Deloitte Insurance Week

Where Reinsurance Meets

Funded Reinsurance & Recent Trends in the UK BPA Market

13 May 2015

Agenda

- BPA Market Landscape
- The Rise of Funded Re
- Regulatory Scrutiny
- Innovation

Presenters

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BPA Market Landscape

Overview of Market Landscape

Overview of Bulk Purchase Annuity ('BPA') contracts

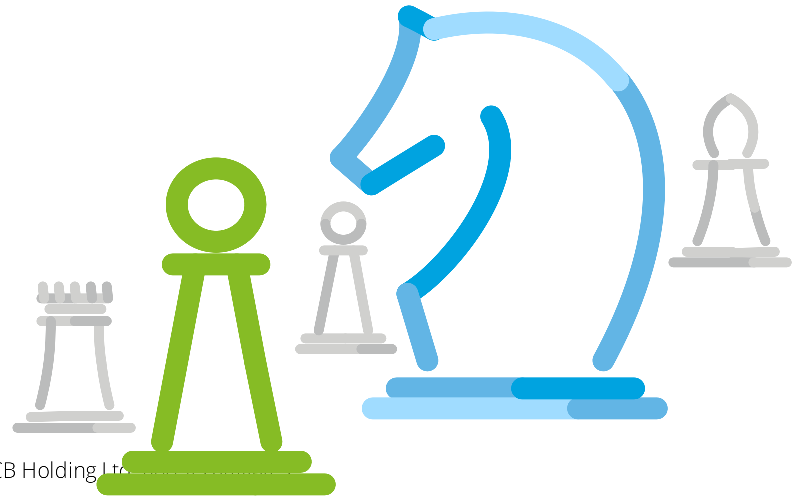
BPA contracts provide a way to achieve finality of outcome and cost for sponsors and schemes, by passing the responsibilities to a life insurer

What is a BPA?

A BPA contract is where an insurer agrees to meet some, or all, of the future obligations of a **defined benefit pension scheme** in exchange for a **premium.**

This **removes the ongoing financial risk** and administrative burden from the scheme sponsor.

BPAs are often considered as a **final step in the de-risking journey** for a DB pension scheme.



There are two types of BPA transaction:

Buy-in

The **pension scheme** buys a BPA contract from an insurer, which becomes an asset of the scheme.

The insurer pays claims to the scheme, which retains responsibility for paying members' pensions.

Buy-out

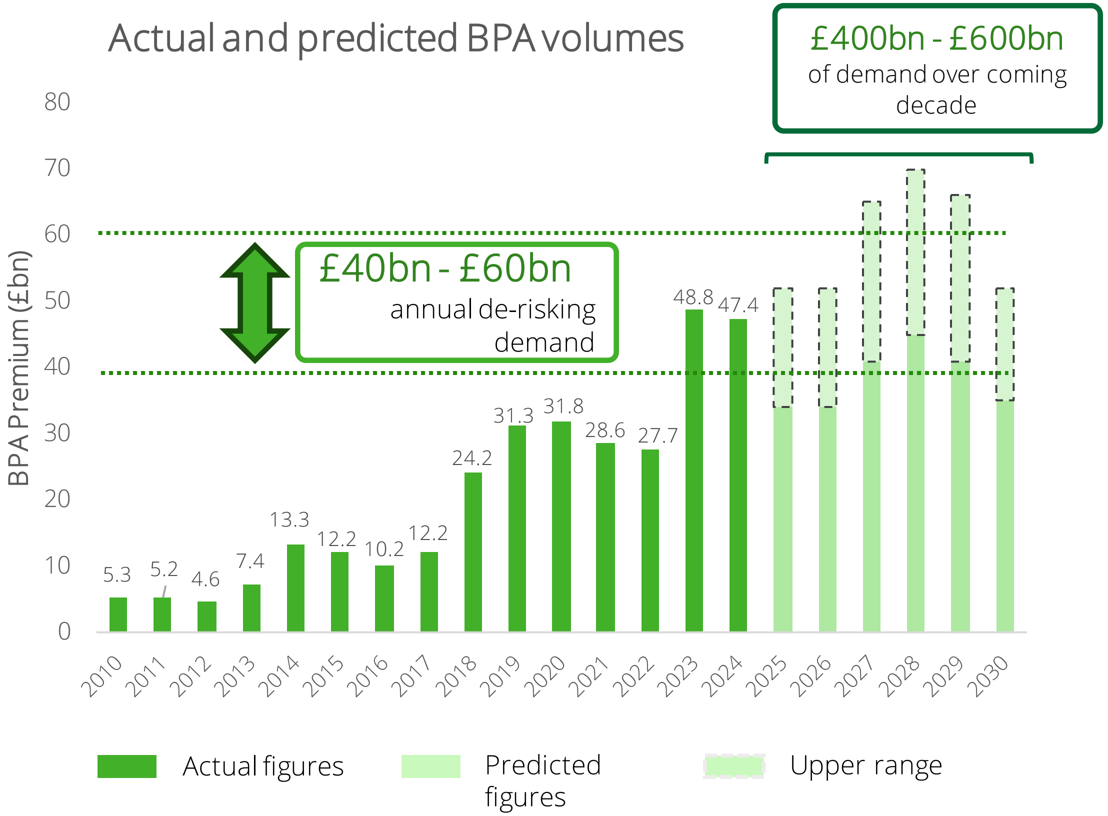
The pension scheme liabilities are **transferred** completely to the insurer's balance sheet, with members becoming **policyholders**.

