BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Publication

Statement of Policy

The PRA's approach to the publication of Solvency II technical information

June 2021

(Updating December 2020)

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

1 Background

1.1 The Prudential Regulation Authority (PRA) is required to publish technical information (TI) necessary for the valuation of insurance liabilities for each relevant currency.[1] This Statement of Policy (SoP) explains how the PRA will fulfil its obligations in this regard. UK firms should use the PRA's published TI for regulatory reporting from and including 11:00pm on Thursday 31 December 2020.

1.2 This SoP is relevant to all UK Solvency II firms, including the Society of Lloyd's and its managing agents, hereafter referred to as 'UK insurers'.

1.3 The PRA refers to the currencies in which it will publish TI as 'PRA relevant currencies'.

2 Overview of the PRA's approach

2.1 The PRA has retained the methodologies and judgements that the European Insurance and Occupational Pensions Authority (EIOPA) incorporates in its TI as at the end of the transition period (TP), with some exceptions as set out in Chapter 3.

2.2 The PRA's TI is published on the Bank of England's website.[2]

3 Variations by the PRA to EIOPA methodologies and judgements

PRA relevant currencies

3.1 The PRA's choice of PRA relevant currencies is based on the relative materiality of technical provisions denominated in each currency, and currencies in which UK insurers have non-zero technical provisions for which the firms are authorised to use the volatility adjustment (VA) or the matching adjustment (MA). The PRA will review the list of PRA relevant currencies from time to time.

3.2 The PRA will use data from the calendar year-end returns of insurers to determine the materiality of technical provisions in each currency. The returns data as at year end N (or, if unavailable at that effective date, at the most recent effective date for which data has been submitted) will be used to choose the PRA relevant currencies in calendar year N+2.

3.3 The PRA will choose PRA relevant currencies using two criteria:

- by materiality; and
- to include currencies in which UK insurers have VA and MA authorisations.

3.4 The PRA will assess materiality by selecting PRA relevant currencies to ensure that at least 99% of group technical provisions are covered which includes the Society of Lloyd's' solo technical provisions. This involves (i) aggregating technical provisions (expressed in GBP and excluding those relating to unit-linked business) by currency and (ii) selecting the top-ranking currencies such that the cumulative proportion of technical provisions exceeds 99%.

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1 Regulation 4B of the Solvency 2 Regulations 2015/575. The PRA will publish the first set of TI by the 8th working day in January 2021.
2 https://www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/technical-information.

3.5 The PRA will use the above criteria to generate the initial list of PRA relevant currencies. In subsequent years, the PRA may add currencies that meet the above two criteria to the list of PRA relevant currencies, or remove currencies from the list that fall outside the above two criteria for three consecutive years.

3.6 Where a UK insurer has technical provisions in a particular currency for which the PRA does not publish TI, it is a firm’s responsibility to propose TI that complies with Solvency II requirements, and to justify this approach to its supervisor. The PRA reminds firms that it can only apply the VA for currencies and national markets where a VA has been published by the PRA.

Basic risk-free rates (RFRs)

3.6A Following the end of the TP, the PRA will need to make judgements about the reference instruments and associated Credit Risk Adjustments (CRAs) to use when constructing the basic RFRs for PRA relevant currencies. For example, some reference instruments and CRAs will need to be updated in light of the cessation of Libor settings. The PRA will make available, for example via the TI area of the Bank of England’s website, relevant information about any changes to the reference instruments and CRAs used to construct the basic RFRs for PRA relevant currencies. The PRA will aim to give firms at least three months’ notice of such changes.

Calculation of the long-term average spread (LTAS)

3.6B For the LTAS calculation, the PRA will calculate the average of spreads over the RFR applicable at the time of the spread data. Therefore, following the transition of TI references from Libor to an OIS rate, historic spreads (over Libor-based RFR) already embedded in the LTAS calculation would remain unadjusted.

