

Bank of England PRA

HMT SOLVENCY II REVIEW

PRA/ABI-INDUSTRY SUBJECT EXPERT GROUPS ON MA-FSSUPERVISORY MEASURES – 2023

Terms of Reference

Background

HMT launched a review of Solvency II via a Call for Evidence published in October 2020 inviting industry views on areas of reform including the Solvency II Matching Adjustment. Following HMT's April 2022 consultation paper, the government announced its response and position on the Solvency II review in November 2022. This included legislation to:

- reduce the risk margin, by an amount equivalent to 65% for long-term life business (including PPOs) under recent economic conditions, and around 30% for non-life firms, and enable the 'modified cost of capital' approach to its calculation;
- broaden asset eligibility for the MA, including so that assets with 'highly predictable' (rather than fixed) cash flows are eligible, subject to the vast majority of assets in matching adjustment portfolios continuing to have fixed cash flows); and
- maintain the current Matching Adjustment / Fundamental Spread (MA / FS) design and calibration, while allowing for the use of notched ratings and the removal of the sub-investment grade cap.

In addition, the Government response asked the PRA to develop of the following supervisory measures by the PRA (in addition to all existing supervision). It supports the PRA in its expectation that at all times insurers will apply high standards of risk management and will cooperate fully with the PRA in the use of these measures.

Where necessary it will legislate to give the PRA the necessary powers:

- to require insurers to participate in regular stress testing exercises prescribed by the PRA to test their resilience to scenarios the PRA will set out, and to allow the PRA to publish individual firm results. This aims to facilitate more effective market discipline, and is in line with existing practice for banks;
- to require nominated senior managers with formal regulatory responsibilities and sanctions under the Senior Managers Regime to attest formally to the PRA whether or not the level of the FS on their firm's assets is sufficient to reflect all retained risks, and that the resulting MA reflects only liquidity premium, on the

basis of a rigorous assessment of the characteristics and valuations of assets held in their MA portfolios, including the results of the stress testing exercises described above;

- to allow insurers to apply a higher FS through an add-on where they conclude that the standard allowance is insufficient considering the work undertaken to support the attestations set out above; and
- to update its MA rules as appropriate to reflect the government's decision to widen the eligibility requirements to include assets with highly predictable cashflows.

With regards to the above, the PRA's objective is to develop the proposed policy reforms and implement a supervisory approach suitable to pursuing the PRA's objectives under the reformed regulations. As set out in HMT's consultation response, the PRA will report to Parliament on how well the measures work to meet the PRA's risk tolerance.

Purpose and role of the PRA/ABI-Industry subject expert groups

To enable the PRA to discuss with industry at a working level and gather a broad range of information on and options for the development of the reforms announced by government as part of the 2022 Autumn Statement.

The subject expert groups will not carry out any of the functions or responsibilities of the PRA. It is for the PRA, applying its usual governance process, to use the input of the subject expert groups (among other considerations) to decide the proposals that will be put to public consultation. The subject expert groups should not be asked to make decisions on preferred proposals or otherwise to determine the content of material that will be put to the PRA's internal governance process for decision.

Final regulatory reforms will be determined by the PRA in accordance with its statutory objectives and 'have regards'. The PRA will seek the views of the wider industry and other interested parties through a formal public consultation process in due course.

Membership

Participation in the subject expert groups is at the invitation of the conveners (ie the PRA and the ABI), and drawn from a broad range of PRA-regulated firms as well as representative trade bodies, to ensure a diverse set of knowledgeable and experienced insurance market participants. In addition, other bodies that represent specific relevant interests may be invited to participate or can request to join.

PRA, firms (and trade bodies) can nominate individuals to be members of the groups. Criteria for selection include:

- has a senior role within their organisations, with managerial and strategic planning responsibilities within their functional areas related to the topic of reform in question as set out by the PRA;
- can make an initial commitment for a period of 3 – 5 months; and
- has relevant experience and skills.

A member who steps down cannot automatically pass on their seat to a replacement within their organisation. As vacancies arise, the conveners will select replacement or additional members as required. The subject expert groups' membership will be published on the PRA's website.

Membership of the subject expert groups is set out in Annex 1.¹

Responsibilities of the subject expert group members

The PRA representatives are expected to:

- attend meetings;
- provide the PRA's perspectives to the meeting discussions.

The subject expert group members are expected to:

- attend meetings convened by the (co-)chair(s);
- provide technical, analytical, and business perspectives and inputs to the meeting discussions.

In-principle scope of discussions

- Industry views/considerations on the following areas of reform relating to the matching adjustment (MA) and the new supervisory measures:
 - MA investment flexibility;
 - notching;
 - attestation;
 - any other area considered appropriate by the plenary (eg risk margin, stress testing.)

