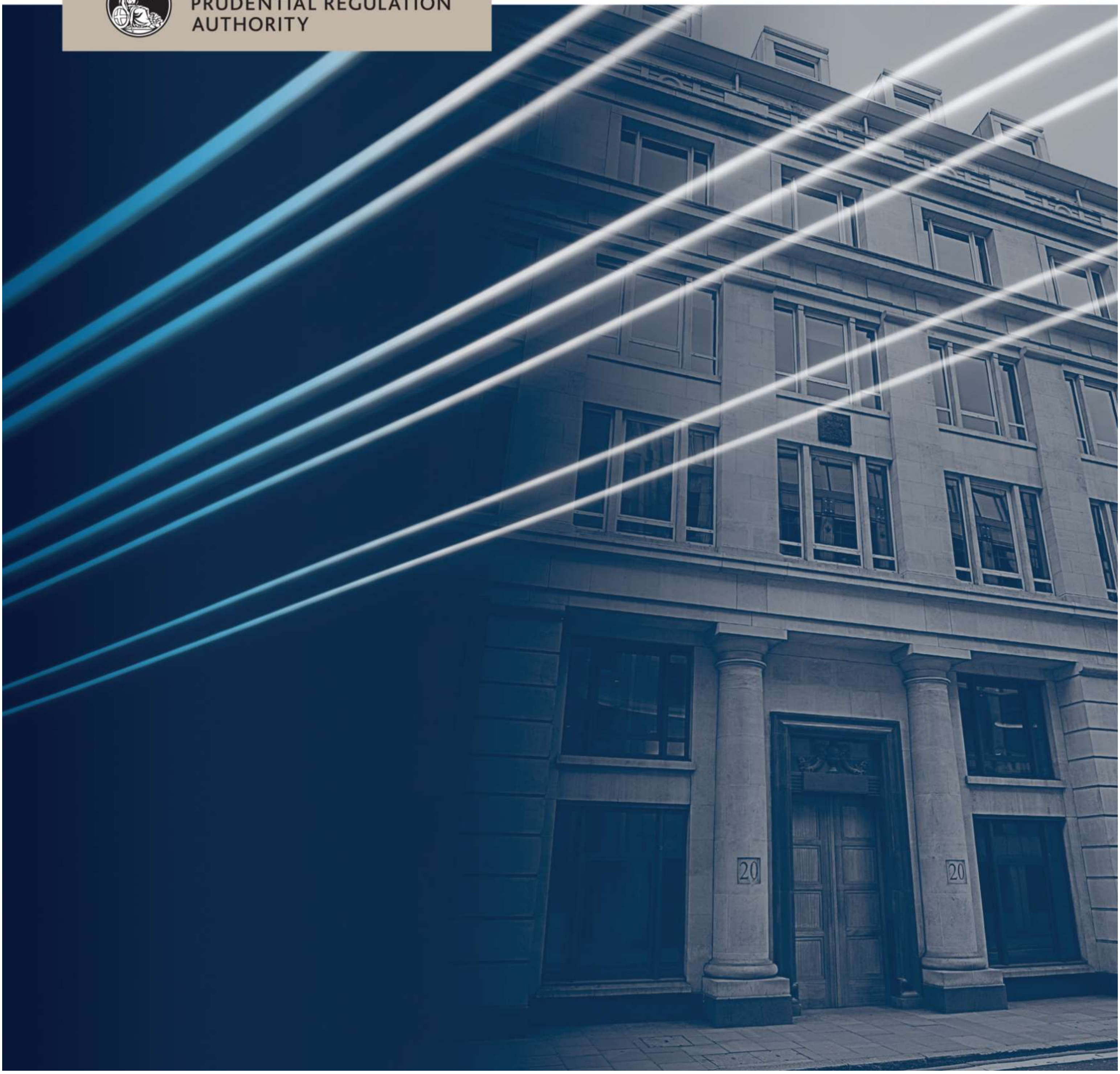
Supervisory Statement | SS18/16

Solvency II: longevity risk transfers

November 2024

(Updating January 2020)

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS18/16

Solvency II: longevity risk transfers

November 2024

(Updating January 2020)

Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1 Introduction

1.1 This supervisory statement is addressed to all UK Solvency II firms and to the Society of Lloyd's and its managing agents. It sets out the Prudential Regulation Authority's (PRA's) views on the general issues arising from longevity risk transfers, and clarifies the PRA's expectations on UK insurers and reinsurers carrying out these transactions as either the buyer or the seller of longevity protection.

1.2 This statement should be read in conjunction with the PRA's rules in the Solvency II Sector of the PRA Rulebook and the PRA's insurance approach document.[1]

1.3 This supervisory statement expands on the PRA's general approach as set out in its insurance approach document. By clearly and consistently explaining its expectations of firms in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders.

1.4 Longevity risk is the risk that policyholders, pension scheme members or other underlying beneficiaries, in aggregate, live longer than expected. The main life insurance products exposed to this risk are immediate and deferred annuities, although certain health contracts and possibly with-profits funds may also be exposed. In addition, there is likely to be some exposure to longevity risk in an insurer's own staff pension scheme, if this is defined benefit. There is also growing longevity exposure among general insurers in relation to periodic payment orders.

