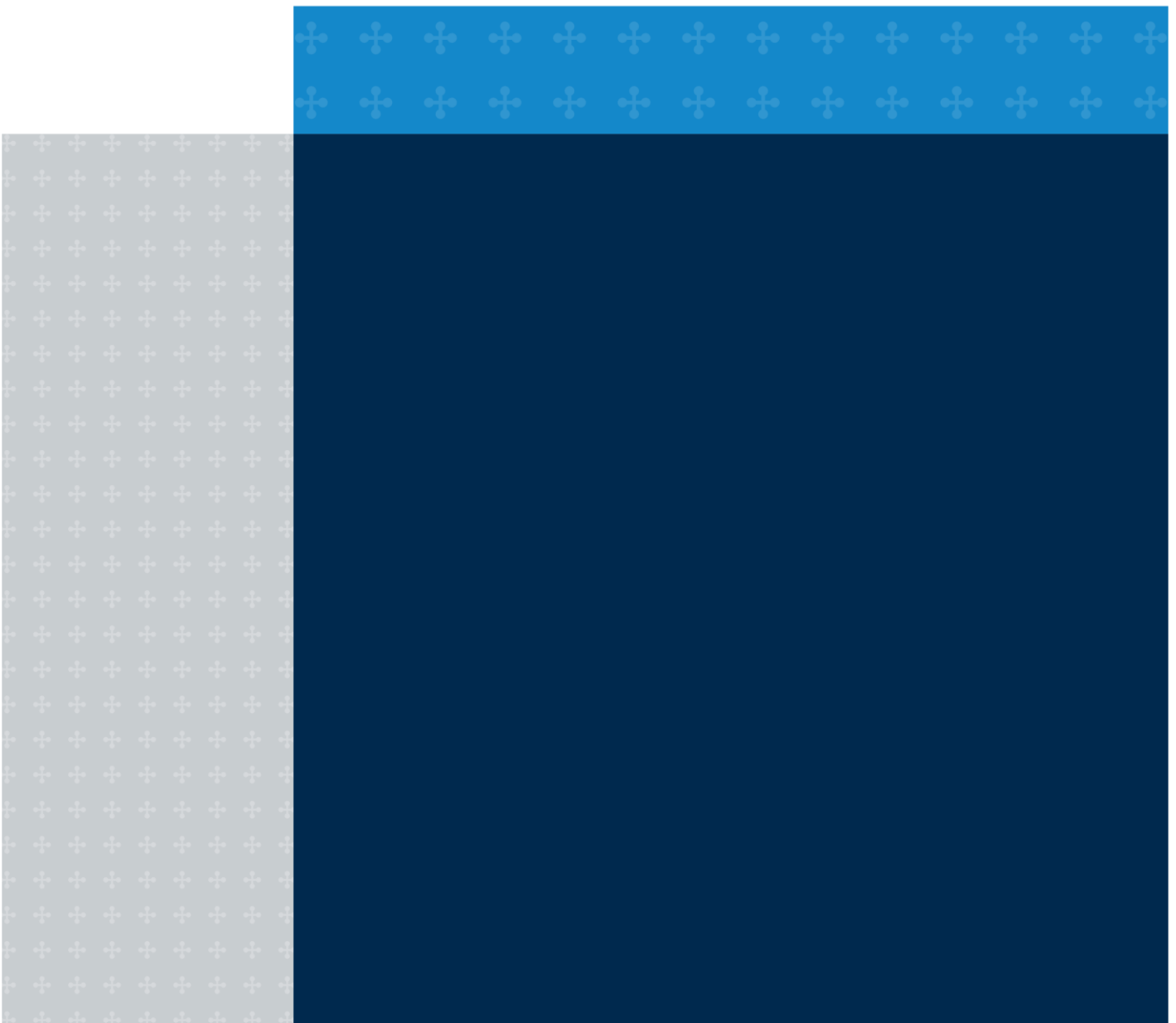




Policy Statement | PS24/20

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

December 2020





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 5/20 'Solvency II technical information: The PRA's proposed approach to the publication at the end of the transition period'.¹ It also contains the PRA's final policy in Statement of Policy (SoP) 'The PRA's approach to the publication of Solvency II technical information' (Appendix).