Typically includes 'all risks' cover, against unforeseen liabilities arising in the future.

Contracts cover liabilities for **pensions in-payment** and **deferred members**.

UK BPA Volumes

Whilst significant risk transfer has already taken place, total BPA volumes over the next decade are estimated at £400bn - £600bn; with demand of c. £40bn+ pa expected



Sources: XPS Bulk Annuity Watch; LCP Pension Risk Transfer Report: Reaching Cruising Altitude; WTW De-risking report 2025; Deloitte Analysis.

The past:

The BPA market has seen rapid growth over the last 10 years due to:

- Improved funding levels of pension schemes driven by rising interest rates
- Cheaper longevity reinsurance following rising interest rates
- Lower New Business Strain ('NBS') on BPA business due to regulatory reforms (i.e. reduction in Risk margin)
- Innovation in the market

2024 saw…

The **largest transaction** to-date: **£11bn NatWest** pension scheme deal with **Rothesay.**

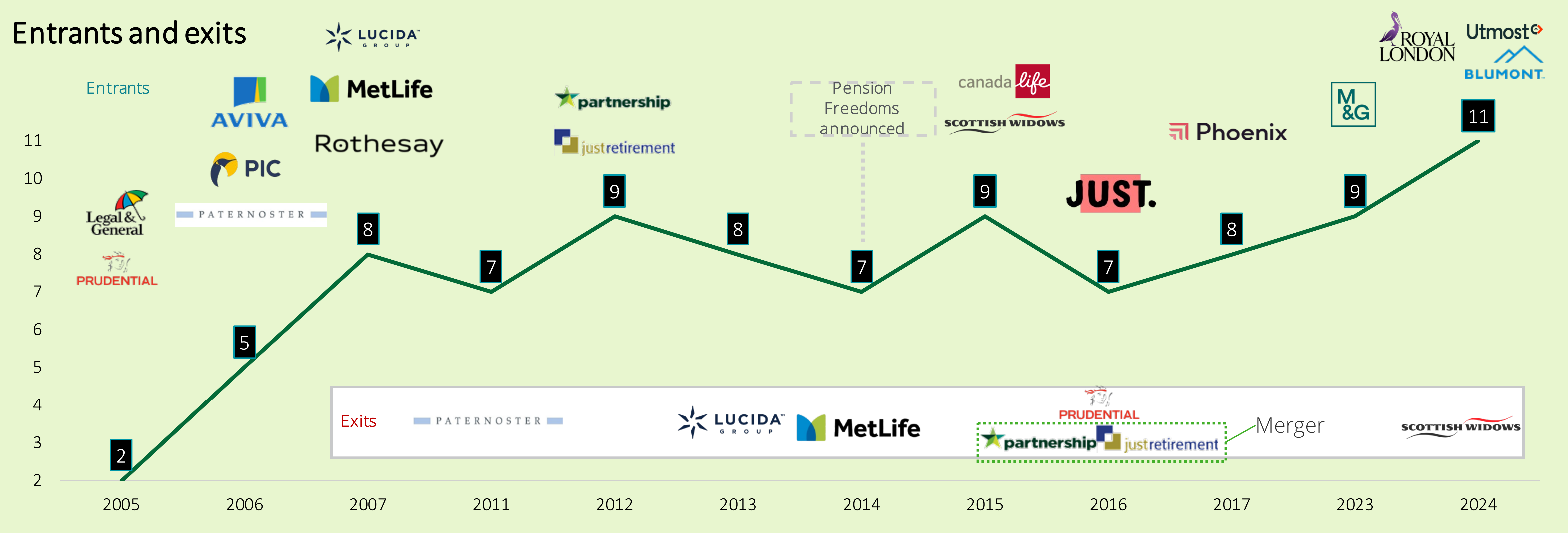
An all-time high number of transactions, with **strong demand** from **smaller schemes;** 80% of deals written in 2024 were valued below £100m.

