BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP5/20

Solvency II technical information: The PRA’s proposed approach to the publication at the end of the transition period

June 2020

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP5/20

Solvency II technical information: The PRA's proposed approach to the publication at the end of the transition period

June 2020

By responding to this consultation, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure to other parties in accordance with access to information regimes including under the Freedom of Information Act 2000 or data protection legislation, or as otherwise required by law or in discharge of the Bank's functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England receives a request for disclosure of this information, we will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England.

Responses are requested by Wednesday 30 September 2020.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: CP05_20@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:
Henrietta Tait, Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Contents

1	Overview	1
2	Proposals	3
3	The PRA’s duty to consult	7
Appendix		10

1 Overview

1.1 This Consultation Paper (CP) sets out the Prudential Regulation Authority's (PRA's) proposed approach to the publication of Solvency II technical information (TI) after the end of the transition period (TP).

1.2 The proposals in this CP would be set out in a new PRA Statement of Policy (SoP) (Appendix 1), to come into effect from the end of the TP.

1.3 This CP is relevant to all UK Solvency II firms, including in respect of the Solvency II groups provisions, to the Society of Lloyd's and its managing agents (hereafter referred to as 'UK insurers'). Non-Directive firms are out of the scope of this CP.

Background

1.4 Following the UK's withdrawal from the European Union (EU) at 11pm on Friday 31 January 2020, the UK entered the TP agreed as part of the Withdrawal Agreement between the UK and EU.

1.5 Until the end of the TP, which is expected to be at 11pm on Thursday 31 December 2020, UK insurers are required to use TI published by the European Insurance and Occupational Pensions Authority (EIOPA) to calculate their regulatory technical provisions under the Solvency II Directive.

1.6 From the end of the TP, the PRA will be required to publish TI for each relevant currency[1]. In the remainder of this CP, the PRA refers to the currencies for which it would publish TI as 'PRA relevant currencies'.

1.7 The PRA plans to issue a separate CP, at a later date in 2020, on its proposals with regard to how LIBOR transition would impact the design and production of TI. The PRA may issue another consultation to propose further changes, once the UK's trading relationship with the EU becomes clearer.

Summary of proposals

1.8 The proposals included in this CP, which would apply at the end of the TP, are as follows:

(a) the PRA's published TI would be derived by adopting the same technical methodologies embodied within EIOPA's TI as at the end of the TP, with some limited exceptions. The exceptions are set out in a draft SoP (Appendix 1), and are generally items that the PRA must change as a result of the UK's changed legal status of having withdrawn from the EU, and the resulting alterations in information flows between the PRA and EIOPA. These changes would also contribute to the TI being relevant and credible for UK firms;

(b) the criteria that the PRA would use to determine the PRA relevant currencies to publish, which would be based on the relative materiality of technical provisions denominated in each currency, and the currencies for which firms have volatility adjustment (VA) or matching adjustment (MA) authorisation;

(c) the PRA's approach to determining the VA reference portfolios (RPs) (which would inform the calculation of the VA) in light of the loss of sharing of regulatory returns data between the PRA and EIOPA; and

1 Regulation 4B of the Solvency 2 Regulations 2015/575.

(d) the publication of TI on the PRA website, and, where there is a deviation in the future from EIOPA's technical methodology, a PRA publication that describes this deviation.

Implementation

1.9 The proposed implementation date for the proposals in this CP would be at the end of the TP, which is expected to be 11pm on Thursday 31 December 2020.

1.10 The calculations referred to above will be impacted by the PRA's proposed use of temporary transitional powers (TTP)[2] at the end of the TP. The general use of the TTP would have the effect of maintaining the current preferential risk treatment and calculation methodologies of EU exposures and assets under the applicable capital frameworks for 15 months after the end of the TP. Therefore, the fundamental spreads for EU27 government bonds will be identical to those published by EIOPA during the 15 months that transitional relief applies.

Responses and next steps

1.11 This consultation closes on Wednesday 30 September 2020. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP05_20@bankofengland.co.uk.

1.12 The proposals set out in this CP have been designed in the context of the UK's withdrawal from the EU and entry into the TP, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the TP, including those arising once any new arrangements with the EU take effect.

1.13 The PRA has assessed that the proposals would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see Policy Statement 5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018'[3] for further details.

---

2 As described in: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/joint-bank-pra-statement-on-proposed-use-of-ttp-at-the-end-of-the-transition-period.

