12 January 2024

PRA CP19/23 - Review of Solvency II: Reform of the Matching Adjustment

IFoA Response

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

The IFoA welcomes the opportunity to respond to the CP19/23 Review of Solvency II: Reform of the Matching Adjustment (MA). As with any IFoA response, we have considered the PRA's MA proposals from an independent, public interest perspective.

We welcome the proposed introduction of measures to give greater investment freedom as part of the MA reforms. This is an important step towards supporting insurers to be able to be invest more freely in productive finance and support the growth of the UK economy. From a policyholder protection perspective, we also recognise the importance of ensuring that, where firms take on additional risks, they are able to understand, measure and manage these risks.

In our view, the MA proposals may focus overly on the PRA's primary objectives. We feel that the PRA's secondary competition objective could be better met, with no meaningful reduction in policyholder security, with a number of specific amendments. Whilst it is important that policyholder security is maintained, a balance needs to be struck as an MA regime that it too restrictive could stifle/ slow down investment..

In principle, we support the proposed inclusion of assets with highly predictable cashflows within the scope of MA eligibility. We agree that this change should improve investment flexibility. However, our reading of the draft regulations suggests to us the potential that some assets already within a firm's MA portfolio could be regarded as having highly predictable cashflows. It would therefore be very helpful if the PRA were to clarify this position, if relevant.

We believe that the proposed 10% cap on the MA benefit may not affect the PRA's primary objective, due to the proposed attestation and other controls around the inclusion of highly predictable cashflow assets. The choice of 10% also seems quite arbitrary in nature.

The interaction of the various MA tests and safeguards, and understanding which may bite and under what conditions, and the resulting decisions firms may take, is unclear to us. In our view, there may be too many controls, and some may clash with each other.

We support a standard approach to Fundamental Spread (FS) additions, although such an approach may not always be suitable, such as on infrastructure debt, for example. We also believe that the FS additions should be applied to variable cashflows only, rather than all of an asset's cashflows.

We welcome the PRA's proposed streamlining of the MA application process for certain types of application, such as where firms propose 'less complex' changes or appropriate safeguards. We do however have a concern that the circumstances where an MA application would be needed could be expanded through the need to consider new risks. This could offset to a greater/ lesser extent the impact of the streamlining elsewhere.

PRA CP19/23 - Review of Solvency II: Reform of the Matching Adjustment

IFoA Response

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the PRA's Consultation Paper CP19/23 Review of Solvency II: Reform of the Matching Adjustment (MA). We support the proposed introduction of measures to give greater investment freedom as part of the MA reforms. This is an important step towards supporting insurers to be able to be invest more freely in productive finance and support the growth of the UK economy. We also acknowledge the PRA's efforts in developing proposals reflecting HMT's conclusions to its review of Solvency II (SII).

2. In developing our consultation response, we have drawn upon input from a range of members working in life insurance, either for insurers themselves or for consultancies. This has included input from members of our Life Insurance Board, and a range of relevant Working Parties.

3. As with any IFoA response, we have considered the PRA's MA proposals from an independent, public interest perspective. In doing so we have considered the potential implications on safety and soundness, maintaining policyholder protection but also advancing the PRA's secondary competitiveness and growth objective.

4. Given the above, we believe that the IFoA has an important role to play in the debate on the future evolution of the MA in the UK. We would therefore be delighted to discuss our response with the PRA in due course.

General Comments

5. From a high-level perspective, we support the direction of travel of the PRA's SII MA reforms and believe they have the potential to lead to better outcomes for future policyholders, and increased investment in UK productive finance.

6. It is in the public interest that insurers should be able to invest in as wide a range of assets as possible:

   - it is good for the wider economy;
   - it diversifies the risks in insurers' portfolios which should reduce the risk of failure; and
   - improves risk-adjusted returns so should lead to better pricing for customers.

7. From a policyholder protection perspective, we also recognise the importance of ensuring that, where firms take on additional risks as a result of greater investment freedoms, they are able to understand, measure and manage these risks. Therefore, we welcome in principle additional safeguards in parallel to the new investment freedoms, as this is also in the public interest.