1.5 The PRA recognises that there has been an active market in the transfer of longevity risk for a number of years. However, the PRA would be concerned if firms became active in this market for reasons other than seeking genuine risk transfer.

2 Risks associated with longevity risk mitigation measures

2.1 An insurer accepting risk from, transferring risk to, or hedging risk with, a single or small number of counterparties (or connected counterparties) may expose itself to possibly significant levels of counterparty risk. Readers are also referred to SS20/16, 'Solvency II: reinsurance – counterparty default risk'.[2]

2.2 Solvency II introduces specific risk management rules which require insurers and reinsurers to have an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis, the risks facing them both now and potentially in the future (see Rule 3.1 in the Solvency II Firms – Conditions Governing Business Part of the PRA Rulebook). The PRA accordingly expects firms to monitor, manage and mitigate these concentration risks. This includes risks which are covered by the solvency capital requirement (SCR) as well as those which are not. In practice this means that holding capital under the SCR in relation to counterparty default risk may not be sufficient in and of itself to mitigate this risk – additional measures besides capital may be necessary.

2.3 There are a range of residual risks introduced through the practice of carrying out longevity risk transfers. The PRA expects firms to have a clear articulation of their exposure and tolerance of these

1 Available at www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.
2 November 2016: www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss2016.aspx.

risks within a clearly defined risk appetite. An example of such a residual risk to be considered is basis risk, where there may be different terms of the annuity contract and the risk transfer.

3 Notification

3.1 In order to supervise firms' risk management practices, the PRA expects to be notified of new large and/or complex longevity risk transfer and hedge arrangements and the firm's proposed approach to risk management well in advance of the completion of any transaction. This expectation applies where a firm is buying or selling longevity protection. The definition of what constitutes a large and/or complex transaction would be those that:

- have a value/financial impact that are larger than typically transacted on a business as usual basis.
- have a structure that is more complex than business as usual transactions (for example, where the risk transfer is structured using instruments less tested in the market such as insurance linked securities, or by the firm, such as automatic reinsurance pools); or
- have a material incremental impact on the firm's ability to meet its Solvency Capital Requirements under Solvency II.

3.2 For all other longevity risk transfers, we have sought to reduce the pre-notification requirements in a way that reduces the level of detail needed and the amount of time firms need to spend compiling this information.

3.3 For these other transactions, firms should update the PRA of the transaction details by completing the template below and returning it to their supervisory contact. This template may be submitted shortly after the reinsurance has been placed.

3.4 As well as allowing the PRA to gain a fuller picture of the market in a way that requires less time and effort on the part of firms, this template would also allow it to understand the potential build-up of risk concentrations as a result of these transactions. This will enable supervisors to consider whether the risks of the proposed transaction are being appropriately managed and that the transaction has an underpinning rationale that is consistent with good risk management principles.

<table>
<tr><td>Counterparty name and location</td><td>Existing counterparty (Y/N)</td><td>Intragroup transaction (Y/N)</td><td>Risk(s) transferred</td><td colspan="2">In respect of the longevity component of the risk transfer, is the transaction a longevity swap, quota share, or other?</td></tr>
<tr><td></td><td></td><td></td><td></td><td colspan="2"></td></tr>
<tr><td>Effective date</td><td>Notional liability amount transferred (£M)</td><td>Notional liability amount covered by collateral (£M)</td><td>Collateral mechanism</td><td>Eligible collateral assets</td><td>Any additional features of note (e.g. pre-Part VII reinsurance etc.)</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

3.5 Note: the purpose of this table is to establish the size and general aspects of the longevity component of risk transfers. If there are additional features, such as complex splits with asset risk, please discuss these with your normal supervisory contact, as these may require more in-depth discussion.

Annex – updates to SS18/16

This annex details changes made to SS18/16 following its initial publication in November 2016 following Policy Statement (PS) 33/16 'Solvency II: consolidation of Directors' letters'.[3]

15 November 2024

This SS has been updated alongside the publication of Policy Statement (PS) 15/24 - Review of Solvency II: Restatement of assimilated law.[4] This includes updating all previous references to the Commission Delegated Regulation (EU) 2015/35 so as to now refer to the relevant rule(s) in the PRA Rulebook. In addition, the following changes were made:

- updated reference to the UK Solvency II firms in paragraph 1.1; and
- fixing broken link in footnote 2.

9 January 2020

Following the publication of PS1/20 'Solvency II: Longevity risk transfers – simplification of pre-notification expectations',[5] Chapter 2 was updated to reflect the PRA's view that recognising basis risk is an important component that should be part of the risk appetite of any firm carrying out longevity risk transfers.

Additionally, Chapter 3 was updated to differentiate the PRA's expectations of pre-notification for transactions that are large and/or complex; with the inclusion of a reporting template to simplify the notification process for transactions that do not fall within this category.

3 November 2016: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-consolidation-of-directors-letters.

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

5 January 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/solvency-ii-longevity-risk-transfers-simplification-of-pre-notification-expectations.