BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Publication

Statement of Policy

The PRA's approach to the publication of Solvency II technical information

November 2024 (Updating June 2024)

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1 Background

1.1 The Prudential Regulation Authority (PRA) is required to publish technical information (TI) that it considers appropriate relating to the calculation of the technical provisions.[1] This Statement of Policy (SoP) explains how the PRA fulfils its obligations in this regard. It also explains the PRA's approach to calculating the symmetric adjustment to the equity capital charge (SAECC), which is relevant to calculation of the SCR by standard formula firms. UK firms should use the PRA's published TI for regulatory reporting.

1.2 This SoP is relevant to all UK Solvency II firms, including the Society of Lloyd's and its managing agents, hereafter referred to as 'UK insurers'.

1.3 The PRA refers to the currencies in which it publishes TI as 'PRA relevant currencies'.

2 Overview of the PRA's approach

2.1 The PRA has adopted methodologies and judgements consistent with those the European Insurance and Occupational Pensions Authority (EIOPA) incorporates in its TI as at the end of the transition period (TP), with some exceptions as set out in Chapter 3. Additionally, since 31st March 2022, the PRA has applied a 30% long term average spread calculation only to UK central government and central bank exposures and no longer to EEA exposures.[2]

2.1A In determining the published technical information on the risk-free interest rate term structures for PRA relevant currencies the PRA uses techniques, data specifications, and parameters which are transparent, prudent, reliable, objective, and consistent over time.

2.1B The PRA's approach to the calculation of the basic risk-free interest rate term structures for PRA relevant currencies is based on the following assumptions:

- firms are able to earn the rates in a risk-free manner in practice; and
- the rates are reliably determined based on financial instruments traded in deep, liquid, and transparent financial markets.

The PRA calculates the rates of the risk-free interest rate term structure separately for each relevant currency and maturity, based on all information and data relevant for those relevant currencies and maturities.

2.1C The PRA determines and publishes a volatility adjustment for each relevant currency. Those volatility adjustments:

a) are based on the spread between the interest rate that could be earned from the assets that are representative of firms' investments in that currency and the rates of the relevant basic risk-free interest rate term structure for that currency, and

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1 Regulation 3 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023: www.legislation.gov.uk/uksi/2023/1347/made. The PRA published the first set of TI in January 2021.

2 Consultation Paper 18/19: UK withdrawal from the EU: Changes following extension of Article 50, Annex BU (Amendments to the Technical Provisions Part), section 7.3: www.bankofengland.co.uk/-/media/boe/files/prudential-regualtion/consultation-paper/2019/cp1819-complete.pdf.

The CP proposals were confirmed as final policy via the joint Bank and PRA statement in April 2020: www.bankofengland.co.uk/prudential-regulation/publication/2020/joint-bank-pra-statement-on-proposed-use-of-ttp-at-the-end-of-the-transition-period.

b) correspond to 65% of the risk-corrected currency spread as set out in paragraphs 3.13 to 3.15.

2.2 The PRA's TI is published on the Bank of England's website.[3]

3 PRA methodologies and judgements

PRA relevant currencies

3.1 The PRA's choice of PRA relevant currencies is based on the relative materiality of technical provisions denominated in each currency, and currencies in which UK insurers have non-zero technical provisions for which the firms are authorised to use the volatility adjustment (VA) or the matching adjustment (MA). The PRA will review the list of PRA relevant currencies from time to time.

3.2 [DELETED]

3.3 The PRA chooses PRA relevant currencies using two criteria:

- by materiality; and
- to include currencies in which UK insurers have VA and MA authorisations.

3.4 The PRA assesses materiality by selecting PRA relevant currencies to ensure that at least 99% of group technical provisions are covered which includes the Society of Lloyd's' solo technical provisions. This involves (i) aggregating technical provisions (expressed in GBP and excluding those relating to unit-linked business) by currency and (ii) selecting the top-ranking currencies such that the cumulative proportion of technical provisions exceeds 99%.

3.4A When assessing the above materiality criterion, the PRA will use data from the calendar year-end returns of insurers. 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) will be used to inform the choice of the PRA relevant currencies in calendar year N+2.

3.5 The PRA used the above criteria to generate the initial list of PRA relevant currencies applicable from 31 December 2020. In subsequent years, the PRA may add currencies that meet either of the above two criteria to the list of PRA relevant currencies.

3.5A A currency may also be removed from the list of PRA relevant currencies, where:

- in the case of a currency that was included on the basis of the materiality criterion, it subsequently ceases to satisfy this criterion and continues not to satisfy this criterion for three consecutive years; or
- in the case of a currency that was included on the basis that it was covered within the scope of a UK firm's MA or VA authorisation, it subsequently ceases to be covered within the scope of any UK firm's MA or VA authorisation.