The Future:

The BPA market is expected to grow further in 2025 and beyond, as total market participants is now at an all-time high of 11.

BPA Market landscape

Evolution of BPA market participants



Multi-line insurers

Mono-line insurers

The Rise of Funded Re

Overview of the Growth of Funded Re

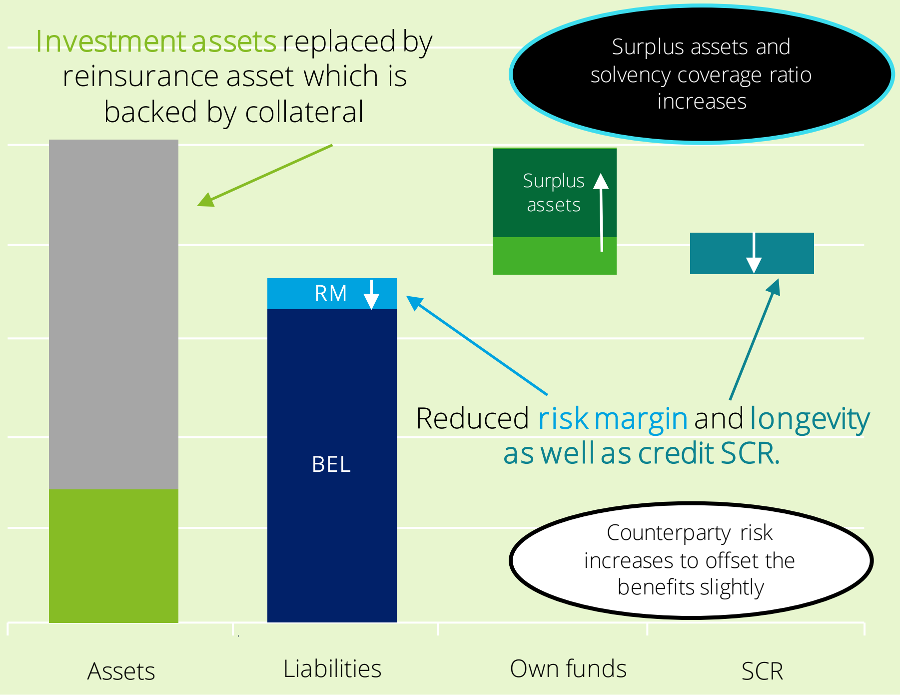
What is Funded Re?

Funded Re is widely used in the BPA market to transfer credit and longevity risk

Funded Re reduces both the **SII Risk Margin** and **longevity solvency capital requirement** ('SCR'), and also transfers the credit risk, resulting in a material reduction in SCR and NBS.

