Bank of England PRA

Meeting Summary

PRA/ABI Stress Testing Subject Expert Group (STSEG): Eighth Meeting

5 October 2023

Bank of England Offices, MS Teams

The PRA, observers from HMT and representatives of the following insurance firms: Aviva, Just, Phoenix Group, PIC, Rothesay, Royal London, Legal & General, Scottish Widows Group, Canada Life, M&G

Agenda

1. Discussion around particular design features:
    a. Credit rating downgrade
    b. Interest rates modelling
    c. Asset shocks
    d. Management actions
2. Submissions timelines

Summary of meeting

This meeting focused on various design features including discussion of any modelling development required, impact on effort and timing to complete next LIST exercise.

- **Credit (downgrade) stress granularity**:
    - The industry members thought that evolving the downgrade stress from LIST 2022 design (where the same downgrade shock was applied to all ratings) to downgrade shock varying by credit ratings was feasible to implement for LIST 2025. Full transition matrix of credit rating downgrades was seen as more

complicated from implementation point of view and as making it potentially difficult to explain results.

  - Some industry members thought that extending granularity of downgrades stresses to be based on other asset characteristics (eg those used for Fundamental Spread calculations – CQS, maturity, currency and financial / non-financial split) could provide a useful different angle of looking at exposures.
  - The industry members also asked how notching introduced by the SoI UK regime will be factored in the design.
  - The members further discussed other characteristics of the assets which could serve as a basis for different credit stress assumptions. Internally-rated assets as a category were seen as too wide and needing a more granular differentiation (eg by sector); it would be unlikely that all of internally rated assets will move in the same way and such stress could create a misleading picture. There was a view that more common sector classifications across firms would be needed to allow meaningful implementation of different credit stress assumptions by the sector.
  - Industry members thought that adding defaults to the stress scenario is plausible from implementation perspective but to produce meaningful results would need consistency of assumptions around recovery expectations for defaulted assets in different sectors.

- **Interest rates**: Industry members preferred simplicity of the level nominal and real interest rates shocks. While term-dependent stress could add value it could make they were seen as making it more difficult to explain the results across firms. Another suggestion was to provide specification for interest curves in different currencies.
- **Asset class shocks**: In addition to specifying approach to ERM securitisation (as in LIST 2022), the industry members suggested that commercial property- backed credit asset could be another area where treatment of assets could be specified.
- **Management actions**: The PRA asked the members what approach to management actions would be preferable to ensure consistency and comparability across firms. The industry members view was that this will depend on the severity of the scenario and there was a preference for restricted management actions (similar to LIST 2022) for less severe scenarios.

- **Submissions timelines:** The PRA asked participants what lead time would be needed to set up the systems once the design is finalised (prior to calibrations). The industry members view was that the scenario and its complexity would have a lot of impact on the timelines and having design instructions would be helpful in advance of H2 2024.