3.5B The PRA aims to give firms at least three months' notice of any addition or removal of a currency from the list of PRA relevant currencies.

3 Available at: www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/technical-information.

3.6 Where a UK insurer has technical provisions in a particular currency for which the PRA does not publish TI, it is the firm’s responsibility to propose TI that complies with the requirements in the PRA Rulebook. Where there is additional relevant policy material, eg supervisory statements, firms should also comply with this material or explain their approach and justify it to their supervisors. The PRA reminds firms that they can only apply the VA for currencies where a VA is published by the PRA.

Basic risk-free rates (RFRs)

3.6ZA1 The PRA derives the basic RFR for each relevant currency and maturity from interest rate swap rates in that currency, adjusted to take account of credit risk.

3.6ZA2 The PRA will use government bond rates, adjusted to take account of credit risk, to derive the basic RFR where:

- interest rate swap rates are not available from deep, liquid, and transparent financial markets for the relevant currency and maturity; and
- government bond rates are available from deep, liquid, and transparent markets.

3.6ZA3 The adjustment for credit risk reflects the level of credit risk inherent in the financial instrument used to derive the basic RFR. If the relevant financial instrument contains negligible credit risk, the adjustment may be zero.

3.6A The PRA needs to make judgements about the reference instruments and associated Credit Risk Adjustments (CRAs) to use when constructing the basic RFRs for PRA relevant currencies. For example, some reference instruments and CRAs have been updated in light of the cessation of Libor settings. To satisfy paragraphs 3.Z6A1-3.6ZA3 the PRA will make available, for example via the TI area of the Bank of England’s website, relevant information about any changes to the reference instruments and CRAs used to construct the basic RFRs for PRA relevant currencies. The PRA aims to give firms at least three months’ notice of such changes.

Extrapolation of the RFR

3.6A1 The PRA will use the same principles for extrapolating the RFR term structure in all relevant currencies. This also applies to the determination of the longest maturities for which interest rates can be observed in a deep, liquid, and transparent market and the mechanism to ensure a smooth convergence to the ultimate forward rate.

3.6A2 The PRA will publish basic extrapolated risk-free interest rate term structures for PRA relevant currencies. Firms with Matching Adjustment (MA) permission can apply the MA to those structures.

3.6A3 Where the PRA publishes risk-free interest rate term structures for PRA relevant currencies including a volatility adjustment, the PRA will apply extrapolation after applying the volatility adjustment to the basic RFR.

3.6A4 For each relevant currency the ultimate forward rate takes account of expectations of the long-term real interest rate and expected inflation, provided those expectations can be determined for that currency in a reliable manner. The PRA will maintain stability in the ultimate forward rate for each relevant currency and will only make changes where there are changes in long-term expectations. The PRA uses the same methodology as that specified by EIOPA in its Report on the Calculation of the UFR for 2024.[4]

3.6A5 The ultimate forward rate does not include a term premium to reflect the additional risk of holding long-term investments.

Calculation of the long-term average spread (LTAS)

3.6B For the LTAS calculation, the PRA calculates the average of spreads over the RFR applicable at the time of the spread data. Therefore, following the transition of TI references from Libor to an OIS rate, historic spreads (over Libor-based RFR) already embedded in the LTAS calculation remain unadjusted.

3.6B1 The LTAS calculation for government bonds interpolates spread data for maturities where there isn't reliable financial market data for that government bond. The PRA will consider EIOPA's published conclusions in this area.

Assessment of the depth, liquidity, and transparency of the markets

3.6C The PRA focuses its assessment of the depth, liquidity, and transparency of the market (the DLT assessment) on interest rate swaps data for the markets of relevant currencies where there is an active swap market and government bonds data where the swap market is insufficiently active.

3.6D The PRA uses the same volume indicators as applied by EIOPA (at the end of the TP) for assessing the liquidity of the swaps market, but with the average (over one year) daily notional turnover requirement being £45 million. These indicators therefore comprise the:

- average (over one year) daily notional turnover of at least £45 million; and
- average (over one year) daily number of trades of at least ten.

3.6E The PRA also considers in its DLT assessment additional criteria developed to avoid excessive volatility in the results of the assessment, specifically that a previously liquid market needs to drop at least 20% below one of the thresholds to be considered illiquid, and a previously illiquid market must meet both thresholds and rise at least 20% above one of the thresholds to be considered liquid. The PRA is guided by these additional criteria as soft thresholds.

