

PRA consults on expectations for funded reinsurance arrangements

AT A GLANCE

November 2023

Contacts

Ross Evans

Partner

T: +44 (0) 7483 388751
E: ross.evans@pwc.com

Neil Farmer

Director

T: +44 (0) 7841 495501
E: neil.farmer@pwc.com

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

Sania Hussain

Manager

T: +44 (0) 7483 916259
E: sania.hussain@pwc.com

What's new?

- The PRA published a consultation paper ([CP24/23](#)) on 16 November 2023, clarifying and expanding its expectations on the use of funded reinsurance (FundedRe) by life insurers to support the writing of bulk purchase annuity business. CP24/23 follows the PRA's April 2023 [speech](#) which highlighted perceived risks associated with life insurers' increased reliance on FundedRe to support BPA business; and the PRA's June 2023 [Dear CRO letter](#) which provided feedback on its thematic review of FundedRe (see our [At a glance](#) on the review).

What does this mean?

- The PRA proposes to set expectations for insurers' risk management and structuring of FundedRe arrangements, alongside expectations on how these arrangements are modelled by insurers using an approved (partial) internal model (IM) to calculate their solvency capital requirements (SCR). In this regard the PRA also reminds insurers using the standard formula (SF) of its expectations around the assessment of SF appropriateness.

with one counterparty, this could present challenges with regards to compliance with the Prudent Person Principle (PPP). The PRA proposes insurers to have additional limits which consider concentration risks, in particular based on the simultaneous recapture from multiple highly correlated counterparties.

Collateral policy

- The PRA expects insurers to consider the nature and size of collateral that they may inherit in a recapture event, to understand whether it is sufficient and adequate to cover the technical provisions and risks recaptured.
- The PRA observes insurers increasingly accepting illiquid assets to back collateral for FundedRe policies, and in some cases insurers assuming that these illiquid collateral assets would be recaptured into matching adjustment (MA) portfolios. Therefore the PRA expects a detailed collateral policy for illiquid assets held in collateral pools backing FundedRe. Collateral policies at a minimum must include details on approaches to credit assessments, valuation methodologies, MA eligibility monitoring, SCR modelling, and investment management approaches on recapture.

Counterparty internal investment limits

- The PRA expects insurers to set limits to their exposures to FundedRe counterparties. Insurers should have risk management processes in place to identify, measure, monitor, manage, and report on the whole tail risk related to their FundedRe arrangements.
- With regards to FundedRe internal investment limits, the PRA expects insurers at a minimum to calculate an 'immediate recapture' metric. This metric should measure the impact on the insurers' SCR coverage ratios of an immediate recapture of all business reinsured (without considering the likelihood of this) with a counterparty.
- The PRA considers where an insurer's business model is materially reliant on FundedRe

AT A GLANCE

November 2023

Contacts

Ross Evans

Partner

T: +44 (0) 7483 388751
E: ross.evans@pwc.com

Neil Farmer

Director

T: +44 (0) 7841 495501
E: neil.farmer@pwc.com

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

Sania Hussain

Manager

T: +44 (0) 7483 916259
E: sania.hussain@pwc.com

Recapture plans

- Insurers should have board approved recapture plans, which among other things, should include a detailed process for recapturing all assets and liabilities from counterparties.
- The PRA expects insurers to carry out annual stress testing in respect of their FundedRe and feed these into their ORSAs. The stress tests should inform insurers' recapture plans and FundedRe internal investment limits.

Modelling of SCR

- The PRA expects insurers using IMs to perform robust modelling taking into account FundedRe risks, and recognise the importance of the output of the IM to decide whether to enter into FundedRe as a risk mitigation technique.
- The PRA makes several proposals with respect to probability of default (PD). Among other things, the PRA expects insurers to clearly set out their data choices for assessing the PD of their counterparties. Further, insurers should set PD assumptions that are informed by contractual terms and wider considerations, such as the likelihood of regulatory intervention, ahead of insolvency.
- With respect to loss given default or downgrade, the PRA expects insurers to stress the cash flows of the insurance obligations reinsured using the same approaches used in the relevant modules of the IM. The PRA also expects insurers to consider the impact on the risk margin of the recapture of risks, amongst other things.
- The PRA further sets out its expectations for the calculation of the risk mitigating impact of collateral on the insurers' SCR calculations - this includes insurers stressing the collateral portfolios on a look through basis to reflect the risks the insurer would be exposed to on a recapture event.
- The PRA expects insurers to assume that assets and liabilities associated with FundedRe contracts be

recaptured outside of an MA portfolio, unless insurers can clearly demonstrate that such an inclusion would not cause non-compliance with the MA.

Structuring

- The PRA expects insurers to continue to comply with the PPP ([SS1/20](#)) when considering whether to enter into and structuring the terms of FundedRe arrangements.
- Insurers should undertake a quantitative assessment to inform the insurer's internal investment limit framework as part of its investment risk strategy. The PRA suggests a four-step framework for this assessment, which involves an approved internal contractual risk appetite statement setting out the maximum acceptable loss at the individual FundedRe contract level.

What do firms need to do?

- Life insurers should review CP24/23 and carry out a gap analysis against their own FundedRe arrangements. The gap analysis should consider collateral policies, recapture plans, overarching frameworks, IMs (and assumptions used), and exposure limit frameworks.
- Discussions and decisions to address any gaps identified should follow appropriate governance processes and be effectively recorded, so that insurers can confidently provide assurances to the PRA. (The PRA confirms it will monitor, and may commission Skilled Person reviews in this area).
- Robust processes should be in place when entering into FundedRe arrangements. Thorough risk assessments should be completed of new and existing transactions, and any risks should be captured in insurers' risk register to ensure ongoing monitoring of the risks.
- An assessment of the risks arising from FundedRe arrangements should be included in ORSAs.

Next steps

The consultation closes on 16 February 2024. The PRA proposes to implement the changes outlined in CP24/23 in Q2 2024.



www.pwc.co.uk/regdevelopments

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2023 PricewaterhouseCoopers LLP. All rights reserved. PwC refers to the UK member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.