Bank of England PRA

Meeting Summary

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

8 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 1 March focussing on the Fundamental Spread (FS) for sub-investment grade assets

2. Updates from the sub-groups on the data-driven and interpolation approach(es) for implementing notching

3. Thematic discussion: implementation of notching – should notching be voluntary or mandatory?

4. Thematic discussion: internal model pathway

5. Close and AOB

Summary of meeting

The fifth NSEG meeting covered the following topic areas:

- **Fundamental spread (FS) for sub-investment grade (SIG) assets:** the NSEG discussed the material uptick in the FS observed between Credit Quality Steps (CQS) 3 and CQS 4 for both financial and non-financial assets and agreed that further work should be done to identify and understand the main drivers of this.

- **Interpolation methods:** the interpolation sub-group presented an alternative interpolation approach (to the linear and exponential methods discussed previously) based on Weighted Average Rating Factors (WARFs). A view was expressed that this was a relatively complex approach for no obvious improvement, compared to other approaches that had been investigated. Conversation moved on to consider whether it is appropriate for a portfolio invested in line with the index to see an increase in the overall FS due to notching being introduced.
- **Implementation of notching being mandatory or voluntary**: advantages and disadvantages of each approach were identified. A mandatory approach was considered likely to give greater consistency across the industry and therefore be more likely to lead to a level playing field. However, it was noted that notching could be onerous for smaller firms or those with closed books. Key advantages of a voluntary approach were noted as being increased ownership of the FS by firms and potentially better reflection of different firms' risk profiles. However, the NSEG identified there was a risk of too much pressure being placed on attestations and poor incentives/behaviours being encouraged.
- **Internal model pathway**: the NSEG discussed whether a model change was likely to be required to allow for notching in stress and the pathway for implementing such a change, if so. There was some concern expressed as to how notching should be reflected in the SCR calculation given sparsity of notched data in the tail of the distribution and the likelihood of notching materially increasing the complexity of the SCR calculation as a whole. On the impact on internal models of the removal of the cap on the Matching Adjustment (MA) for SIG MA assets, there was discussion of whether removal of the cap for the purposes of calculating Technical Provisions should automatically lead to removal of the cap in stress or if there may be more of a role for such a cap in stress.