8. However, in our view the MA proposals may focus overly on the PRA's primary objectives. We feel that the PRA's secondary competition objective could be better met, with no meaningful reduction in policyholder security, with a number of specific amendments. Whilst it is important that policyholder security is maintained, a balance needs to be struck as an MA regime that it too restrictive could

stifle/ slow down investment. Whilst it is important that policyholder security is maintained, a balance needs to be struck as an MA regime that it too restrictive could stifle/ slow down investment.

9. We have set out the amendments or clarifications that we would consider effective in this response below.

   Appendix 1 of CP19/23 sets out corresponding consultation questions. We have answered the bulk of these questions in the sections which follow, where we have a specific point to raise.

(PRA) Overview

Question 1: The PRA invites feedback on the proposals set out in this consultation, including: a. the specific reform proposals per chapter; b. the cost benefit analysis set out within Chapter 10; and c. the implementation timeline set out above.

10. We note that the consultation paper does not cover implementation. Given the very limited time between finalising the policy and the expected implementation date of 30 June 2024, we urge the PRA to ensure that implementation is as straightforward as possible, with no requirement for MA or Major Model Change Applications in 2024 (unless firms are planning a significant change from current practices). It may also be challenging to complete Board, Senior Management and external audit sign off by the 30 June 2024 deadline.

Investment Flexibility

11. We make two general comments in relation to the PRA's proposals for investment flexibility. First of all, it would be helpful if the PRA were to articulate a clearer link between the UK Government's objectives and the proposals within CP19/23, particularly in relation to the formulation of the 'highly predictable' Fundamental Spread (FS) considerations. We suggest that the PRA provide examples of the 'before and after' view of which assets and/ or features the new highly predictable rules would permit for inclusion in MA portfolios, to support understanding of the changes. Further clarity on the proposed rules for highly predictable cashflows in the PRA Rulebook updates would be useful; in particular, in relation to assets with extension clauses, or prepayment clauses for 'unlikely events'.

12. In implementing the MA reforms, we assume that firms are not expected to take advantage of relevant investment opportunities ahead of 30 June 2024 as final policy will not be available until close to this date. However, clarity from the PRA on when firms may be able to apply for permissions to start investing in highly predictable cashflow assets and hold these in their MA portfolio would be useful.

Question 2: Do you have any comments on the proposed criteria for the inclusion of assets with highly predictable cashflows?

13. In principle, we welcome the proposed inclusion of assets with highly predictable cashflows within the scope of MA eligibility. We agree that this change should improve investment flexibility and should give insurers an incentive to invest in a wider range of assets, including long-term productive assets. We believe this increase in flexibility is in the public interest.

14. However, our reading of the draft revised PRA SS7/18 suggests to us the potential that some assets already within a firm's MA portfolio could be regarded as having highly predictable cashflows; for example, assets with extension on default clauses. On the other hand, our interpretation of CP19/23 is that assets currently within a firm's MA portfolio would continue to be regarded as having fixed cashflows. We are therefore unsure whether this discrepancy – if our interpretation is grounded - is intended. It would therefore be very helpful if the PRA were to clarify this position, if relevant.

15. We understand that public bond markets include significant issuance of assets containing extension clauses. If these assets are classified as having highly predictable cashflows going forward, this will mean a minimum 10 basis point FS add-on given the PRA's wider proposals within this consultation paper. This could result in firms reassessing deployment into these assets.

16. We suggest that firms be allowed to choose whether to use the current fixed callable bond treatment or to use the highly predictable cashflow treatment (rather than be required to use the highly predictable cashflow treatment, as is proposed in section 4 of the draft revised PRA SS7/18). For example, firms may wish to decide what assets to treat as highly predictable based on their investment or Asset Liability Matching approaches, or for practical reasons.

17. The prescriptive requirement for cashflows to be contractually bound (as in draft PRA Rulebook, Appendix 2, section 5.3) may prohibit some assets, such as current equity release mortgage assets.

Question 3. Do you have any comments on whether the proposed cap of 10% of the MA benefit being generated by assets with highly predictable cashflows affects: (i) risks to the PRA's primary objectives, particularly to safety and soundness, and policyholder protection, and (ii) the benefits to the PRA's secondary objectives, particularly the growth objective?