3.6F The PRA may also consider other metrics and expert opinion in order to supplement its assessment as required for the relevant currencies, which are set out in its published results and analysis of the DLT assessment.

3.6G For non-GBP currencies, the PRA makes use of externally published DLT data and analysis, including that published by EIOPA and the International Association of Insurance Supervisors (IAIS), to contribute to its own DLT assessments and any other DLT assumptions required for the calculation of the SII TI.

3.6H [DELETED]

4 www.eiopa.europa.eu/eiopa-publishes-ultimate-forward-rate-ufr-2024-2023-04-27_en.

Reference portfolios (RPs) for the Volatility Adjustment

3.7 [DELETED]

3.7A The RP for a relevant currency is one that is representative of the assets which are denominated in that currency and which firms are invested in to cover the best estimate for insurance and reinsurance obligations denominated in that currency.

3.8 The PRA derives VA RPs using a similar technical approach as EIOPA.[5] Further details on this, including specific areas where the PRA's approach differs, are explained below. The methods applied by the PRA when determining the RPs are the same for all currencies.

3.8A For each relevant currency, the assets of a RP are those for which a reliable market value is observable, are valued in accordance with the rules in the Valuation Part of the PRA Rulebook,[6] and are traded in markets that, except in periods of stressed liquidity, are active, deep, liquid, and transparent. The PRA only expects to include financial instruments that do not have a reliable market value and aren't traded in markets that are active, deep, liquid, and transparent where the status is temporary, and that market is expected to comply with those criteria again within a reasonable time period. Furthermore, the RP exhibits the following features:

(a) where available, the portfolio is based on relevant indices which are readily available to the public and published criteria exist for when and how the constituents of those indices will be changed;

(b) it includes all of the following:

- bonds, securitisations, and loans, including mortgage loans;
- equity; and
- property.

For the purposes of point (a), investments of firms in collective investment undertakings and other investments packaged as funds are treated as investments in the underlying assets.

3.9 The derivation of the VA RPs reflects UK firms' asset exposures. Specifically:

• the VA RPs used to calculate the GBP VA are 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 are derived by taking a weighted average of:

(i) EIOPA's published VA RPs derived using QRT data submitted to EIOPA; and

(ii) the VA RPs derived using QRT data submitted to the PRA for (UK) parent undertakings (as defined in the Glossary Part of the PRA Rulebook). This QRT data is aggregated together with solo QRT data submitted to the PRA by the Society of Lloyd's. The respective RPs are weighted using the aggregate market value of assets as reported in the QRT data of (i) European Economic Area firms and (ii) (UK) parent undertakings and the Society of Lloyd's.

5 www.eiopa.europa.eu/document/download/9c56797a-ff5c-428a-897d-9dfc9346d9b1_en?filename=16.12.2020%20%E2%80%93%20Technical%20documentation.

6 PRA rulebook Valuation 6.

3.10 The PRA applies 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 assumes that the exposures within CIUs in respect of duration, sector, and rating are the same as exposures held outside of CIUs.

3.11 The PRA does not publish separate country VA RPs for any of the relevant currencies.

3.11A The PRA's approach will only treat exposures to central governments and central banks as government bonds, with all bonds issued by regional governments and local authorities (RGLAs) classified as corporate bonds.

3.12 The PRA aims to give firms at least three months' notice of the change in the VA RPs. The PRA's VA RPs will become effective from the next 31 March following publication.

Risk Corrected Currency Spread

3.13 The PRA calculates the risk-corrected currency spread referred to in paragraph 2.1C(b) as the difference between the spread referred to in paragraph 2.1C(a) and the portion of that spread that is attributable to a realistic assessment of expected losses or unexpected credit risk or other risk of the assets.

3.14 For each relevant currency the RP spread referred to in paragraph 3.13 is equal to the following:

$$S=w_{gov}\cdot\max(S_{gov},0)+w_{corp}\cdot\max(S_{corp},0),$$

where:

(a) w_{gov} denotes the ratio of the value of government bonds included in the RP of assets for that currency and the value of all the assets included in that RP;

(b) S_{gov} denotes the average currency spread on government bonds included in the RP of assets for that currency;

(c) w_{corp} denotes the ratio of the value of bonds other than government bonds, loans, and securitisations included in the RP of assets for that currency and the value of all the assets included in that RP; and

(d) S_{corp} denotes the average currency spread on bonds other than government bonds, loans, and securitisations included in the RP of assets for that currency.

For the purposes of this calculation 'government bonds' means exposures to central governments and central banks.

