

Bank of England PRA

Meeting Summary

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

22 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.
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Agenda

1. Reflections on discussion at previous meeting held on 15 March revisiting the mandatory/voluntary application of notching
2. Update from interpolation sub-group
3. Thematic discussion: internal ratings, including validation
4. Thematic discussion: internal model pathway
5. Close and AOB

Summary of meeting

The seventh NSEG again revisited topics that needed deeper consideration based on conversations at previous meetings. The following topics were discussed:

- **Mandatory/voluntary application of notching:** the NSEG identified that application of a notched fundamental spread (FS) would likely be useful to reflect the risk retained by firms with large portfolios or those with more complex asset holdings. Some further advantages of a voluntary application were also

considered, including this approach giving more weight to firms' own risk management.

- **Interpolation – Whether the FS should be notched by individual component or at overall FS level:** the NSEG discussed interpolation at the level of the overall FS versus interpolation by FS component. The potential complexities of de-risking on a notched basis and possible knock-on impacts for the SCR were noted in respect of a 'by component' interpolation approach. However, it was identified that only interpolating at the level of the overall FS could create odd results with inconsistencies between the total FS and its individual components, and was arguably not as reflective of risk.
- **Interpolation – Appropriateness of FS for sub-investment grade (SIG) assets:** the NSEG discussed the FS for SIG assets post removal of the SIG matching adjustment (MA) cap. It was identified that a lack of credible data for SIG investments, coupled with the range of potential reasons why an asset may have a SIG rating, means validation of the FS for such assets was more difficult.
- **Validation of internal ratings in a notched world:** the NSEG further discussed how ECAI validation may need to change to accommodate notching as well as other validation firms could use for internal ratings.
- **Reflection of notching and the SIG MA cap in the internal model solvency coverage ratio (SCR) calculation:** the NSEG discussed notching being reflected in the SCR calculation and considered the approach and complexity would vary by firm. It was suggested that a simpler approach may be needed rather than materially expanding existing calculation methodologies and calibrations. For the removal of the SIG MA cap, the main consideration of the NSEG was around whether a major model change would be expected.