18. For an asset with highly predictable cashflows, our view is that only the MA benefit arising from the non-fixed cashflows should contribute to the 10% MA benefit cap, rather than the whole MA benefit arising from the asset.

19. We believe that the proposed 10% cap may not affect the PRA's primary objective, due to the proposed attestation and other controls around the inclusion of highly predictable cashflow assets. The choice of 10% also seems quite arbitrary in nature.

20. We also question the rationale behind the 10% cap, and whether this will satisfy the secondary growth objective. We do not doubt that the full utilisation of this allowance within all MA portfolios will lead to a significant increase in productive investments such as construction-phase infrastructure, which is a key objective of the UK Government in its Solvency II reforms. However, this will be tempered by the following factors:

    - individual firms' cost benefit analysis at the 10% level may lead them to decide not to invest in these assets given the additional compliance requirements and modelling complexities;

    - firms may leave a margin for deviation and operate at lower than the 10%. This also includes the possibility that such assets are longer dated in nature increasing the likelihood of the 10% being breached in future;

    - firms may utilise part of the 10% for unstructured assets (existing asset classes) prior to MA structuring, rather than investing in new asset classes; and

    - one incentive for firms to invest in highly predictable cashflow assets would be to achieve a higher MA, hence the 10% on MA benefit may translate to a less than 10% of assets invested.

21. We are also concerned about the potential impact (of setting the cap to X% of overall MA benefit) on the secondary competition objective. Established market participants will be able to back, and hence price, new business assuming a large proportion of highly predictable cashflow assets are used to back this business, while keeping within the X% on their overall MA portfolios. New market participants, or those relatively new to the market, would be constrained to a greater extent, i.e. closer to the X% cap, in their new business asset mixes hence pricing.

Question 4. Do you have any comments on whether the proposed controls to mitigate the additional risks to the quality of matching changes adequately capture the additional risks from the widening in asset eligibility?

22. The interaction of the various tests and safeguards, and understanding which may bite and under what conditions, and the resulting decisions firms may take, is unclear to us. In our view, there may be too many controls, which may discourage firms from leveraging this additional flexibility and some may clash with each other. For example, the 10-basis point minimum highly predictable cashflow add-on assumes asset rebalancing, but additional Matching Tests 4 and 5 assume assets are held to maturity and remain cashflow matched.

Question 5. Do you have any comments on the proposed standard approaches for assets with highly predictable cash flows, including the proposed calibrations for the strength of the FS addition for assets and the allowance for reinvestment and/or rebalancing costs? This includes a yield to worst approach for economic optionality and provisioning for c ¼ of the additional MA benefit for event driven optionality.

23. In general terms we support a standard approach to FS additions, although such an approach may not always be suitable, such as on infrastructure debt, for example.

24. We also believe that the FS additions should be applied to variable cashflows only, rather than all of an asset’s cashflows.

25. We note the proposed 10 basis point minimum FS add-on in relation to reinvestment/ rebalancing costs. It is not clear to us whether this is necessary given the proposed additional Matching Test 4 in relation to reinvestment risk.

26. We are also unclear on how the proposals would work for the potentially wide range of investments that firms will look to invest in. For example, some investments permit prepayment under remote scenarios. However, it is not clear to us if or how the proposals reflect the remoteness of these events. To address this point, we suggest the PRA could provide more worked examples, which were a welcome addition to illustrate how capital add-ons might work in PRA Consultation Paper CP12/23.

27. Paragraph 10.29 of CP19/23 explains that many of the investment case studies discussed during the Subject Expert Group (SEG) meetings could be included in the Highly Predictable cashflow asset bucket. However, consideration should be given to whether firms would consider it worthwhile including them under the proposed rules? For example, for an investment that can prepay at any time, the worst-case MA could be zero, and so the resulting FS add-on could make the investment unattractive to invest in the MA portfolio. The standard approaches to FS add-ons would appear to only work in a small range of circumstances, such as some callable bonds. Upwards-only rent reviews is cited as economic variability, but the ‘worst case’ to use would be zero increases (as currently used).