Base Solvency II balance sheet: insurer perspective

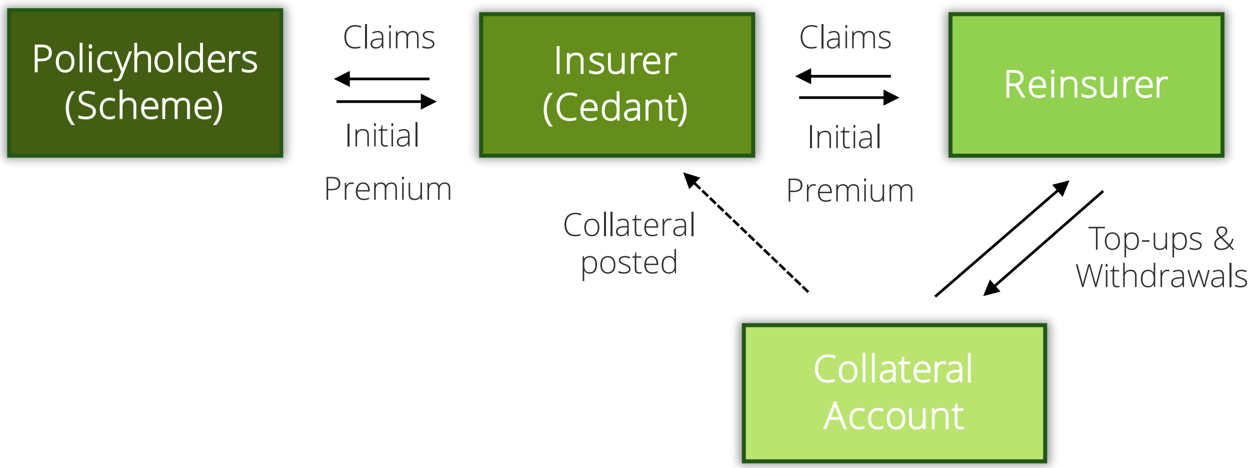
Impact from funded reinsurance: insurer perspective



Collateral in the context of Funded Re

Collateral accounts are used to mitigate counterparty credit risk for the ceding insurer

Transfer of funds



Why is collateral important?

Credit Risk Mitigation
Collateral protects the insurer against reinsurer default, crucial given the long-term nature of bulk annuity liabilities.

Regulatory Compliance
Collateral is essential for meeting Solvency II requirements in the UK, particularly for large bulk annuity deals.

Asset-Liability Matching
High-quality, long-dated collateral helps ensure asset proceeds are available to meet long-term pension obligations should the reinsurer fail.

Ratings Impact
Strong collateralisation supports the insurer's credit rating, impacting capital costs and market perception.

Negotiating Leverage
Collateral terms are negotiable within a given treaty, impacting the cost of reinsurance.

Why do firms use it?

Funded Re reduces capital requirements, improves solvency ratio and enables firms to write more and / or larger deals

Why is Funded Re relevant to the UK and how are UK firms using it?

Historically, Funded Re has been used:

- To **reduce new business strain**, enabling insurers to write more and larger deals whilst avoiding UK regulatory capital requirements.
- As a **source of capital**, with historically low interest rates restraining the flow of capital and new firms entering the market.
- For **asset origination**, helping insurers tap into different asset origination capabilities and access different markets.

In today's high interest rate environment, with increased demand for BPAs:

- Asset origination remains a key use case, however, **wider investment opportunities due to regulatory reform may reduce demand** for Funded Re.
- SII SCR coverage ratios are healthy, and so **availability of capital might not be a biting constraint**.
- **Collateral is being scrutinised by the regulator**, which could be limiting firms' use of Funded Re.

Demand for Funded Re persists, however, firms' uses are now more nuanced and sophisticated

- **Just Group wrote their largest ever deal in 2024** (£1.9bn), of which £1.1bn was reinsured using Funded Re.
- Examples include L&G and Phoenix who have both set up offshore **internal reinsurers**.
- **Other firms do not use it at all** (e.g., Rothesay & most new entrants).