Assessment of the depth, liquidity, and transparency of the markets

3.6C The PRA will focus its assessment of the depth, liquidity, and transparency of the market (the DLT assessment) on interest rate swaps data for the markets of relevant currencies where there is an active swap market.

3.6D The PRA will use the same volume indicators as applied by EIOPA (at the end of the TP) for assessing the liquidity of the swaps market, but with the average (over one year) daily notional turnover requirement being £45 million. These indicators will therefore comprise the:

- average (over one year) daily notional turnover of at least £45 million; and

- average (over one year) daily number of trades of at least ten.

3.6E The PRA will also consider in its DLT assessment additional criteria developed to avoid excessive volatility in the results of the assessment, specifically that a previously liquid market needs to drop at least 20% below one of the thresholds to be considered illiquid, and a previously illiquid market must meet both thresholds and rise at least 20% above one of the thresholds to be considered liquid. The PRA will be guided by these additional criteria as soft thresholds.

3.6F The PRA may also consider other metrics in order to supplement its assessment as required for the relevant currencies, which will be set out in its published results and analysis of the DLT assessment.

3.6G For non-GBP relevant currencies, the PRA will make use of externally published DLT data and analysis, including that published by EIOPA and the International Association of Insurance Supervisors (IAIS), to contribute to its own assessment.

3.6H The PRA will apply the granular country level EIOPA DLT assessment used for the aggregated composition of the EUR VA reference portfolio, considering amendments as necessary.

Reference portfolios (RPs) for the Volatility Adjustment

3.7 The PRA will use EIOPA’s VA RPs (to calculate the VA) in effect at the end of the TP. Under the current timetable for TP completion on Thursday 31 December 2020, this approach will apply until Tuesday 30 March 2021. If the timetable for TP completion changes, the PRA will update users of the TI on its revised approach.

3.8 From Wednesday 31 March 2021, the PRA will derive VA RPs using the same technical approach as EIOPA, except for three specific areas where the PRA’s approach will differ, as explained below.

3.9 The first difference in the PRA’s approach will be that the derivation of the VA RPs will reflect UK firms’ asset exposures. Specifically:

- the VA RPs used to calculate the GBP VA will be derived using data from the Quantitative Reporting Templates (QRTs) submitted to the PRA by UK solo insurers; and

- the VA RPs for non-GBP PRA relevant currencies will be derived by taking a weighted average of EIOPA’s published VA RPs derived using QRT data submitted to EIOPA, and the VA RPs derived using QRT data submitted to the PRA for (UK) parent undertakings (as defined in the Solvency 2 Regulations 2015). The respective RPs would be weighted using the aggregate market value of assets as reported in the QRT data of European Economic Area firms and (UK) parent undertakings (as defined in the Solvency 2 Regulations 2015).

3.10 The second difference in the PRA’s VA RP approach is that the PRA will apply a simplified approach to determining the weights for the government and corporate bond portfolios when ‘looking through’ into the underlying assets held within collective investment undertakings (CIUs). The PRA will assume that the exposures within CIUs in respect of duration, sector, and rating are the same as exposures held outside of CIUs.

3.11 The third difference in the PRA’s approach is that the PRA published country VA RP for GBP will be the same as the currency VA RP.

3.12 The PRA will aim to give firms at least three months’ notice of the change in the VA RPs. The PRA’s VA RPs will become effective from the next 31 March following publication.

Annex – Statement of Policy updates

This annex details the changes that have been made to this SoP following its initial publication in December 2020:

2021

June 2021

Following publication of PS12/21 'Solvency II: Deep, liquid and transparent assessments, and GBP transition to SONIA', paragraph 2.2 was added to include a reference to the TI section of the Bank of England's website. Paragraphs 3.6A–3.6H were added to describe the reference instruments used for the basic risk-free rates, calculation of the long-term average spread (LTAS) and assessment of the depth, liquidity, and transparency of the markets.

This policy is effective from Thursday 3 June 2021.