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

Background

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

1.4 For the purposes of calculating their technical provisions as at a point in time before the end of the TP, UK insurers must comply with the PRA's current rules and the Solvency 2 Regulations adopted under Article 86 of the Solvency II Directive, using the technical information (TI) published by the European Insurance and Occupational Pensions Authority (EIOPA) under Article 77e(2) of the Solvency II Directive. "TI" refers to the relevant risk-free rate term structures, the fundamental spreads for the calculation of the matching adjustment and for each relevant national insurance market, the volatility adjustments.

1.5 From the end of the TP, the PRA will be required to publish TI for each relevant currency.² The first time the PRA will publish TI will be as at the reference date of Thursday 31 December 2020. Therefore all regulatory reporting for UK firms as at a point in time from and including 11:00pm on Thursday 31 December 2020 should use the PRA's published TI. This means that a firm with a reporting year-end of Thursday 31 December (which calculates technical provisions as at 11:59pm on Thursday 31 December) will need to use the PRA's published TI. The PRA will continue to review our post-TP rules to ensure this is clear.

1.6 In the remainder of this PS, the PRA refers to the currencies for which it will publish TI as 'PRA relevant currencies'.

Summary of responses

1.7 The PRA received four responses to the CP. Respondents raised a range of operational concerns with the PRA's proposed implementation and publication dates for the TI. Responses included several requests for clarification, especially concerning PRA relevant currencies.

1.8 The details of the responses and the PRA's feedback and final decisions are set out in Chapter 2.

Changes to draft policy

1.9 The PRA has made the following minor changes to the draft policy:

¹ June 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/solvency-ii-technical-information>.

² Paragraph 4B(1) of the Solvency 2 Regulations (updated 31 December 2020) - Duty to publish technical information.

- (a) clarified its approach to determining the 'PRA relevant currencies'; and
- (b) updated the timing of the publication of the volatility adjustment (VA) representative portfolios (RPs).

1.10 These changes are described in full in Chapter 2 of this PS.

These changes to the draft policy do not result in any additional requirement on firms compared to the original proposals.

Implementation

1.11 This PS will come into effect at the end of the TP, which is expected to be 11pm on Thursday 31 December 2020. The policy has therefore been designed for the context that the UK is no longer bound by EU law and the amendments to retained EU law under the EU (Withdrawal) Act 2018 have been made. Please see CP13/20, 'UK withdrawal from the EU: Changes before the end of the transition period' for further details.³

1.12 The TI will be impacted by the PRA's proposed use of temporary transitional powers (TTP) at the end of the TP.⁴ 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.

³ September 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/uk-withdrawal-from-the-eu-changes-before-the-end-of-the-transition-period>.

⁴ 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>.

2 Feedback to responses

2.1 The PRA must consider representations that are made to it in accordance with its duty to consult on its general policies and practice and must publish, in such manner as it thinks fit, responses to the representations.⁵

2.2 The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions. The structure of this PS is broadly aligned with that of the CP.

Feedback to CP Chapter 1 – Overview

2.3 The CP stated that 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.

2.4 One respondent requested the PRA to publish a CP addressing LIBOR transition as a priority given that LIBOR is likely to cease at the end of 2021.

2.5 The PRA intends to publish a CP at the earliest practicable date which is expected to be in early 2021, setting out its proposed approach to determine the TI in light of the expected transition from LIBOR to SONIA.

2.6 The implementation date for the final policy, and the reference date for the PRA's first publication of TI, was proposed as the end of the TP, which is expected to be 11:00pm on Thursday 31 December 2020. Therefore, a UK firm would be required to use the PRA's published TI for its regulatory reporting from and including 11:00pm on Thursday 31 December 2020.

Operational challenges

2.7 One respondent advocated a minimum six-month delay during which firms might continue using EIOPA's TI. The rationale for this was that firms working on year-end regulatory reporting would not have sufficient capacity to design, build and test systems to accommodate the changes resulting from switching to the PRA's TI.