Reasons for increased use of Funded Re

There are signs of potential changes in the way UK insurers use Funded Re but there continues to be new providers of Funded Re entering the market

Increasing demand for BPA

With increasing demand for BPAs, insurers have increased their use of Funded Re, albeit there may be have been a paring back in 2024.

FT FINANCIAL TIMES — Funded Re deals surged from £1.9 billion in 2022 to £6 billion in 2023.

AON — Over the second half of 2024, we saw a reduction in the amount of Funded Re sought by insurers.

New entrants

We've also seen new entrants, which shows that the market is still growing:

- Warwick
- Resolution Re
- InEvo RE

Established players

As well as more established players:

- Prudential
- Pacific Life Re
- RGA
- Athene
- Canada Life Reinsurance

June 2020 – Prudential enter Funded Re market through an agreement with Aviva.

Dec 21 – During the 2nd half of 2021 Pacific Life Re supported Phoenix in writing BPA business.

Dec 23 – Warwick Re completes their first c$500m Funded Re agreement with Just Group.

Dec 23 – Resolution Re enters the Funded Re market through a £2bn transaction with a 'prominent UK-regulated insurer'.

Feb 24 – Warwick Re complete a second $550m Funded Re agreement with Just Group.

Mar 25 – InEvo Re complete their first Funded Re transaction with a UK insurer.

Regulatory Scrutiny

Overview of Regulatory Landscape

The PRA's ongoing scrutiny of Funded Re

The PRA has highlighted growth in this area, potentially leading to inadequate risk management, as a source of concern

Timeline

2023

Dear CRO Letter – Thematic Review, June 2023
- Focused on firms' practices in transaction structuring, risk frameworks, and capital requirements.

Consultation Paper 24/23 on Funded Re, Nov 2023

2024

Supervisory Statement 5/24, July 2024
- Set out the PRA's expectations on Risk Management, Capital Requirements and Entering New Transactions.

Dear CEO Letter, July 2024
- Boards to report to the PRA how they complied against the new standards in SS5/24.

Board Submission, Oct 2024

2025

Insurance Priorities Letter, Jan 2025
- The PRA highlighted progress in compliance but raised continuing concerns around the adequacy of firms' risk limits.

Gareth Truran Speech, April 2025
- Risk limits and risk frameworks not aligned to expectations

Funded Re Recapture Scenario, Dec 2025
- A recapture scenario will be included in industry wide stress testing exercise and aggregate results published in Q4 2025.

Key concerns of the regulator

1. Counterparty risk

The rapid growth of UK cedants' exposure to concentrated reinsurance markets focused on credit returns rather than insurance risk.

2. Systemic risk

Concentrated exposures to correlated reinsurers could increase systemic risk.

3. Commercial pressures

Competitive pressures may incentivize insurers to accept lower reinsurance standards.

4. Risk underestimation & recapture risk

Underestimating counterparty and recapture risks in the balance sheet can lead to rapid risk accumulation.

SS5/24: areas of PRA focus

SS5/24 includes guidance on Ongoing Risk Management, SCR, and Structuring Funded Re deals. SS5/24 was also accompanied by a Dear CEO letter requesting a submission to the PRA to evidence compliance

Key Pillars of the PRA's Supervisory Statement 5/24

Ongoing Risk Management

- Counterparty Limits
- Collateral Policies
- Recapture Plans

Solvency Capital Requirement

- Probability of Default
- Loss given Default
- Collateral
- Recapture within MA Portfolio

Entering & Structuring

- Quantitative Assessment
- Assess Basis and Collateral Risks
- Documented Policies & Guidelines

The impact of SS5/24 on the reinsurance market (1/3)

