Matching adjustment attestation - industry perspectives

November 2023

pwc

Matching adjustment attestation

Introduction

The Prudential Regulation Authority's ("PRA") Consultation Paper 19/23 ("CP19/23") was published on 28 September 2023 and provided detail on the PRA's proposed reforms of the matching adjustment ("MA"). One of the key aspects of the proposals is MA attestation, which requires the senior manager who holds the responsibility for the production and integrity of the firm's financial information, and its regulatory reporting, to attest to the PRA on the sufficiency of the fundamental spread ("FS") and the quality of the resulting MA generated by the assets in their MA portfolio(s).

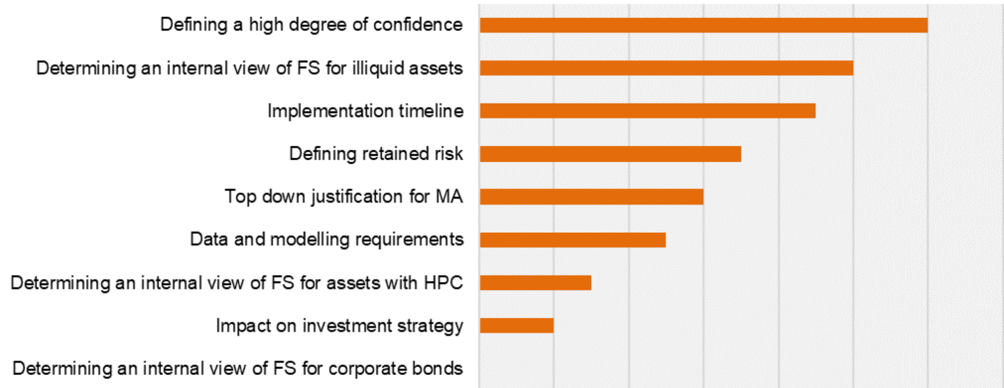
To further discuss MA attestation, we held a roundtable discussion on 15 November 2023 for firms with MA portfolios, with the majority of firms in that industry represented.

It was a lively debate covering firms' top implementation challenges, areas that require further industry debate, the PRA's 3-step process set out in the draft updates to Supervisory Statement 7/18 ("SS7/18") and firms' priorities for the coming months. In this note we have summarised the participants' views expressed during the roundtable discussion.

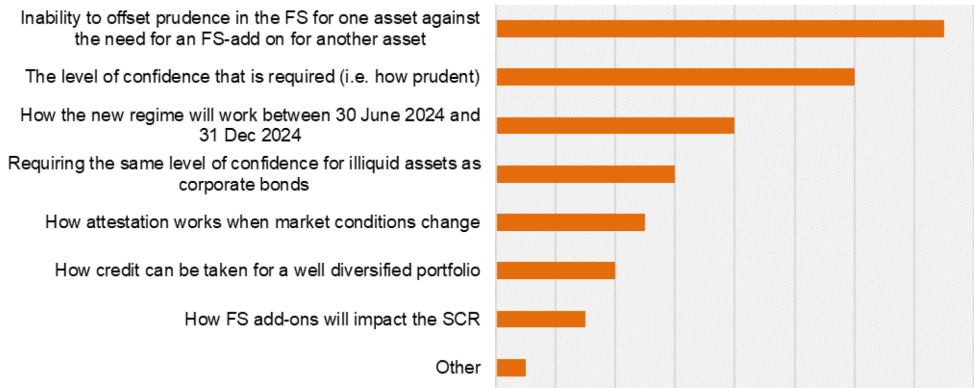
Top implementation challenges and areas for further debate

Before getting into the details of the PRA's 3-step process, we asked participants to pick what they consider to be the top three implementation challenges for MA attestation and the top three areas that may require further debate prior to the PRA's rules being finalised in Q2 2024.

Implementation challenges



Areas of further debate



Step 1 of the PRA's 3-step process

Step 1 requires firms to primarily consider the adequacy of the FS arising from their corporate bonds holdings.

There was consensus amongst the participants (given wording in CP19/23 around "proportionality") that the level of effort required for corporate bonds is not expected to be significant.

The discussion highlighted that the analysis should focus on:

- Demonstrating that the corporate bond portfolio is well diversified and assessing sources of concentration risk;
- Identifying assets with a negative rating outlook; and
- Assessing the extent to which future risks are not allowed for within the FS (e.g. climate risk).