2.8 The respondent also highlighted the operational complexity and cost to UK-based insurance groups with EU subsidiaries. These groups may require dual reporting as solo Quantitative Reporting Templates (QRTs) for EU subsidiaries would need to be based on EIOPA's TI, while the UK group and UK solo QRTs would require the PRA's TI. It was therefore requested that the PRA allows UK-based insurance groups with EU subsidiaries to choose whether to use the PRA's TI, or to continue to use EIOPA's TI. Alternatively, that for all UK and EU insurers the PRA could publish the TI for pounds sterling (GBP) only, while EIOPA would publish the TI for all other currencies. A final suggestion was that the PRA permits all UK firms to calculate their own TI according to principles established by the PRA (including the option to use EIOPA rates where compatible with the principles).

2.9 Regulation 4B of the Solvency 2 Regulations 2015/575 requires the PRA to publish the TI for each relevant currency. It does not provide an option for the PRA to simply provide principles or delegate this responsibility to another institution. As a result, the PRA cannot change its implementation date for the final policy.

2.10 For currencies for which the PRA does not publish TI, it is a firm's responsibility to propose TI that complies with Solvency II requirements and justify its approach to its supervisor. This is discussed further below.

⁵ Sections 2L and 2N of the Financial Services and Markets Act 2000 (FSMA).

2.11 The CP proposed that the PRA's 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. Owing to this approach, the PRA does not anticipate any meaningful differences between the PRA's and EIOPA's TI until the PRA's planned update of the VA reference portfolios at the end of March 2021 to reflect UK firms' exposures.

Comparison with EIOPA's TI

2.12 A respondent asked the PRA to conduct a parallel run of its TI with EIOPA's version in the months ahead of implementation, to ensure a smooth publication of the PRA's TI in January 2021.

2.13 The PRA, in its own internal analysis, has conducted a number of parallel runs and has been able to replicate exactly EIOPA's published TI in respect of the basic risk-free rates (RFR) and the VA. Minimal differences arise in some cases in the calculation of the long-term average spread component of the fundamental spread, although these are expected to have an immaterial impact on firms' regulatory technical provisions. These differences are understood to arise because of some small differences in the historic credit spread data obtained by the PRA versus the data used by EIOPA.

2.14 To minimise the operational challenge for firms the PRA will, for the first three month-end publications (the Thursday 31 December 2020, Sunday 31 January 2021 and Sunday 28 February 2021 reference dates), compare the PRA-derived TI to EIOPA's published TI for each of the PRA relevant currencies. Where a discrepancy between the PRA and EIOPA's TIs is minimal, or unlikely to lead to a material difference in the level of the regulatory technical provisions, the PRA will align the PRA's TI to EIOPA's published TI. This should temporarily relieve any additional burden for firms of running two sets of calculations for technical provisions for year-end regulatory reporting, and give firms more time to adapt their systems and processes.

Format of the PRA's TI

2.15 A respondent noted that even minor changes to the format of the published TI could cause issues for firms where valuation or capital models rely on automatic data feeds.

2.16 The PRA confirms that its published TI will continue to follow the format currently used by EIOPA. It also intends to work with industry to gradually improve the format of publication, to better suit the end users' needs.

Feedback to CP Chapter 2 – Proposals

Publication of TI

2.17 The CP proposed that the PRA should publish the TI on the PRA website on the eighth working day of each month. This was intended to reflect the requirements of the on-shored regulations which require the PRA to publish by the eighth working day of the month that follows the end of each relevant quarter.⁶

2.18 Three respondents noted that EIOPA currently publishes TI on the third working day of each month. They highlighted that the extra five working days would pose significant issues to both large and small firms to meet reporting timelines and provide solvency monitoring information.

2.19 The PRA acknowledges that the CP proposal should have stated that the PRA shall publish the TI by (rather than on) the eighth working day of each month, and that this would better have reflected the PRA's obligation as stated in 4B(1) of the Solvency 2 Regulations. The PRA intends to publish the TI at the earliest possible date each month, once its validation is complete. The PRA

⁶ 4B(1) of the Solvency 2 Regulations.

notes that EIOPA only brought forward its publication timescales to the third working day in 2019, after gaining four years' experience with the publication of the TI.