3.15 The PRA calculates the portion of the average currency spread that is attributable to a realistic assessment of expected losses, unexpected credit risk or any other risk referred to in paragraph 3.13 in the same manner as the fundamental spread referred to in Regulation 6(1) to (8) of The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.

4 Symmetric adjustment of the equity capital charge (SAECC)

4.1 The PRA will calculate and publish an SAECC figure in line with the rules set out in the Solvency Capital Requirement – Standard Formula Part of the Rulebook, Section 3D – Market Risk Module 3D12, 3D13, and 3D14 on a monthly basis. Firms can use that figure to adjust the standard equity capital charge in their calculation of the equity risk sub-module referred to in rule 3.11(2)(b) of the Solvency Capital Requirement – Standard Formula Part of the PRA Rulebook.

Annex – Statement of Policy updates

This annex details the changes that have been made to this SoP since the update in June 2021:

2024

November 2024
Following publication of policy statement (PS) 15/24 – Review of Solvency II: Restatement of assimilated law,[7] the below updates to this SoP have been finalised.

Chapters 2 and 3 has been extended to include additional details on the requirements relating to the production of technical information relevant to basis risk-free interest rate term structures and volatility adjustment. Captured in the addition of the following:

- paragraphs 2.1A, 2.1B and 2.1C within the Overview of the PRA's Approach chapter;
- paragraphs 3.6ZA1, 3.6ZA2, 3.6ZA3 within the Basis risk-free rates section;
- new section on Extrapolation of the RFR within chapter 3 - new paragraphs: 3.6A1, 3.6A2, 3.6A3, 3.6A4, 3.6A5;
- paragraphs 3.7A, 3.8A within the Reference portfolios (RPs) for the Volatility Adjustment section; and
- new section on Risk Corrected Currency Spread within chapter 3 - paragraphs 3.13, 3.14 and 3.15.

There have been minor amendments to the following paragraphs: 1.1, 2.1, 3.6, 3.6A, 3.8 and 3.9. These changes reflect the addition of the new material above.

The requirement to publish country specific volatility adjustment reference portfolios has been removed from paragraph 3.11.

Chapter 4 has been added to include the PRA's approach to publish technical information on the symmetric adjustment to the standard equity capital charge. Paragraph 1.1 has been updated to include this addition.

This policy is effective from 31 December 2024.

June 2024
Following publication of Policy Statement (PS) 10/24 'Review of Solvency II: Reform of the Matching Adjustment', paragraph 1.1 was amended to reflect the requirement of regulation 3 of The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023. Footnote 1 was amended to replace references to regulation 4B of the Solvency 2 Regulations 2015 with reference to regulation 3 of the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023.

Minor typographical changes (of a presentational nature) have been made to other footnotes.

This policy is effective from 30 June 2024.

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7 http://www.bankofengland.co.uk/prudential-regulation/publication/2024/november/review-of-solvency-ii-restatement-of-assimilated-law-policy-statement.

2023

December 2023

Following publication of PS19/23 'Responses to CP8/23 'Occasional Consultation Paper', paragraph 3.9 was amended and paragraph 3.11A was added to reflect minor technical updates to the PRA's approach for determining VA RPs.

This policy is effective from Friday 22 December 2023.

2022

August 2022

Following publication of PS7/22 'Responses to CP3/22 'Occasional Consultation Paper', paragraphs 3.4A, 3.5A and 3.5B were added to explain the PRA's revised approach to determine the relevant currencies. Paragraph 3.6B1 was added and existing paragraphs edited to clarify that the PRA's approach to the LTAS calculation and DLT assessments. The PRA deleted paragraph 3.6H since the content is now covered in the updated paragraphs 3.6B1 and 3.6G of the amended SoP.

The PRA also updated the terminology throughout the SoP from the 'future' to 'present' tense to reflect that, as the transition period has now ended, the PRA now implements the approach in the SoP to publish the Solvency II TI. Paragraph 3.7 was deleted since this described the PRA's approach to calculate the VA for a short period at the end of the TP and is no longer relevant.

This policy is effective from Thursday 1 September 2022.

2021

June 2021

Following publication of PS12/21 'Solvency II: Deep, liquid and transparent assessments, and GBP transition to SONIA', paragraph 2.2 was added to include a reference to the TI section of the Bank of England's website. Paragraphs 3.6A–3.6H were added to describe the reference instruments used for the basic risk-free rates, calculation of the long-term average spread (LTAS) and assessment of the depth, liquidity, and transparency of the markets.

This policy is effective from Thursday 3 June 2021.