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ECRS Client Note

The PRA's Approach to the Life Insurance Stress Test (LIST) 2025

More complex and prescriptive

On 10 July, 2024, the PRA published its approach to the 2025 Life Insurance Stress and Scenario testing exercise (LIST 2025 approach) and a technical input request. Insurers in scope include the majority of those in the bulk purchase annuity market (BPA). This will be the first stress testing exercise for life insurers where the PRA will publish results on an individual firm basis as well as in aggregate for the sector. In addition, the metrics that will be disclosed on an individual basis include not only the impact of the scenarios on solvency coverage ratios but also the impact on the matching adjustment (MA). Compared to previous LISTs, the 2025 exercise is more prescriptive, particularly around restrictions on the use of management actions. As a result, insurers in scope should consider the LIST design and specification very carefully and engage with the PRA to ensure a smooth process in 2025.

The LIST will provide valuable insights both from a sector and an individual firm point of view. From a sector perspective, the PRA expects the results will foster transparency while helping supervisors understand the overall market's resilience against several key risks and inform its future supervisory work and activities. For

example, the PRA expects trustees of pension schemes to consider the new publicly available metrics when choosing buy-out partners. The fact that not all BPA insurers will take part in the exercise might create some issues in a market that is highly competitive. From an individual firm perspective, the PRA expects the exercise (and results) to prompt firms to **improve their risk management and modelling capabilities**, particularly in the context of Solvency UK (SUK) reforms.

This request **will close on Friday 6 September 2024.** Insurers in scope have very little time to review and provide feedback on the various elements. Below, we provide a summary of key considerations for insurers to prepare for the LIST 2025.

Timelines and frequency

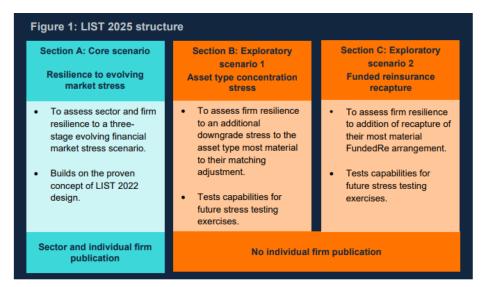
- The PRA will **launch the LIST in January 2025** (including publishing the final scenario design and calibrations)
- The LIST 2025 will run over 11 months. The deadline for data submission will be H1 2025
- Results will be published in Q4 2025
- The PRA will be running LISTs **every two years** starting in 2025
- The PRA also announced that its final rules on Funded Reinsurance (FundedRe) will be published in July 2024



Source: PRA's approach to LIST 2025

Individual firm and sector metrics that will be published

• The LIST 2025 will contain three different scenarios. The core scenario will assess resilience to a three-stage financial market stress, with both sector and individual firm results set to be published. For the two exploratory scenarios (which will assess resilience to asset concentrations and FundedRe), the PRA will publish sector results only but it plans to incorporate FundedRe as part of the core scenario in future iterations of the LIST. The two exploratory scenarios build on the core one.



Source: PRA's approach to LIST 2025

- The individual firm results of the core scenario that will be published will
 include details beyond impact on solvency coverage ratios, including the
 MA. The level of detail required, and the sensitivities around publishing this
 type of data (particularly given some BPA players will not participate in the
 exercise), will require careful consideration by firms in scope.
- At a minimum, the individual firm metrics to be published for the core scenario include:
 - Information on each insurer's portfolio asset composition and risk exposure, including sources of MA
 - Impact of the scenario on Solvency coverage ratio and Eligible
 Own Funds, with a breakdown of the most significant risk drivers
 - Additional metrics on each MA portfolio, demonstrating how the MA responds to stresses and affects overall results.

What is different compared to LIST 2022?

- LIST core scenario results will be made public for each participating firm.
- The proposed LIST 2025 is more complex and prescriptive in nature than previous exercises. For example, the LIST 2022 provided only one scenario that examined the impact of a severe financial market shock in four stages (including a longevity stress); the LIST 2025 includes one core scenario and two additional exploratory scenarios that build on the first. This time around, SUK reforms will also add an additional layer of complexity to the exercise, as firms will be asked to submit relevant data during a significant time of change when some will still be implementing changes related to the SUK reforms.
- Management actions are more prescriptive and restrictive in the LIST 2025 compared to previous exercises. In the LIST 2025, in Stage 3 of the core scenario, firms will be required to rebalance their MA portfolios by bringing 25% of each asset downgraded in Stage 2 of the scenario to its previous credit quality step. The PRA will also prescribe a minimum cost of credit quality rebalancing (trading costs) following the downgrade stress. In

addition to restricting management actions, firms now also need to be able to explain how these can be implemented within appropriate timeframes.

Actions in-scope insurers should take

- This will be a much more complex and potentially onerous stress testing exercise than previously managed by firms with publication of individual results. This means that firms should review the PRA's approach and technical input request in detail to identify feedback areas. Given the short deadline, firms need to form a view as to which areas of the specification might need change or further clarification.
- The PRA expects that "firms may need to extend or adapt their models to enable them to calculate the change in capital requirements after stress or to model the impact of different management actions or exploratory events not captured in the normal range of their models". Firms need to consider how they plan to adapt their models as expected including the need for validation and governance over such adaptations. We expect some firms will have significant work to do to get their stress testing capabilities up to scratch, particularly given previous PRA feedback to life insurers in this area.
- Firms should assess their management action plans and timeframes required for implementation under stress.
- Lastly, firms may also want to look at what they can learn from the experience of banks to assess their need for time and resources to conduct the exercise in 2025. Individual large bank results have been published for many years. Key areas of focus include managing the narrative and interpretation of results with investors and robust governance over the process to ensure good quality submissions. The PRA will perform quality assurance and validation over life insurers' submissions. The risk of resubmission of individual results will carry significant reputational risks and means getting it right first time will be crucial. Over the summer, we will publish a follow up article covering the lessons insurers can learn from banks' stress testing experience.

CONTACTS

¹ PRA's Approach to Life insurance stress test 2025 paragraph 4.8

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