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LATEST FROM THE PRA ON THE BPA MARKET

On 30 April Gareth Truran (PRA Executive Director for Insurance Supervision) gave a speech at the Annual Bulk Annuities Conference on "Overseeing BPA growth safely". The PRA's focus on bulk purchase annuity (BPA) transactions and the reinsurance of those deals is not new; regulatory scrutiny has increased in recent years in light of rapid growth in the sector. The speech highlighted a number of recent developments which will be of interest to those in the market. The PRA also provided further commentary on its perspective in relation to matching adjustment reforms and the forthcoming Life Insurance Stress Test (LIST 2025).

THE BPA MARKET

Solvency termination triggers

Mr Truran highlighted the "increasing feature" of the use in buy-in policies of termination rights linked to breach of solvency thresholds calculated by reference to an insurer's solvency capital requirement. A key concern raised was that any requirement for termination payments from an insurer to insured pension schemes in these circumstances could, if not properly designed and considered in the aggregate, expose the insurer to liquidity risk and/ or asset concentration risk. Firms are expected to consider these risks and to set prudent exposure limits on the use of solvency related termination rights.

In response to questions from the audience, Mr Truran commented on the importance of insurers having sufficient discretion over what assets should be included in the termination portfolio, to ensure that a relevant recapture does not leave the insurer in a worse solvency coverage position. It is important that the use of solvency termination triggers does not impact the overall resilience of the firm, which would be detrimental to its other policyholders.

From the perspective of trustees and sponsoring employers, termination rights (and, potentially, collateral) are often an important feature on higher value BPAs. This is even more the case since the introduction in 2023 of the new section 377A of the Financial Services and Markets Act 2000, which allows for the write down of insurance liabilities in situations where an insurer "is likely to become" unable to pay its debts. Mr Truran indicated that the application of these powers would be case-specific, so could not be the subject of prescriptive guidance. A termination trigger which takes effect at an earlier point than insolvency of the insurer therefore potentially provides important optionality and protection for the pension scheme trustees. It should be noted that BPA policies continue to be protected by the Financial Services Compensation Scheme, which will look at pre-write down liabilities when considering any top up or compensation payments to be made to policyholders.

Insurers are generally conscious of the potential impact on wider policyholders when special termination rights are included in BPAs, but will also take into account the benefits for all stakeholders of the insurer receiving what can be multi-billion pound premia. Insurers will continue to operate in a very competitive BPA market, especially where they seek to win the highest value deals. Nevertheless, the views expressed by the PRA on solvency related termination rights are likely to be considered in the context of future discussions between pension schemes and insurers on the terms of BPA policies.

Solvency termination rights in BPA policies are not a novel feature of these transactions. It is possible that the PRA has chosen to focus on them at this point following its recent scrutiny of recapture risk the context of funded reinsurance arrangements, and given that the rapid growth of the BPA market could increase the aggregate impact of these rights on insurers in a stress scenario if not properly designed.

Funded reinsurance

Mr Truran also made some remarks regarding the use of funded reinsurance in the BPA market. The PRA does not consider that the limits which insurers have set to manage their funded reinsurance exposures (in accordance with SS5/24) are always aligned with its expectations, or that their risk management frameworks are adequate. The suggestion appears to be that, in some cases, the baseline approach set out in the PRA's supervisory statement has not been sufficiently built upon by relevant insurers.

Further action may, therefore, be taken by the PRA - for example, to prevent a perceived trend towards weaker collateral standards.

MATCHING ADJUSTMENT REFORMS

In the speech Mr Truran highlighted the establishment of a new dedicated MA Permissions Team to speed up the PRA's approval process for matching adjustment permissions. Along with the new flexibility in respect of MA eligible assets introduced last June, the PRA considers that it has done what it can to enable insurers to increase investment in UK productive assets, and Mr Truran commented that he looked forward to an update on insurers' £100 billion investment commitment. This refers to commitments given by insurers to the PRA during the Solvency II review, and in particular to the stated aims of the Investment Delivery Forum.

In his speech Mr Truran commented that many of the examples so far of firms seeking to use assets with "highly predictable cashflows" in their MA portfolios relate to investments overseas (which was not entirely the point of the reforms, albeit that there is no regulatory requirement for firms to invest in the UK). It is not clear, however, how many firms are actually seeking permission for these types of assets in their MA applications - at a House of Commons Treasury Committee hearing earlier in the week Sam Woods (CEO at the PRA) commented that of 10 new MA approval applications the PRA had received since the MA reforms were introduced, only two had included permissions related to assets with highly predictable cashflows.

LIST 2025

For the first time, individual as well as firm-wide results will be published following the 2025 Life Insurance Stress Test. The stress test will include two new exploratory scenarios, in respect of asset concentration stress and a funded reinsurance recapture scenario. These new scenarios will not be included in individually published results.

The PRA considers that publication of firm-specific stress test results will increase transparency, strengthening market understanding of resilience to severe but plausible events. For the BPA market this may also assist pension schemes and sponsoring employers in comparing potential providers.

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