SS5/24 includes guidance on Ongoing Risk Management

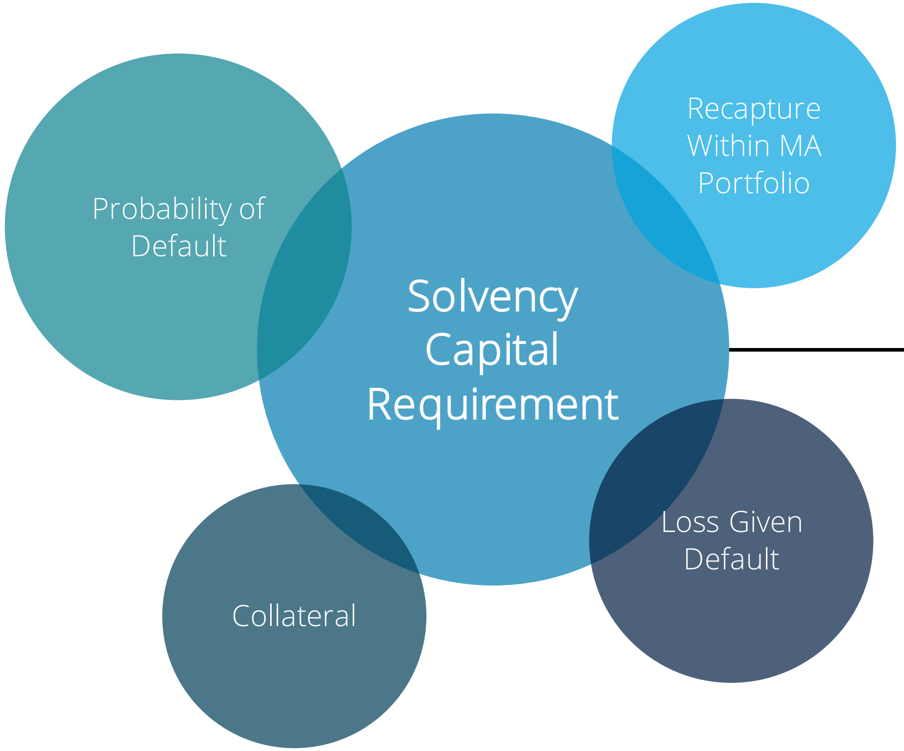
Key Pillars of the PRA's Supervisory Statement 5/24

- **Increased competition** following demand for new reinsurers to enter the market.
- Insurers **diversifying their reinsurance counterparties** to avoid breaching single counterparty limits.
- Firms must choose if they should **reduce the extent of Funded Re used** if the level used **breaches limits**.
- **Less investment flexibility** on collateral.
- **Additional information** requests to support the monitoring of Reinsurers' financial condition

The impact of SS5/24 on the reinsurance market (2/3)