Some participants stated that it would be beneficial to receive clarification from the PRA on the nature and extent of retained risks allowed for in the current FS calibration to prevent firms double counting risks. Finally, some participants highlighted a lack of clarity around the level of prudence in the current FS for corporate bonds, in particular what parts the PRA consider to be prudent.

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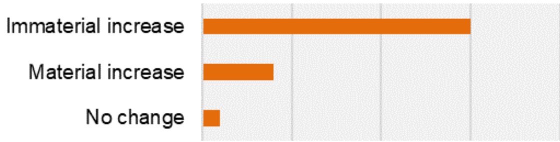
Step 2 of the PRA's 3-step process

Step 2 requires firms to primarily consider the adequacy of the FS arising from their illiquid asset holdings.

Most participants agreed that the internal credit rating assigned to these assets provides a sensible starting point for the analysis required. However, they acknowledged that it is important to understand the risks which are and are not captured by the credit rating to ensure that these are appropriately considered within the FS. It was also noted by some participants that internal ratings may incorporate adjustments to allow for uncertainty. There was a view expressed by the participants that firms should focus on preparing analysis to demonstrate the adequacy of the FS, rather than developing suites of new models.

Some participants noted that there will be a need to clearly communicate the analysis performed in relation to illiquid assets to both senior management and the PRA, especially given that the work will likely span many teams and functions. A number of the participants also noted that it could be helpful for best practice or guidance to be developed by industry bodies, to support insurers to meet the requirements of Step 2.

We asked participants what level of FS change they expect for assets in Step 2 (relative to current levels)



Step 3 of the PRA's 3-step process

Step 3 essentially requires firms to justify the level of MA benefits from a top-down perspective.

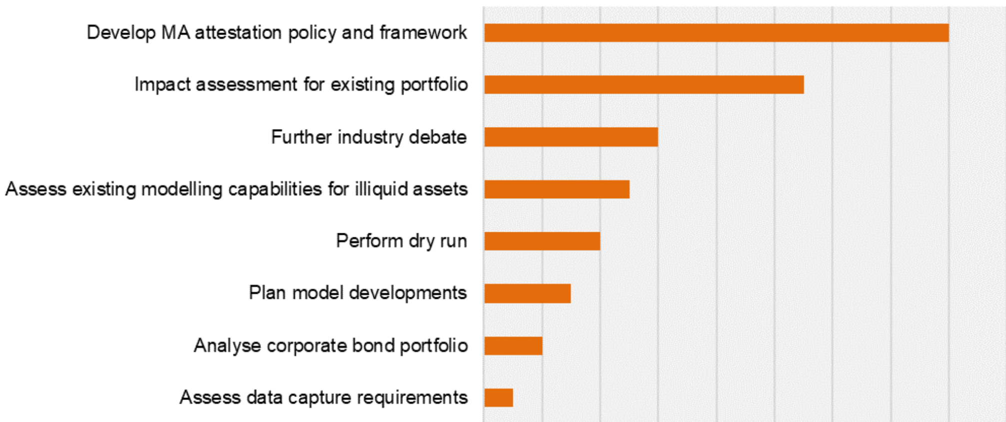
Most participants did not express any significant concerns in performing the analysis required under Step 3. Some mentioned that the Matching Adjustment Asset and Liability Information Return ("MALIR") template could provide a useful starting point to perform this analysis where the top contributing assets to the MA could be analysed further to justify and evidence the level of MA earned.

We asked participants whether they anticipate there being a significant change to the FS between Steps 2 and 3

Other areas discussed and firms' priorities for the coming months

During the discussion, participants also noted that the requirement to attest that the MA can be earned with a "high degree of confidence" is an area where judgement will be needed and quantification might be challenging. Further, some participants raised questions as to why prudence in the FS for some assets could not be offset against the need for an FS add-on for other assets, given that the attestation is for the overall MA portfolio.

We asked participants to pick their top three priorities for the coming months



It is clear that there is still debate to be had within the UK Life Insurance industry on the requirements of MA attestation and the approaches to achieving compliance. Further, implementation timelines are tight, and there are key challenges facing firms such as defining a high degree of confidence and forming an internal view of FS for illiquid assets. Firms are now focused on developing their policies and frameworks and assessing the impact on their portfolios.

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Thank you

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