3 April 2019: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.

2 Proposals

2.1 This Chapter sets out the PRA proposals regarding:

- adoption of EIOPA's methodologies underlying the TI;
- choice of PRA relevant currencies in which to publish TI;
- how the PRA would derive RPs; and
- publication of the TI.

Adoption of EIOPA's technical methodologies underlying the TI

2.2 The PRA proposes that its published TI would be derived using the same methodologies embodied within EIOPA's TI as at the end of the TP, with some limited exceptions.

2.3 TI for each PRA relevant currency comprises:

- the relevant risk-free interest rate term structure used to calculate the best estimate, without any MA or VA;
- for each relevant duration, credit quality, and asset class, a fundamental spread for the calculation of the MA to the relevant risk-free interest rate term structure used to calculate the best estimate for a portfolio of life insurance or reinsurance obligations; and
- for each relevant national insurance market, a VA to the relevant risk-free interest rate term structure used to calculate the best estimate.

2.4 The UK contributed to the development of the methodologies, judgements and calibrations underlying EIOPA's TI, so the PRA considers the vast majority of these to remain relevant for UK insurers at the end of the TP. Furthermore, the PRA considers that adopting, where possible, the same methodologies as EIOPA facilitates a smooth transition in UK insurers' balance sheet positions at the end of the TP.

2.5 However, the PRA proposes to make some changes to EIOPA's practice and methodology, as set out in the remainder of this CP.

Choice of PRA relevant currencies in which to publish TI

2.6 The PRA proposes to use certain criteria to determine the PRA relevant currencies. These criteria would be based on the relative materiality of technical provisions denominated in each currency as measured by UK insurers' exposures; and the currencies for which the firms are authorised to use the VA or MA, provided that they have non-zero technical provisions in those currencies.

2.7 The PRA's primary criterion would be to determine the PRA relevant currencies such that at least 99% of the group technical provisions of UK insurers are covered. This would be measured by aggregating technical provisions for each currency (expressed in GBP terms and excluding those relating to unit-linked business). The top ranking currencies that cumulatively make up at least 99% of group technical provisions of UK insurers would be included within the PRA relevant currencies.

2.8 The PRA's secondary criterion would be to add any further currencies in which UK insurers are authorised to use either the VA or MA, providing that those firms hold non-zero technical provisions in those currencies.

2.9 The PRA would use data from the calendar year-end returns of UK 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) is proposed to be used to choose the PRA relevant currencies in calendar year N+2. This is because returns data as at year end N is available only in year N+1 and, allowing for notice periods, would be conveniently acted upon only in year N+2.

2.10 At the end of the TP, the PRA proposes to use the above criteria to generate the initial list of PRA relevant currencies. In subsequent years, the PRA would add to the list of PRA relevant currencies using the above criteria, and remove a currency from its list of PRA relevant currencies if it falls outside the above two criteria for three consecutive years. By way of illustration, applying the above criteria to UK quantitative reporting template (QRT) data as at year end 2018, and taking into account firms' current VA and MA authorisations, the list of PRA relevant currencies would be as follows:

Table A: Illustrative list of PRA relevant currencies

Currency	Country
GBP	UK
EUR	Eurozone
USD	USA
AUD	Australia
CAD	Canada
JPY	Japan
SEK	Sweden

2.11 Where UK insurers have technical provisions in a particular currency for which the PRA does not publish TI, the PRA proposes that these undertakings should approach their supervisors to discuss suitable TI to use. The PRA envisages that such cases would likely be limited to the derivation of the risk-free interest rate term structure. The PRA will assess whether a firm's proposed TI for a currency fulfils the requirements of the PRA Rulebook (Technical Provisions 5.1, 5.2) and Articles 44 to 48 and 53 to 54 of the Commission Delegated Regulation (EU) 2015/35 as onshored.

2.12 The PRA considers its proposed approach to determining the PRA relevant currencies to be proportionate and risk-based, and uses its resources in the most efficient and economic way.

PRA's methodology for deriving reference portfolios for the volatility adjustment

2.13 At the end of the TP, the PRA would use EIOPA's VA RPs (to calculate the VA) in effect at that time. Under the current timetable for TP completion, this approach would apply until Tuesday 30 March 2021. If the timetable for TP completion changes, the PRA would update users of the TI on its revised approach.

