Default and Downgrade Costs for the Scenario-Based Approach - 14 April 2024

https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fcdn.bma.bm%2Fdocuments%2F2024-04-15-14-06-57-Default-and-Downgrade-Costs-for-the-Scenario-Based-Approach.xlsx&wdOrigin=BROWSELINK

Refer to the Prudential Rules and the BSCR Instructions Handbook for rules and further instructions on default & downgrade costs and their application

A. Assets for which the Authority does not publish Default & Downgrade Costs

For any assets for which the Authority does not publish default and downgrade costs, the default and downgrade costs applied within the Scenario-Based Approach (SBA) shall be determined by the insurer in accordance with the Rules and Instructions, subject to approval by the Authority, and subject to the default and downgrade cost floors (see below) as well as other requirements prescribed in the Rules and instructions.

B. Default & Downgrade Cost Floors

For all assets for which the Authority publishes default and downgrade costs, the published default and downgrade costs must be used. For all assets for which the Authority does not publish default and downgrade costs, the default and downgrade costs applied within the SBA shall be determined as the greater of:

- i) the insurer’s own default and downgrade cost assumptions for the asset (determined according to the Rules and Instructions, and subject to BMA approval); and
- ii) the applicable floors.

The applicable floors are defined as the corporate bond (senior unsecured) default and downgrade costs for the corresponding rating, unless otherwise prescribed by the Authority. For structured assets and securitizations, the floors apply to the tranches (as opposed to the underlying collateral assets).

Different costs may be applied in accordance with paragraph 28(28) of the Rules.

C. 5-year Transitional for the Downgrade Cost component for business written prior to 1 Jan 2024

For business written on or before 31 Dec 2023, the downgrade cost component of the default and downgrade costs will be phased in gradually over 5 years. The downgrade costs published by the Authority in tab "D&D Costs" are the full ultimate downgrade costs, whereas the downgrade costs to be applied at each relevant valuation date are determined as follows:

- For valuation dates during 2024, including 31 Dec 2024: 20% of the full ultimate downgrade costs will be used.

- For valuation dates during 2025, including 31 Dec 2025: 40% of the full ultimate downgrade costs will be used.
- For valuation dates during 2026, including 31 Dec 2026: 60% of the full ultimate downgrade costs will be used.
- For valuation dates during 2027, including 31 Dec 2027: 80% of the full ultimate downgrade costs will be used.
- For valuation dates during 2028 and later: 100% of the full ultimate downgrade costs will be used.

In each case, the downgrade costs after application of the phase-in factor are to be rounded to the nearest whole basis point, to be done individually for all the applicable asset type/rating/tenor combinations.

Insurers may choose to early adopt the full downgrade costs at any point. However, once elected, it is not possible to revert back without prior written approval from the Authority.

For the avoidance of doubt, the phasing in does not apply to the default cost (expected loss) component, which will apply in full immediately regardless of when the business was written. For business written after 31 Dec 2023, there is no phasing in of any costs i.e., the full ultimate downgrade costs apply immediately in addition to the default costs.