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Longevity 18 Conference

UK regulatory environment – helping or hindering pension risk transfer

Kirsty Maclean

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Agenda

- Solvency UK
  - Background
  - Reform relevant to life insurers
  - Current outlook
- Funded Reinsurance: PRA thematic review
- Defined Benefit (DB) Consolidators
  - The Pensions Regulator (TPR) Guidance
  - Department of Work and Pensions (DWP) Consultation
- Insurers in financial distress
  - FSMA changes - write-downs and moratoria
  - Insurer Resolution Regime (IRR)

Solvency II reform - how did we get here?

1 January 2016	Solvency II goes live in the UK
23 June 2016	Brexit vote: UK votes to leave the EU
23 June 2020	UK government announces it would review certain features of Solvency II
19 October 2020	HM Treasury (HMT) publishes review of Solvency II: Call for Evidence
31 January 2020	Exit day: UK leaves the EU
31 December 2020	Brexit transition period ends
1 July 2021	HMT publishes Response to the Call for Evidence
20 July 2021	Bank of England (PRA) launches Quantitative Impact Study
28 April 2022	HMT Consultation on Solvency II reform
28 April 2022	PRA Statement and Discussion Paper DP 2/22 (re. Risk Margin and Matching Adjustment)
21 July 2022	ABI published response to HMT Consultation (and consultations close)
17 November 2022	HMT publishes Response to Consultation on Solvency II Reform
17 November 2022	PRA publishes Feedback Statement 1/22 on Discussion Paper DP 2/22
22 June 2023	HMT publishes draft Statutory Instruments to implement certain Solvency II Reforms
29 June 2023	Financial Services and Markets Act 2023 granted Royal Assent
29 June 2023	PRA publishes Consultation Paper CP 12/23
September 2023	Planned date for release of second PRA Consultation Paper
TBD	HMT and PRA to publish responses to consultations and further proposed legislative changes

Solvency UK – Risk Margin

- **The Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023**
  - Risk Margin – what is it?
  - Currently calculated using a cost of capital measurement using a standard 6% rate
  - Criticised for being too sensitive to movements in interest rates
  - Nearly all longevity risk reinsured
  - **Regulations** reduce the capital rate from 6% to 4%
  - New risk tapering factor
  - HMT estimates that changes will reduce the risk margin by 65% for long-term life insurers
  - Impact on hedging activity

Solvency UK – Matching Adjustment

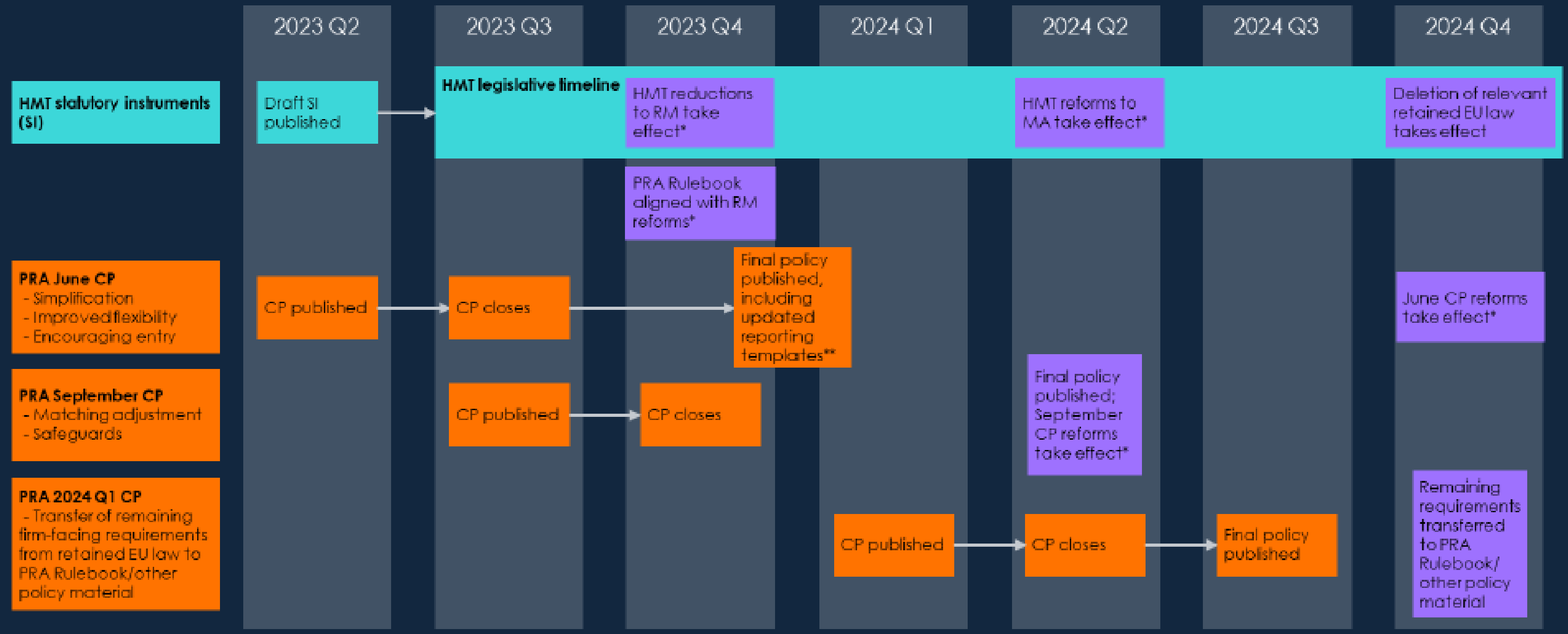
- **The Insurance and Reinsurance Undertakings (Prudential Requirements) (No. 2) Regulations 2023**
  - Matching Adjustment – what is it?
  - PRA view is that it is not properly calibrated and is too high – insurers benefitting from too much capital relief
  - **Regulations** maintain the requirement for fixed cashflows but include some exceptions for some non-fixed cashflows subject to certain conditions:
    - the risks to the quality of matching are not material
    - limited portfolio as determined by the PRA