Question 6. Do these calibrations demonstrate adequate allowance for the additional retained risks, given the need for the MA to be earned with a high degree of confidence?

We have no points to raise in answer to this question.

Question 7. Do you have any comments on the proposal to permit a deterministic approach to determining the asset cashflow projections, or should the PRA require a more sophisticated approach?

28. We note the PRA's proposal that firms should have discretion over the methodology used to project asset cashflows, with the approach tailored to the risks presented by the relevant assets. We support this general approach, and in particular the use of a deterministic methodology.

Question 8. Do you have any further investment case studies in addition to ones shared previously with the PRA?

Not applicable

Liability Eligibility

Question 9. Do you have any comments on the PRA's proposals on liability eligibility?

29. We do not have any comments on the PRA's proposed changes to liability eligibility to the MA. However, we do note the comment in paragraph 3.18 of CP19/23:

This expansion of eligibility would apply to with-profits annuities, but not to the guaranteed elements of other policies such as periodic payment orders where the risks associated with the variable portion of the benefits are materially different and would raise challenges for appropriate asset-liability matching.

30. Whilst we understand the PRA's view, we reiterate a point made in our response to HMT's earlier consultation on the Review of Solvency II (July 2022):

General insurers with exposure to Periodic Payment Orders (PPO)s often have very long-tailed liabilities with a steady stream of cashflows; they are much akin to long-term life insurers' annuity portfolios. Adjusting the MA liability criteria in a way that general insurers could use the MA on these PPO exposures would have several benefits:

- *encouraging better matching of assets to these long-tailed liabilities, which would ultimately be beneficial to policyholder security;*
- *encouraging firms to invest in assets such as infrastructure debt and other similar investments which can be in the public interest.*

Question 10. Do you have any comments on the PRA's proposal to allow the guaranteed elements of WP annuity liabilities into the MAP subject to these guaranteed elements being able to be organised and managed separately in accordance with 4 and 5 of the MA regulations?

We have no points to raise in answer to this question.

Credit Ratings Under the MA

Question 11. Do you have any comments on the PRA's proposed expectations in respect of SIG assets?

31. We support the removal of the need to apply an MA cap to Sub-Investment Grade (SIG) assets. This removal should open up more assets for investment to some extent; as noted in CP19/23, some assets may be rated as SIG whilst in construction phase. The removal also provides flexibility to firms in dealing with assets that have downgraded from investment grade to SIG - i.e. not having to sell an asset at a less than ideal time.

32. SIG assets may be higher risk in nature. We agree that they will need to be managed accordingly by firms through their risk wider management/ investment framework, including consideration of Prudent Person Principle requirements and the treatment of SIG assets within internal models.

Question 12. Do you have any comments on the PRA's proposals in respect of internal credit assessments?

33. We support the principle that internal credit assessments should consider all risks to which the relevant asset is exposed. We also recognise the need for robust validation of a firms' internal credit assessment process. In relation to such validation, we suggest that the PRA take a pragmatic approach. It is feasible that an internal credit rating subject to suitable governance may be more appropriate/ effective than an external Credit Rating Agency assessment, particularly for emerging/ innovative assets.

MA Permissions, Breaches and Consequential Amendments

Question 13. Do you have any comments on the PRA's proposals on MA permissions, breaches or consequential amendments?

34. In our response to HMT's earlier consultation on the Review of Solvency II (July 2022), we explained that it was appropriate that there be an initial approval process for the regulator to ensure that the insurer has appropriate processes, systems and controls to manage its MA portfolio appropriately. We also noted that insurers currently have to reapply for a new approval for what can often be minor changes to their MA portfolios, which is both resource intensive for insurers and regulators and causes significant delays to insurers actually making investments. We went on to explain that we believed that only material changes to insurers' process or restructuring of the MA portfolio should necessitate a further approval process. Other more minor changes could be adequately dealt with through normal supervisory engagement activities and requirements for insurers to notify the regulator of minor changes.

35. We note that the PRA propose a range of new safeguards within CP19/23, including - amongst others - MA attestation requirements, additional Matching Tests and FS add-ons in relation highly predictable cashflow assets.