2.14 From Wednesday 31 March 2021, under the current timetable for the completion of the TP, the PRA would derive VA RPs using the same technical approach as EIOPA, except for three specific areas where the PRA's approach would differ, as explained below. The PRA considers the vast majority of EIOPA's methodology to determining the VA RPs to be suitable for the PRA's use. The proposed differences are limited to changes the PRA considers necessary in light of the data available to derive the VA RPs.

2.15 The first difference in the PRA's proposed approach would be that the derivation of the VA RPs would reflect – as credibly as possible – UK firms' asset exposures. Specifically:

- the VA RPs used to calculate the GBP VA would 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 would 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).4 The respective RPs would be weighted using the aggregate market value of assets in reported in the QRT data of EEA firms and (UK) parent undertakings (as defined in the Solvency 2 Regulations 2015).

2.16 The PRA considers that taking a weighted average would allow the VA RPs to be determined using a more complete dataset than is available from the QRT data submitted by UK firms alone. This should reduce the year-on-year volatility in the composition of the VA RPs caused by changes in the asset exposures of a single UK firm. Furthermore, this approach would reduce the risk of a single firm's investment strategy being identified (ie for PRA relevant currencies in which relatively few firms hold liabilities).

2.17 The second difference in the PRA's proposed VA RP approach is that the PRA would 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 would assume that the exposures within CIUs in respect of duration, sector and rating are the same as exposures held outside of CIUs.

2.18 This approach represents a simplification, compared to EIOPA's methodology, which the PRA considers would be equally appropriate for the derivation of the VA RP. The EIOPA methodology excludes CIU assets where any discrepancy between the value of the CIU asset (in the asset database) and the value of the look through assets (where the data is completed on a 'best endeavours' basis) exceeds a threshold of 1%. However, the PRA has not found evidence that the excluded assets have a materially different profile in terms of the proportions of government bonds, corporates, and other assets, nor duration, sector and rating. The PRA's view is therefore that it would not introduce systematic distortion into the calculation if all the CIU assets were included.

2.19 The third difference in the PRA's approach would be that the PRA published country VA RP for GBP would be the same as the currency VA RP.

2.20 This proposal is driven primarily from the PRA lacking access to reported asset data in respect of insurance and reinsurance undertakings outside of the UK. This results from the way that the EU and the UK will regard each other's insurance and reinsurance undertakings under Article 13(3) of the Solvency II Directive and under Regulation 2 of the Solvency 2 Regulations 2015 as amended, respectively. The UK's onshored Solvency 2 legislation will regard all foreign countries as third countries and, under Solvency II, the EU will regard the UK as a third country. Resulting from this, the UK will no longer contribute a full set of Solvency II prescribed insurance regulatory data for the compilation of the VA RPs that EIOPA uses to calculate the VA. As a result, the RPs that EIOPA applies, and hence the VAs that it calculates, may no longer be appropriate for UK firms. Because of

4 The Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019.

the overlap between the currency and country data, the PRA does not expect there to be a difference between the country and currency RP.

2.21 The PRA proposes to publish the VA RPs on its website (with the proposed differences in methodology as described above) in the fourth quarter of calendar year 2020, based on the current TP completion timetable, and these would become effective from 31 March 2021. The VA RPs would be based on year-end 2019 QRT data submitted from UK insurers.

2.22 In future years, similar to EIOPA's current practice, the PRA proposes to give firms at least three months' notice of the change in the VA RPs. Therefore, the PRA's VA RPs would be published on the PRA website in the fourth quarter of each calendar year, and would become effective from 31 March the following year.

Publication of TI

2.23 The PRA shall publish the TI on the PRA website on the 8th working day of each month for all PRA relevant currencies. This would be in a similar format to EIOPA's TI.

3 The PRA's duty to consult

3.1 The PRA has a statutory duty to consult when introducing new rules and, when not making rules, has a public law duty to consult widely where it would be fair to do so. When doing so, the PRA provides the following in relation to the proposed policy:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with the PRA's duty to act in a way that advances its general objective,[5] insurance objective,[6] and secondary competition objective;[7]
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with its duty to have regard to the regulatory principles;[8] and
- a statement as to whether the impact of the proposed policy will be significantly different for mutuals than for other persons.[9]

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.[10]

3.3 The PRA is also required by the Equality Act 2010[11] to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

Cost benefit analysis

3.4 The PRA considers that the proposals contained within this CP would have limited marginal impact on UK firms' regulatory balance sheets using the UK's published TI to determine their technical provisions. This reflects that the vast majority of the PRA's published TI would be based on the proposal to retain EIOPA's technical methodology and underlying assumptions. The PRA considers that the proposals would result in a stable transition in the TI used to determine UK firms' technical provisions at the end of the TP on Thursday 31 December 2020 (this date is based on the current TP timetable).