    (in each case as determined by the PRA rules being developed pursuant to an upcoming consultation)
  - Fundamental spread changes
    - Increasing the risk sensitivity with notched allowances within major credit ratings
    - Add-ons at the option of the insurer to apply a higher fundamental spread

Solvency UK – Reporting and Application Processes

- **CP 12/23 - Review of Solvency II: Adapting to the UK insurance market**
  - Package for changes intended to increase flexibility, reduce the burden of regulation, promote competition and incentivise market entry
  - Easing the burden of reporting and administrating requirements by simplifying and reducing the frequency of certain reporting requirements
  - Simplification and process improvements to the calculation of the transitional measure on technical provisions
  - New, streamlined set of rules for internal models (reducing prescriptive requirements and introducing more supervisory judgement and principles-based requirements)
  - Greater flexibility in the calculation of group solvency requirements
  - The removal of certain requirements for branches and international insurers operating in the UK (to increase the attractiveness of the UK sector to inward investment)
  - A new mobilisation regime to facilitate entry and expansion for new insurers and facilitate competition
  - Increase to the size thresholds at which small insurers are required to enter the Solvency II regime – so more small insurers fall outside the regime.

PRA's implementation expectations



The finalisation of HMT's legislation is a necessary pre-requisite for the PRA's proposed reforms. However, at the date of this publication, the legislative timetable is not confirmed. The timescales in this chart are based on current expectations that the relevant legislation is laid and made from Q3 2023. In addition, the timescales may also depend on other factors, such as the number and substance of consultation responses received.

*This indicates the earliest date reforms could be implemented by firms, subject to legislation.

**Firms can begin to make and test changes to reporting systems from Q1 2024, ahead of YE24 reporting.

Funded Reinsurance: PRA thematic review

- Funded Re / Asset-Intensive Reinsurance – transfers longevity risk and market risk
- Large upfront premium payable to the reinsurer (similar to a buy-in); insurer benefits from security
- PRA concerns with credit-focussed new entrants
- "Same way" and recapture risk
- Are firms entering into funded reinsurance transactions that they wouldn't have entered into but for the surge in BPA demand?
- PRA focussing on:
  - level of exposure
  - suitability of the assets in the collateral pool and how well assets responds to market stress
  - other transaction risks, e.g. counterparty risk, and how mitigated through contractual features
- What does it mean for the market and what next?

DB Consolidators – TPR Guidance

- TPR recently issued new guidance on DB "Superfunds"
- Aimed at making it easier for schemes to transfer into a superfund, for example:
  - Clarifying guidance on assessment process and clarifying when it is the right time for a fund to consider transferring
  - Extending the gateway period during which ceding trustee is to assess whether a buy-out is affordable
  - Updated position on profit extraction from the fund
  - Changing funding expectations by amending the discount rate from gilts+0.5% to gilts+0.75% (but maintaining a fixed rate subject to future review, rather than a dynamic rate).

DB Consolidators – DWP Consultation

- Government published a call for evidence on how to increase investment by DB schemes into "productive finance"
- Follows HMT's Mansion House Reforms – a package of measures that includes the creation of a permanent superfund regulatory regime
- Proposals include consolidation models, including a "public sector consolidator" in particular considering whether the Pension Protection Fund (PPF) could fulfil this function

Insurers in Financial Distress – FSMA changes

- Changes to Insurer insolvency arrangements (Schedule 12 and 13 of FSMA 2023)
- Drivers:
  - Protection of policyholders
  - Continuity of coverage (avoiding actual insolvency) by allowing earlier intervention by regulatory authorities
  - Help maintain public confidence in the UK's insurance sector
- Impact on counterparties to UK insurance companies in financial difficulty (i.e. reinsurers):
  - Clarify and expand the existing statutory powers in s377 of FSMA to write-down an insurer's liabilities
  - Ban on counterparties exercising termination and other rights against the insurer (ipso-facto clauses)
  - Stay on surrender options available to policyholder of a life insurance policies

Insurers in Financial Distress – IRR

- New Insurer Resolution Regime (IRR)
- Broadly follows the resolution regime for banks
- Four new "stabilisation options" – including:
  - transfer to a private sector purchaser
  - transfer to a bridge institution
  - bail-in
  - temporary public ownership
- Safeguards for creditors and counterparties
- Overlap with write-downs; IRR likely to be used only with systemically important insurance companies
- Comfort for pension schemes and reinsurers – increases likelihood that arrangements will transfer to a solvent insurer