible own funds*;

...

3.8 ...

(2) The ORSA must include at least the following:

...

(b) the compliance, on a continuous basis, with:

- (i) the *SCR* and *MCR*; and
- (ii) the requirements regarding *technical provisions*, as set out in the Technical Provisions and Matching Adjustment Parts; and

...