36. In principle therefore, we welcome the PRA's proposed streamlining of the MA application process for certain types of application, such as where firms propose 'less complex' changes or appropriate (MA) safeguards. We also welcome the proposed flexibility in removing requirement to formally undertake a complete assessment of an MA application with reference to an application clock, in that any PRA request for further evidence would not formally stop the 'review clock'.

37. We do note however that the updated draft PRA SS7/18 indicates when an MA application may be needed, and amongst others it makes reference to 'new risks'. We have a concern that this could expand the circumstances where an MA application would be needed, offsetting to a greater/ lesser extent the impact of the streamlining elsewhere. This could then have a knock-on impact on the regulatory burden and time required - or potential likelihood of losing out on the opportunity - to make the relevant investment. We question the need for this potential widening of the circumstances requiring an MA application in the context of the range of additional MA safeguards also being proposed.

38. We welcome changes to the procedures for dealing with MA compliance breaches, in particular the removal of the revocation of the MA approval for 24 months if compliance is not restored within a period of two months. The reform proposals still give a strong incentive to restore compliance in a

timely fashion (via the 10% reduction in the MA benefit for every month compliance is not restored after the two-month period), but the proposals appear more proportionate than the status quo.

Matching Adjustment Attestation

Question 14. Do you have any comments on the proposed standardised wording for the attestation?

39. The PRA proposes that the standard attestation wording to be set out in the PRA Rulebook would be:

    As at the effective date of the firm's Solvency and Financial Condition Report (SFCR): the Fundamental Spread used by the firm in calculating the matching adjustment reflects compensation for all retained risks, and the Matching Adjustment can be earned with a high degree of confidence from the assets held in the relevant portfolio of assets.

40. In our view it would be helpful if the PRA provide clarify the standard that is required for 'high degree of confidence' of earning the MA means. Our reading of the text is that the confidence level required is as per SS7/18 5.27 to 'target the same level of certainty as they would for a portfolio of liquid corporate bonds with fixed cash flows and up to date, accurate credit ratings.' We believe that this is a sensible principle but note that judgement will be required from firms and the attestors and it will take time for a market standard to emerge.

41. In reference to *high degree of confidence*, this is a very firm assertion for a single asset, meaning this statement is more aligned with a portfolio/asset class view, particularly for Step 2 of the proposed attestation process (draft revised PRA SS7/18, paragraph 5.35).

42. Otherwise, we agree with the proposed standardised wording for the attestation, subject to our comments below on some of the expectations and factors that underpin the attestation. We also welcome the absence of reference to a liquidity premium in the proposed attestation wording (given that this is immeasurable).

Question 15. Do you have any comments on the suggested list of factors that firms should consider in attesting to the FS covering all retained risks?

43. This list is comprehensive; however, we have the following comments on some of the factors that firms should consider in attesting to the FS covering all retained risks:

    - we believe that an effective attestation process should focus on the 'outlier' assets, i.e. those that have features or risks that are not adequately captured by the standard FS formula. A process that is too broad will necessarily be a blunt tool that will not reflect the specific risks on an individual asset basis;

    - we disagree with the expectation in paragraph 5.36 of the draft revised PRA SS7/18 that firms should *not assume that prudence for one asset can be offset against insufficient FS for another*. This expectation is, by definition, not aligned to the underlying risk in the portfolio and we therefore consider it inappropriate. In our view this expectation would not incentivise good investment behaviour. Offsetting effects can be taken into account by requiring that the portfolio FS covers all retained risks, and the MA can be earned with a high level of confidence. Without changing this approach to allow offsetting, the FS may only 'ratchet-up', and this ultimately will reduce the potential income available to future annuitants. Similar to the proposal for notching, we consider that the attestation should lead to a better reflection of underlying risk on the portfolio as opposed to a one-way ratchet. We request that the PRA removes this constraint;

