Financial Services Risk and Regulation

PRA confirms 2023 supervisory priorities for insurers

AT A GLANCE

January 2023

What's new?

- The PRA issued a Dear CEO letter to life and general insurers dated 10 January 2023, setting out its supervisory priorities for the year ahead.
- The letter highlights six areas of focus, detailed below. It also outlines the PRA's intention to encourage the industry to better manage non-natural catastrophe risk, and to assess firms' compliance with its expectations on managing financial risks arising from climate change. The PRA further states that it expects insurers to continue to embed diversity, equity and inclusion in their cultures.

What does this mean?

Financial resilience

- The PRA recognises the challenging outlook for the UK economy, which presents different challenges to the life and general insurance sectors.
- The PRA states that in relation to internally rated assets, life insurers may experience greater exposure to credit and concentration risk.
- The PRA notes that general insurers are likely to see pressures on claims inflation continue, ultimately causing uncertainty around future claims settlement costs.

Risk management

- Given ongoing uncertain macroeconomic conditions, the PRA states firms should take proactive steps to assess the adequacy of their risk management and control frameworks.
- Firms should be prepared for novel risks, changes in risk correlations and increases in distressed assets.
- The PRA expects firms to reassure themselves about the appropriateness of their capital models. Insurers should consider the extent to which the PRA's consultation paper on model risk management principles for banks can apply to them.
- The PRA plans to conduct a thematic review of the bulk purchase annuity (BPA) sector to understand whether the risk management disciplines of firms are keeping pace with their BPA growth ambitions.
- Recognising the recent Liability-Driven Investment shock event, the PRA states it expects firms to test the resilience of liquidity sources.

Implementing financial reforms

- The PRA states that it will engage with firms on the technical detail of the Solvency II reforms throughout 2023, and set out its supervisory approach to branches. In addition, the PRA will engage with the life sector to adapt its existing stress testing framework.

Reinsurance risk

- The PRA is closely monitoring the high level of longevity reinsurance and the emergence of new 'funded reinsurance' in the UK life market, to see whether these arrangements reduce the level of policyholder protection. The PRA plans to examine the need for policy action on reinsurance structures and limits, to mitigate systemic risks.

Contacts

Will Gerritsen
Director

T: +44 (0) 7718 865076
E: will.gerritsen@pwc.com

Anirvan Choudhury
Senior Manager

T: +44 (0) 7483 423721
E: anirvan.choudhury@pwc.com

pwc

AT A GLANCE

January 2023

Operational resilience

- The PRA will continue its focus on assessing firms' compliance with its operational resilience expectations as set out in its Supervisory Statement 1/21. The PRA also draws attention to its expectations on outsourcing and third party risk management as set out in Supervisory Statement 2/21.

Ease of exit for insurers

- Later this year the PRA plans to consult on specific requirements for insurers to prepare resolution plans so that they can exit the market in an orderly fashion if required.

What do firms need to do?

- The PRA expects firms to ensure that their risk management and control frameworks have been robustly tested and remain valid in light of the risks highlighted in the Dear CEO letter.
- The PRA expects firms to conduct robust stress tests to assess the impact of prolonged recession and elevated inflation on their business and capital models. For example, life insurers should assess adverse credit scenarios while general insurers should consider the impact on their pricing, reserving, business planning, and capital modelling. In addition, the PRA expects firms to test the resilience of liquidity sources and to evaluate potential liquidity demands caused by the use of derivative instruments.
- Firms will want to to engage closely with the PRA to help shape the technical details of the Solvency II reforms, and monitor changes to Solvency II introduced through legislation. Firms may wish to model proposed changes to the risk margin and the matching adjustment as these are likely to impact their reinsurance, capital management and investment strategies going forward.
- Firms should address any gaps in data, tools, and expertise for assessing the impact of climate risks and continue to take steps to embed climate risk within their overall risk management frameworks. The PRA warns that it will use a range of supervisory tools where it considers that firms are making insufficient progress in assessing financial risks arising from climate change.
- The PRA expects for firms to consider the reinsurance counterparties' resilience for the full duration of the exposures, as well as the potential impact from a mass recapture event if large reinsurance counterparty concentrations exist. In addition, the PRA expects firms to comply with the Prudent Person Principle in relation to their reinsurance activities.
- The PRA expects firms that underwrite casualty classes, including cyber risks, should assess the impact of non-natural catastrophe losses on their capital positions and financial resilience. From an operational resilience point of view, firms should assess their impact tolerances under a range of severe but plausible scenarios, including cyber-attacks.
- Ahead of the introduction of new rules on resolution planning, the PRA states that firms should assess whether there are inherent barriers to their ability to recover from stresses or be resolved. Firms can utilise the insight that emerges when looking at their business through a R&R lens to support a wider view of risk management practices and respond to vulnerabilities.

Contacts

Will Gerritsen
Director

T: +44 (0) 7718 865076
E: will.gerritsen@pwc.com

Anirvan Choudhury
Senior Manager

T: +44 (0) 7483 423721
E: anirvan.choudhury@pwc.com