Bank of England PRA

Meeting Summary

PRA/ABI Solvency UK Notching Subject Expert Group (NSEG): Fourth Meeting

1 March 2023

Location: Bank of England Offices, MS Teams

Attendees: The PRA, ABI and HMT
Representatives of the following insurance firms:

- Aviva, Just, Legal & General, M&G, PIC, Rothesay.

Agenda

1. Reflections on discussion at previous meeting held on 22 February

2. Thematic topic: operational considerations

3. Thematic topic: sub-investment grade (SIG) assets

4. Close and AOB

Summary of meeting

The NSEG concluded its initial exploration of the topics being considered by the group, focussing on the operational implications of introducing notching and the Fundamental Spread (FS) for sub-investment grade (SIG) assets. Updates were also given by the two sub-groups of the NSEG covering data-driven and interpolation approaches respectively:

- **Data-driven approach for implementing notching** – the NSEG considered that a data-driven approach would present very material challenges due to limited data being available on a notched basis, data potentially requiring to be sourced from a range of providers (presenting possible consistency concerns) and the likely need for smoothing to be applied to avoid distorted outputs.

- **Interpolation approach(es) for implementing notching** – The NSEG discussed two key issues that had been identified by those looking at interpolation methods: (1) the extent to which the existing FS by the Credit Quality Step (CQS) should be 'disturbed' by moving to a notched basis; and, (2) the method of interpolation and what this means (in particular) for the notches between CQS 3 and CQS 4 where there is a material increase in the FS. It was suggested that whilst the starting point was that the FS for the middle notches should be equal to the existing FS, further work could be done to assess the arguments for and against reworking the existing FS by CQS to accommodate notching. The fact that different interpolation approaches could lead to different impacts was acknowledged, but it was also noted that any interpolation approach would need careful justification both on a qualitative and quantitative basis.
- **Operational considerations** – the NSEG anticipated the need to update valuation systems and processes to accommodate a notched FS, including data sourcing. It was thought this could start early and take around six months assuming that notched ratings were available, and no systems issues emerged. The main area of operational concern continued to be around allowing for notching in the Solvency Capital Requirement (SCR) calculation.
- **SIG assets** –The NSEG considered the implications arising from removal of the existing cap on the MA for SIG assets (commonly referred to as the 'BBB cliff'). It was acknowledged that this would reduce Technical Provisions and was also likely to allow a more flexible portfolio construction approach, with any changes in firms' holdings of SIG assets also depending on a range of factors including risk appetite, appropriateness of the assets to back annuity business and the types of assets/transactions available at a given point in time.