SS5/24 includes guidance on the Solvency Capital Requirement

Key Pillars of the PRA's Supervisory Statement 5/24



Implications for reinsurers

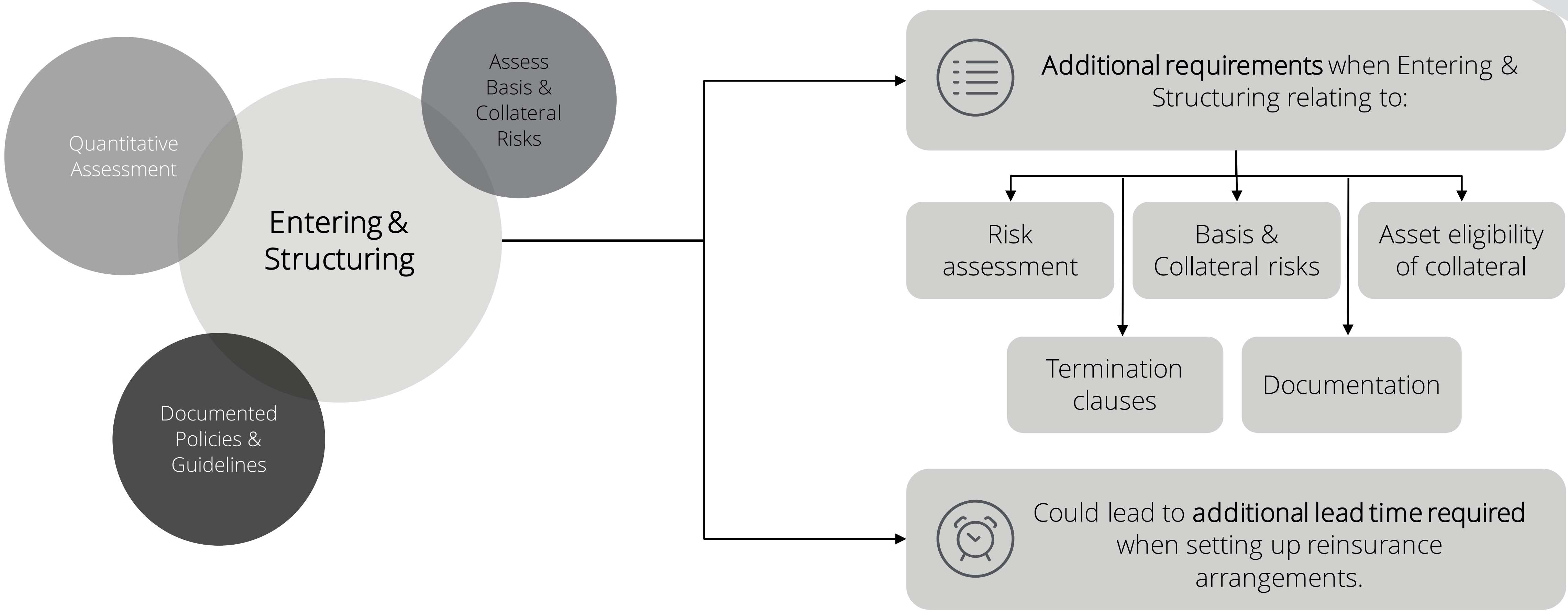
- **More due diligence** (DD) by insurer when engaging a new reinsurer
- **Data requests** on solvency ratio **sensitivities**
- **Data requests** to support insurers' assessment of **probability of default**
- **Additional data requests** and more **frequent reporting on collateral data**.

The impact of SS5/24 on the reinsurance market (3/3)

SS5/24 includes guidance on Entering & Structuring reinsurance arrangements

Key Pillars of the PRA's Supervisory Statement 5/24

Implications for reinsurers

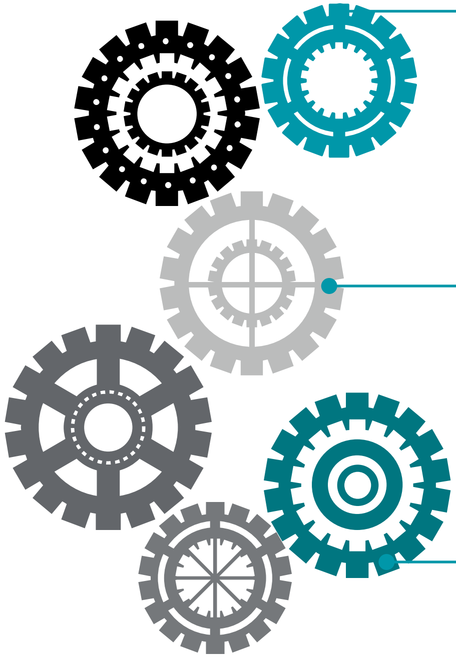


Recent Changes and Updates to US Regulatory Landscape

NAIC and US state regulators have similar concerns to the UK's PRA around Funded Reinsurance, especially as this relates to **offshore reinsurance** and the involvement of PE firms.

Key concerns of the US regulator

- **Lack of transparency** due to complex ownership structure
- **Conflicts of interest,** where PE firms can exert significant control and might also manage assets backing reinsured policies.
- The increasing use of **high yielding illiquid assets** raises concerns about **adequacy of assets** and potential for conflicts of interest in pricing, capital and asset selection.
- **Misalignment of interests,** where PE owners may prioritise short-term returns over long-term policyholder obligations
- Use of complex assets to back **PRT** raises questions on insurer resilience, asset valuation, and stress testing.