- we are concerned with the expectation in paragraph 2.3 of PRA SS8/18 that *Changes to the FS in stress conditions should include any changes to additions made to the FS used to calculate the TPs, including those made as part of the attestation process*. It is likely that FS add-ons, as a result of attestation, will be applied to 'outlier' assets on an individual basis. The derivation of any FS add-on is likely to be highly subjective as there is no objective data source. The FS on all assets increases significantly under stress, including on 'outlier' assets that have a FS add-on. Typically, the FS stress, applied to all assets, has been calibrated to the Great Depression. In our view, expecting firms to have an additional stress applied to the FS add-on is disproportionate, unlikely to be based on any data and will lead to increased complexity for credit risk modelling in the Internal Model (which is highly complicated). We would urge the PRA to modify its expectation on this, firms increasing the FS add-on in stress should be the exception (in some circumstances) as opposed to the expectation;

- it would be helpful if the PRA could confirm our expectation that The Effective Value Test (EVT), as set out in PRA SS3/17, which limits the MA on Lifetime Mortgage notes and firms are required to test the EVT in stress, would be sufficient to meet the 'high degree of confidence' statement within the attestation;

- in reference to the wording *all the risks are fully captured in the asset's rating*: given the existing requirement to form an internal view of the credit rating of assets in the MA portfolio, clarity over the purpose of stating this requirement here would be useful; and

- in relation to *when compared to the data underlying the published Fundamental Spread, the portfolio could experience a reduced level of diversification due to common risk factor:* we question whether lack of diversification should be considered within the base balance sheet, as we believe it is more logical to deal with this within firms' wider risk management practices and note that it would manifest in setting capital requirements.

44. We note the suggestion that non-corporate bonds need additional scrutiny with respect to the FS applied. We note further that there may be more uncertainty in more novel asset classes however:

- risks can be non-corporate bond like but still quantified based on solid data (e.g. house price indices for Lifetime Mortgages); and

- rating frameworks can take account of lack of data by applying prudence; care will need to be taken to ensure that this is reflected in considering any FS add-on, to avoid double counting.

45. In respect of MA risks other than credit risk, most risks are covered by rating but some, such as prepayment, may not. Features that are credit positive may not be MA positive. For example:

- paired assets that reflect the 'worst' rating of the two assets but are actually exposed to either counterparty failing; a derivative counterparty failure may cause the trade to unwind leading to loss of future interest as an example. This may suggest an FS add-on is needed; or

- insurance wrapped assets where the 'best' rating of the underlying and insurer is taken but you get your money as long as one survives. This may suggest the base FS used is too high.

46. Given the above, some consideration could be given as to whether firms could modify their internal ratings to be more 'MA aligned'. However, this may deviate from the need to be External Credit Assessment Institution (ECAI)-equivalent.

47. Paragraph 5.37 in the draft revised PRA SS7/18 states that firms should target the same degree of confidence as for a portfolio of liquid corporate bonds where the credit ratings are *up-to-date*. It is not clear to us what the PRA means by *up-to-date*, and what the implications would be for some of the

ratings not meeting this definition. These are issues that firms will need to grapple with and there is a role for the IFoA to help develop practice/ thinking here.

48. In relation to the need to consider whether *the rating transition behaviour or loss on downgrade are expected to be different from that assumed in the standard published FS;* it is unclear to us what this means.

49. The consultation paper makes no mention of recovery on default. At times this is captured in the rating, but sometimes only via a notching-up process (e.g. 1 or 2 notch uplift). However, it is not always captured in the rating.

50. We also note that, even for vanilla corporate bonds currently with in the FS portfolio, the FS is a though-the-cycle amount based on historical data. Therefore, in some circumstances and for some assets these standard FS will be deemed to be insufficient. However, this assessment will vary by sector, rating and duration, and we note that for some data points the standard FS will be deemed to be excessively prudent. Again, firms will need to consider the level of granularity, e.g. individual asset, asset class, portfolio level, etc, at which this assessment should be made.

Question 16. Do you have any comments on the proposed level of confidence that firms should have in the MA, taking into account its material contribution to firms' capital resources and its role in reducing capital requirements in relation to credit risks?

