Bank of England PRA

Meeting Summary

PRA/ABI Solvency UK Investment Flexibility Subject Expert Group (IFSEG): Fifth meeting

9 March 2023

Location: Bank of England Offices, MS Teams

Attendees: The PRA, ABI and HMT
Representatives of the following insurance firms:

- Aviva, Phoenix Group, PIC, Legal & General, Rothesay

Agenda

1. Introduction of any delegates

2. Reflections, if any, on the previous meeting

3. Thematic topic: Predictable Revenue Streams / Whole loans. Focus on approaches for how such assets could be included in matching adjustment portfolios (MAP)

4. AOB/ Conclusion

Summary of meeting

During the fifth meeting, the IFSEG discussed, in relation to the thematic topic of predictable revenue streams/ whole loans:

- The possibility of holding whole assets in MA portfolios, either by (i) allowing ‘junior notes’ to be included in MA portfolios or (ii) by holding the underlying investment either fully inside or outside the MA portfolio and hypothecating a notional ‘senior note’ to determine the amount of MA benefit. Advantages and disadvantages were discussed, in the context of the Prudent Person Principle (PPP), impact on HMT’s investment objectives, credit ratings, operational considerations, costs and ability for the PRA to supervise.

- The concept of a simple and an advanced implementation of reforms to restructuring was discussed, with increased risk exposures leading to more sophisticated and bespoke approaches.
- The IFSEG noted that under the current MA legislation assets require a credit rating, particularly for assigning a fundamental spread. Firms using internal credit ratings without being able to externally validate these could weaken the reliability of the mapping between rating and credit quality steps (CQS) and hence confidence in the assigned fundamental spread.
- A possible reform model was suggested whereby a fundamental spread (FS) add-on is applied to assets to allow for the risk of uncertainty over future cashflow timing and/or amount, combined with a controls framework that measures and mitigates the amount of cashflow uncertainty at a portfolio level.

The IFSEG also returned to the previous week’s discussion on FS add-ons for structural features:

- The IFSEG debated the practicality of an approach using spread differentials between assets with highly predictable cashflows and reference assets. It was discussed that perfect reference assets would not exist so taking a pragmatic approach was important and that a key benefit of such an approach was that it did not need many parameters to be calibrated and the calculation would be straightforward. A number of challenges were also noted and the IFSEG resolved to consider this and other possible approaches at a future meeting.