¹ The PRA will recirculate Annex 1 if there are changes in membership (and update the information published on its website accordingly).

- Other relevant aspects of reform which may require industry engagement (such as stress testing) will be initiated as appropriate in due course. We will update these Terms of Reference as necessary.

Meetings

Approach

The PRA will set the agenda for each meeting, taking input from the relevant subject expert group members. Meetings will initially focus on gathering views/ considerations from industry on the development and implementation of the above reforms.

Meetings and materials

The subject expert groups will meet regularly, when a majority of the members of that group determine to meet. The co-chairs may also choose to meet with the relevant participants depending on the meeting topic (i.e. where the topic may not be applicable to all members). By default, the subject expert groups will hold hybrid meetings at PRA or ABI offices. Members are encouraged to attend in person but may also elect to attend virtually via MS Teams, in order to accommodate members' needs and diary constraints.

At this stage, the PRA cannot provide detail of the consultation timelines for the reforms. However, it is the PRA's current expectation that the subject expert groups will continue to meet until such time that it determines that the groups are no longer required.

An agenda and, where applicable, associated papers will be produced by the PRA and circulated, ideally three days and no less than one day, in advance. Summaries of each meeting will be prepared by the PRA and published on the PRA website.

Any information and/or potential policy proposals contained in materials provided to, or discussed at, the subject expert groups are for the purposes of discussion and information gathering only and should not be taken to indicate the PRA's likely final policy on any aspect of the Solvency II review. No discussion or decision of the subject expert groups shall bind the PRA in relation to any future policy development.

Regular plenary sessions will be held by the ABI/PRA where the chair of each subject expert group will provide updates and summaries of their discussions to interested

parties outside of the subject expert groups' membership on the topic areas discussed. The plenary sessions will be hosted as hybrid meetings, and the minutes will be prepared by the PRA and published on the PRA website.² The purpose of the minutes will be to serve as a record of the issues discussed rather than the preference for particular proposals, consistent with the purpose of the subject expert groups.

Confidentiality

Subject expert group participants should consider and comply with their own confidentiality policies before sharing information within a group setting. Any non-public information disclosed or opinions expressed during group meetings will be treated as confidential unless and until the members collectively have authorised their public release according to the majority opinion. Where there is no clear majority, the (co)chairs will make the final decision. Information provided to the subject expert group by the PRA shall be treated as confidential, shall not be distributed within participant organisations except as necessary to fulfil the objectives of the subject expert group, and shall not be disclosed to third parties.

The PRA shall publish a list of participating entities on the PRA's website; and to ensure sufficient transparency of the PRA's approach in engaging with the industry via this forum, the PRA shall publish a central log of the meetings held which will include high level summaries of the subject expert group's meetings.³ Consistent with the minutes for the plenary sessions, the purpose of the summaries will be to serve as a record of the issues discussed rather than the preference for particular proposals, consistent with the purpose of the subject expert group.

In its formal public consultation on proposals for regulatory reform in the areas discussed by the subject expert groups, the PRA may refer to information and feedback generated by the group.

Deliverables and timelines

At this stage (January 2023), the PRA cannot provide detail of the consultation timelines for the reforms. The PRA will draw on the input generated by the subject expert groups in conjunction with other considerations, including the proposed outcomes of the Solvency II review to prepare the package of policy reforms for public consultation in due course. The decision on proposals to include in the public consultation will be taken by the PRA independently of the subject expert groups.

² The minutes will not be verbatim but will include key points discussed, such as suggestions and ideas presented at the meeting, nature of the discussions and any outcomes and actions.

³ The summaries will be high level. They will include key points discussed, such as suggestions and ideas presented at the meeting, nature of the discussions and any outcomes and actions.

Annex 1: Membership of the subject expert groups

Group 1: MA investment flexibility

- Representatives from the PRA
- Representatives from the following ABI member firms: Aviva, LBG, Phoenix, PIC, Rothesay Life
- Representative from the following non-ABI member firm: L&G
- Observers from HMT
- Observer from ABI

Group 2: Notching

- Representatives from the PRA
- Representatives from the following ABI member firms: Aviva, Just, M&G, PIC, Rothesay Life
- Representative from the following non-ABI member firm: L&G
- Observers from HMT
- Observer from ABI

Group 3: Attestation

- Representatives from the PRA
- Representative from ABI
- Representatives from the following ABI member firms: Aviva, Just, LBG, Phoenix, PIC, Rothesay Life, Royal London
- Representative from the following non-ABI member firm: L&G
- Observers from HMT