51. We are unclear on how attestation should feed through to the Solvency Capital Requirement (SCR).

52. We agree that firms should have a high level of confidence that the MA is appropriate and reflects the underlying risks in the portfolio. However, we do not think that this should imply a higher level of prudence than the Solvency II framework already requires. The MA is not a capital buffer, it is a valuation adjustment that reflects the illiquidity premium embedded in the assets and liabilities. The capital requirements for credit risk are derived from the FS and the SCR stresses, which are calibrated to a 99.5% confidence level over a one-year horizon. We do not believe the attestation should introduce an additional layer of prudence that is not justified by the data or the risk profile of the portfolio.

Question 17. Do you have any comments on the proposal not to require public disclosure of the evidence underlying the attestation, and the appropriate balance between the need to ensure commercially sensitive information remains confidential with the objective of providing for more market discipline and transparency on firms' MA?

53. We support the proposal not to require public disclosure of the evidence underlying the attestation, as we consider that this information is commercially sensitive and could reveal firms' investment strategies and risk appetites. We also think that public disclosure could create confusion and misunderstanding among market participants and stakeholders, as the attestation process is complex and subjective, and the evidence may not be comparable across firms. Hence, in our view public disclosure would not be in the public interest.

54. Furthermore, we believe that the PRA has sufficient supervisory tools and powers to ensure that firms comply with the attestation requirements and that the MA is appropriate and prudent.

55. For completeness, we have three further comments to make in relation to attestation:

- the attestation steps in revised PRA SS7/18 paragraph 5.35, suggest that some existing assets will attract additional FS. This does not seem consistent with the UK Government's view that the FS should not change (and which HMT is bringing in legislation to preserve);

- applying asset-by-asset FS add-ons could aggregate to something significant, given the upwards only nature of FS add-ons. There is a need to be careful to avoid introducing excessive prudence; and

- our understanding is the Chief Actuary (SMF20) will effectively have to attest to the MA as part of their sign-off of the overall Technical Provisions. Given this, we wonder whether any further Senior Manager Function (e.g. Chief Financial Officer or Chief Risk Officer) sign-off is required.

Assumptions Underlying the MA

Question 18. Do you have any comments on the PRA's proposals on assumptions underlying the MA?

56. In section 7 of CP19/23 the PRA sets out its view of the conceptual and technical assumptions underlying the MA. We have a number of observations on the points made here:

    - the conceptual view makes reference to spread decomposition. Our interpretation of the PRA's text is that firms may be expected to justify their use of the MA with reference to spread decomposition. In our view spread decomposition is quite subjective and could require significant judgement in any justification of the MA;

    - the conceptual view also explains that the FS applied to each asset is derived from historical, long-term data relevant to the asset duration/ credit quality and asset class. Whilst this is reasonable, we note that emerging/ innovative investments may not have a long-term asset data history; and

    - the technical assumptions view describes credit ratings/ equivalent assessments as an objective and reliable measure of risk. In our view, credit ratings can be another area of subjectivity.

57. We note that the PRA is not proposing to change its policy or practice relating to the potential use of capital add-ons for the MA, although we also note further consultation activity in this area is planned. We reiterate a point made in our response to the PRA's earlier consultation paper CP12/23. In relation to the potential use of capital add-ons, we believe that open and constructive dialogue between the PRA and firms is key.

Matching Adjustment Asset and Liability Information Return Data Collection

Question 19. Do you have any comments on the PRA's proposals on the MALIR?

We have no points to raise in answer to this question.

Notching

Question 20. Do you have any comments on the PRA's proposals on notching?

58. We support the mandatory use of a notched FS. The introduction of notching should promote better risk management, in particular removing the incentive to hold assets with the lowest credit quality within the Credit Quality Step.

59. Where time is needed for firms to extend their internal credit rating assessment or internal models to split by rating notches, further clarity would be helpful in terms of implications between the rules coming into force, and the models/ internal rating framework being developed. For example, would

firms be expected to hold additional capital in the meantime, and if so, how would this be determined?

Cost Benefit Analysis

Question 21. Do you have any comments on the cost benefit analysis?

We have no points to raise in answer to this question.

Should you want to discuss any of the points raised please contact me, Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham

On behalf of Institute and Faculty of Actuaries