3.5 The PRA's proposals in relation to the VA RP may result in differences between the VA determined by the PRA and EIOPA's published VA. Based on analysis against EIOPA's current VA RPs and market conditions at Tuesday 31 December 2019, the PRA does not expect its proposal to have a material impact on UK firms' regulatory balance. This applies especially with regards to the GBP currency VA, which represents the main currency for which UK firms use the VA. Furthermore, the PRA considers that, in future, any difference between the PRA's published VA and EIOPA's published VA would be appropriate, as the PRA's VA RPs would more closely represent UK firms' exposures.

3.6 The PRA also does not consider that firms would be materially impacted by its proposed approach to determining the PRA relevant currencies, given the proposal to publish PRA relevant currencies covering at least 99% of UK firms' group technical provisions, as well as any other

5 Section 2B of FSMA.
6 Section 2C of FSMA.
7 Section 2H(1) of FSMA.
8 Sections 2H(2) and 3B of FSMA.
9 Section 138K of FSMA.
10 Section 30B of the Bank of England Act 1998.
11 Section 149.

currencies for which firms have VA and MA authorisation. Arrangements that would be in place for TI in respect of currencies outside the list of PRA relevant currencies means that impacts on firms are likely to be immaterial.

3.7 Additional costs would be incurred by the PRA of publishing TI for each additional currency. These include costs associated with research, production, development and maintenance of TI, as well as any expenses associated with obtaining the required currency data feeds.

3.8 The PRA has also considered the operational impacts that the proposals in this CP may have on firms, for example in using the PRA's published TI to calculate the technical provisions. The PRA has concluded that there would be limited impacts and limited additional costs to firms. This reflects that firms would already have in place the necessary processes to calculate technical provisions, and the PRA's proposals largely retain the status quo, with limited exceptions that are explained in this CP.

Compatibility with the PRA's objectives

3.9 The PRA has a statutory obligation at the end of the TP to publish TI to enable UK insurers to calculate technical provisions. There is some discretion in setting that TI, and the PRA does not propose to make any material changes to the current position. The PRA contributed to the development of Solvency II requirements and to the methodology and judgements underlying the TI. The PRA considers that the methodologies and judgements underlying the TI are appropriate for the calculations of technical provisions, and furthermore are suited to its objectives of safety and soundness and of policyholder protection.

3.10 The PRA has assessed whether the proposals in this CP facilitate effective competition and considers that their impact would be minimal.

Regulatory principles

3.11 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Two of the principles have particular relevance.

3.12 The first is the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden. The PRA has followed this principle when developing the proposals outlined in this CP, and has indicated in the CP the key areas of its judgements.

3.13 The second principle is that the PRA needs to use its resources in the most efficient and economic way. Each additional currency for which the PRA publishes TI increases the PRA's operational expenses; for example, in undertaking assessments of the depth, liquidity, and transparency of the swaps and bonds markets. The PRA considers that the methodology outlined in the CP would result in an appropriately targeted set of PRA relevant currencies.

Impact on mutuals

3.14 The PRA considers that the impact of the proposed changes on mutuals would be no different from the impact on other firms.

HM Treasury recommendation letter

3.15 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[12]

3.16 The aspect of the Government's economic policy most relevant to the proposals in this CP are competition and competitiveness. Competition has been addressed in the 'compatibility with the PRA's objectives' section above. The government wishes to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as the leading international financial centre. The government considers that achieving this aim in a manner that is consistent with robust institutions and a resilient system will support its aims for sustainable economic growth. The proposals would ensure that the UK has a smooth transition at the end of the TP that minimises disruption and consequently help maintain the UK's position as an attractive domicile.

Equality and diversity

3.17 The PRA considers that the proposals do not give rise to equality and diversity implications.

12 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Appendix

---

1 **Draft Statement of Policy: 'The PRA's approach to the publication of Solvency II technical information' available at: http://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2020/solvency-ii-technical-information.pdf**