Symmetric Adjustment of the Equity Capital Charge

2.20 Two respondents queried when the PRA intends to publish information on the Symmetric Adjustment of the Equity Capital Charge (SAECC), and to what timescale.

2.21 The PRA recently consulted on proposals to determine an equity index for the SAECC that is representative of the equities held by UK insurers.⁷ The PRA is considering responses to this consultation, and will publish a policy statement with its final policy which will be implemented at the end of the TP.

Adoption of EIOPA's technical methodologies underlying the TI

2.22 The PRA proposed 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. 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 appropriate for UK insurers at the end of the TP.

2.23 One respondent explicitly agreed with the PRA's proposed approach. Other respondents requested several clarifications of the PRA's proposed approach (as explained in the subsequent paragraphs).

Level of detail in PRA's proposed documentation

2.24 One respondent queried why the PRA does not intend to adopt the full EIOPA technical documentation.⁸

2.25 The PRA does not consider it appropriate to adopt in full EIOPA's technical documentation nor, at this stage, to publish its own technical documentation.

2.26 In due course the PRA intends to work with industry to determine an appropriate level of technical documentation which best suits the industry's needs.

Specific queries about PRA's methodology

2.27 A respondent asked the PRA to confirm specific details about the PRA's methodology to calculate the TI.

2.28 The PRA confirms that:

- fundamental spreads will be published for the PRA's relevant currencies;
- the ultimate forward rate for 2021 will be the same as that published by EIOPA in July 2020;⁹ and
- the PRA has retained the methodologies and judgements that EIOPA incorporates in its TI as at the end of the TP, with limited exceptions, listed in the SoP (see Appendix).

⁷ Paragraphs 4.4 to 4.9 of CP13/20 (September 2020), available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/uk-withdrawal-from-the-eu-changes-before-the-end-of-the-transition-period>.

⁸ Available at: https://www.eiopa.europa.eu/sites/default/files/risk_free_interest_rate/21.08.2020_-_technical_documentation.pdf.

⁹ Available at: https://www.eiopa.europa.eu/content/eiopa-publishes-ultimate-forward-rate-ufr-2021_en.

Choice of PRA relevant currencies in which to publish TI

Determination of relevant currencies

2.29 The CP proposed criteria to determine the relevant currencies for which the PRA would publish TI. The primary criterion would be to ensure the relevant currencies cover at least 99% of the group technical provisions of UK insurers. A 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. The CP contained an illustrative list of seven relevant currencies (GBP, EUR, USD, AUD, CAD, JPY and SEK) determined using YE18 regulatory reporting data.

2.30 One respondent agreed with the proposed choice of currencies, which would avoid the publication of 'excessive volumes of information'.

2.31 Another respondent asked the PRA to consider increasing the number of relevant currencies.

2.32 As noted in the CP, the PRA needs to use its resources in the most efficient and economical way. Each additional currency for which the PRA publishes TI increases the PRA's operational costs. The PRA considers its proposed approach meets the requirement to publish TI for relevant currencies while using its resources efficiently.

2.33 The PRA has now updated its list of relevant currencies by applying the approach as set out in the CP, using data from UK insurers' year-end 2019 QRTs and taking into consideration any VA and MA approvals (for which non-zero technical provisions apply) authorised up until October 2020. The nine PRA relevant currencies are shown below in Table A and shall apply from Thursday 31 December 2020 and throughout the calendar year 2021.

Table A: List of PRA relevant currencies from Thursday 31 December 2020

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

2.34 However, the PRA wishes to clarify that the derivation of the above list of relevant currencies was based on the group technical provisions of UK insurers and the solo technical provisions of the Society of Lloyd's. This is expected to give the widest set of currencies that fall within the 99% criterion. This was validated against separate analysis of all UK solo technical provisions data. The SoP has been updated to reflect this minor clarification.

Reporting Solvency II Technical Provisions for separate currencies

2.35 The Commission Implementing Regulation (EU) 2015/2450 requires a firm to complete several quantitative reporting templates by individual currencies up to a materiality threshold. One respondent sought clarification from the PRA that the designation of a currency as a relevant currency (for the PRA) would not automatically require all firms to separately report technical provisions for that currency.

