Title: The Solvency 2 (Credit Risk Adjustment) Regulations 2021	De minimis assessment
SI No: 2021 No. 463	**Date: 12/04/2021**
Other departments or agencies:	**Type of regulation: Domestic**
Contact for enquiries: **Thomas Hetherton**	**Date measure comes into force:** **28/05/2021**
Cost of Preferred (or more likely) Option **Nil**	**Equivalent Annual Net Direct Cost to Business per year** (EANDCB in 2019 prices) **Nil**

1. What is the problem under consideration? Why is government intervention necessary?

Under Solvency II, the prudential regulatory regime, insurers are required to discount their liabilities by the rate of return from a theoretical investment that is 'risk free', referred to as the risk-free rate (RFR). Liabilities across a range of maturities are discounted by the appropriate point on the risk-free rate discount curve.

The Prudential Regulation Authority (PRA) calculates this rate for GBP liabilities based on the London Inter-bank Offered Rate (LIBOR). However, LIBOR will not be published after the end of 2021. Therefore, the PRA plans to switch the RFR from GBP LIBOR to SONIA (Sterling Overnight Index Average). The PRA's Consultation Paper 1/21 proposes to effect the switch on 31 July 2021.

Current legislation specifies that a credit risk adjustment (CRA) of between 10 and 35 basis points must be applied to the reference benchmark when calculating the RFR, to reflect credit risk. Whilst this adjustment is appropriate for a LIBOR-based RFR, it is not appropriate for a SONIA-based RFR, because SONIA is considered to contain negligible credit risk already. Greater flexibility is therefore required in the determination of the CRA, and it is necessary for the Government to amend legislation to allow for this.

2. What are the policy objectives and the intended effects?

A statutory instrument (SI) is required to give more flexibility to the PRA in its determination of the RFR calculation, to allow for an appropriate SONIA-based RFR to be set. The current boundaries are too restrictive - a CRA set within the current specified bounds may lead to an inappropriate RFR.

This legislation has no direct impact on business. It allows for an appropriate CRA to be set by the PRA, without determining what that CRA (or RFR) should be. The PRA's Consultation Paper 1/21 discusses the CRA in the context of SONIA rates in paragraph 2.14. Paragraphs 3.4-3.7 provide a cost benefit analysis on the wider proposals in CP1/21.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

We have explored with the PRA the possibility that legislation is not required, i.e. whether the current CRA bounds can be disapplied in the context of a RFR based on SONIA. However, PRA and HMT have agreed that the current legislation does require the application of the bounds in all circumstances. As above, such an application may lead to an inappropriate RFR being set. The proposed legislation allows the PRA the flexibility to set the appropriate CRA in all circumstances.

4. Please justify why the net impacts (i.e. net costs or benefits) to business will be less than £5 million a year.

Businesses will not need to do anything differently as a result of this legislation. Instead, the PRA will be required to use an updated methodology in its determination of RFR curves. There is therefore no direct impact on businesses from this legislation, including any direct costs or benefits. As at present, UK insurance firms regulated under Solvency II will be required to apply the RFRs set by the PRA.

5. Please confirm whether your measure could be subject to call-in by BRE under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**
We have considered the factors a) to e). There are no significant distributional impacts.

b) **Disproportionate burdens on small businesses**
There are no disproportionate burdens on small businesses.

c) **Significant gross effects despite small net impacts**
The are no significant gross effects.

d) **Significant wider social, environmental, financial or economic impacts**
There are no significant wider impacts.

e) **Significant novel or contentious elements**
There are no novel or contentious elements.

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Insurance and Pensions Markets

Signed: ***Emma Kavanagh*** Date: 01/04/2021

SCS of Better Regulation Unit

Signed: ***Linda Timson*** Date: 01/04/2021

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

(Steve Barclay, Chief Secretary to the Treasury)

Signed: ***Steve Barclay*** Date: 12/04/2021