2.36 The PRA confirms that its designation of a currency as a relevant currency should not impact a firm's assessment of how it meets its reporting obligations for individual or immaterial currencies.

Approaches for a currency that is not a PRA relevant currency

2.37 The CP proposed that where a UK insurer has technical provisions in a particular currency for which the PRA does not publish TI, it should approach its supervisors to discuss suitable TI to use.

2.38 Two respondents asked for further clarity about the types of approaches that will be available to firms in these cases. For currencies 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 considers that suitable approaches may include, subject to discussion with a firm's supervisor, use of:

- a publicly available source of TI (eg from EIOPA). However, firms should consider carefully whether the public source complies with the Solvency II requirements, and what adjustments may be necessary before it is suitable for the calculation of its UK technical provisions; or
- the TI of one of the PRA's relevant currencies that is a suitable proxy for another currency, with adjustments where necessary.

PRA's methodology for deriving reference portfolios (RPs) for the volatility adjustment

2.39 The CP proposed that the PRA would publish the VA RPs on its website in the fourth quarter of 2020, and these would become effective from Wednesday 31 March 2021.

Approach for the Volatility Adjustment (VA) at Thursday 31 December 2020

2.40 A respondent asked the PRA to confirm whether it intends to publish a year-end 2020 VA that is identical to EIOPA's.

2.41 The PRA confirms that it will initially use the VA representative portfolios published by EIOPA which came into effect at the end of March 2020.¹⁰ Please see paragraph 2.14 for PRA's proposal to align to EIOPA's TI for minimal differences until end-March 2021. At the end of March 2021, the new RPs, which reflect the PRA's final policy, will come into effect.

2.42 The PRA's VA RPs include a weighting to EIOPA's VA RPs. Therefore, publication depends on the availability of EIOPA's VA RPs and may be delayed until the beginning of the first quarter of the following calendar year. For example, the PRA may publish updated RPs only in January 2021 to become effective from Wednesday 31 March 2021. The PRA considers that this slight potential delay to publication will not significantly affect firms with VA approval.

External providers

2.43 One respondent noted that Bloomberg currently publishes the Solvency II VA through an automated data feed (EIOPUKVA Index). The respondent asked the PRA to consider the timetable of external data vendors, on the grounds that otherwise insurers using automated systems for solvency calculations will have to resort to manual processes.

2.44 The PRA reminds firms of their responsibility to use the PRA's published TI rather than TI published by an external provider. As set out in paragraph 2.16, the PRA will initially publish TI using the same format as EIOPA but intends to work with industry to gradually improve the format of publication, to better suit end users' needs.

¹⁰ Available at: https://www.eiopa.europa.eu/content/eiopa-updates-representative-portfolios-calculate-volatility-adjustments-solvency-ii-risk_en.

Feedback to CP Chapter 3 – The PRA's duty to consult

Cost benefit analysis

2.45 The PRA's cost benefit analysis stated that the proposals would have limited impact and would cause limited additional costs to firms.

2.46 A respondent challenged that the proposed implementation date of year-end 2020 and the delayed publication on the eighth working day may lead to significant operational risks and cost implications for firms.

2.47 The PRA acknowledges that a firm's switch from using EIOPA's TI to using PRA's TI may introduce an additional cost. As explained in paragraph 2.9, the PRA does not have any discretion for the implementation date of year-end 2020 and therefore this was not considered as part of the CP's cost benefit analysis. Nevertheless, the actions detailed in paragraph 2.11 should mitigate any initial implementation cost for insurers.

2.48 The PRA acknowledges that publishing the TI on the eighth working day may result in additional costs to firms, when compared to EIOPA's current timescales for publishing the TI. Therefore, the PRA has clarified in Chapter 2 that it will publish TI by the eighth working day (rather than on the eighth working day), and as close as possible to EIOPA's scheduled publications. The PRA considers that this clarification helps to mitigate the concerns raised by the respondent about the PRA's publication timescales.

Appendix

1. **Statement of Policy 'The PRA's approach to the publication of Solvency II technical information', available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/the-pras-approach-to-publication-of-sii-technical-information>.**