Asset adequacy analysis

In 2023, asset adequacy testing performed under Actuarial Guideline 53 required disclosure of:

- capped reinvestment-sensitivity measure,
- collectability-risk reporting, and;
- required supplementary information for assets and reinsurance.

NAIC Macroprudential Working Group

In 2023, the NAIC's Macroprudential Working Group (MWG) announced list of 13 regulatory considerations and measures applicable to PE owned and other insurers.

MWG have developed reinsurance comparison sheet as an optional disclosure form to increase the transparency of offshore reinsurance transactions.

PRT Transactions

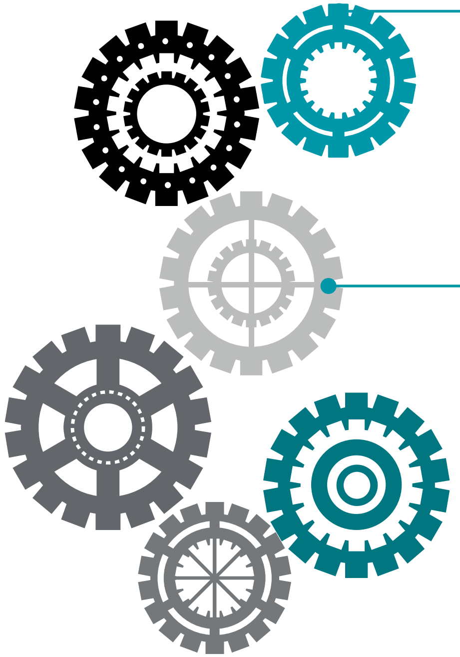
NAIC is assessing adequacy of protections for pension beneficiaries and treatment of complex assets backing PRT liabilities

Recent Updates to Bermuda Regulatory Regime

In Bermuda, the BMA has enhanced its regulatory oversight and supervision, as cedent regulators intensifying their scrutiny of **asset-intensive reinsurance practices**.

Steps taken by BA

- **Enhancing regulatory oversight**, by:
    - collaboration with other regulators
    - increasing own supervisory capacity
    - augmenting governance requirements
    - closer engagement with (re)insurers focused on key investment risks
- **Targeted enhancements** to regulatory and supervisory regime for **commercial insurers**, impact calculation of TPs, BSCR and flexibility of BSCR framework
- Introduction of **transaction approval process** for long-term block reinsurance
- **Increasing disclosures requirements** relating to insurers' investment portfolios (particularly illiquid assets) and liability profiles.



Risk Management Governance

- Application of **Prudent Person Principle (PPP),** ensuring investment decisions are made in best interests of policyholders
- **Recovery planning** regime
- **Liquidity management** frameworks
- **Affiliate**, related parties or connected **parties** require prior approval and should be identified on look-through basis

SBA Process Governance

- Model documentation and data requirements for Scenario-Based Approach (SBA) process
- Model risk management process requiring model inventory, documentation, validations, review and development
- Additional internal controls relating to SBA modelling
- Extending accountability of C-suite members, internal audit and approved actuary for elements of SBA process

Recent Updates to Bermuda Regulatory Regime - SBA

Insurance (Prudential Standards) Amendment Rules 2024 include the following enhancements (effective 31 March 2024).

Component	Item	Description
Technical Provisions and ALM	• Scenario-Based Approach (SBA) BEL	• Reapproval of treaties only required where there is a material change to an existing SBA model • Fungibility of assets between different blocks of liabilities is not permitted without BMA approval • Based lapse adjustment applied when using the SBA • Modelling of optionality assumptions in BEL calculation
	• Default and Downgrades:	• BMA prescribed D&D rates • Requirements governing the use of internal model and internal ratings as alternatives to the prescribed D&D assumptions
	• Transaction costs	• Reflect realistic bid-ask spreads and other transaction costs
	• Reinvestment and disinvestment	• Long-Term Spreads can be used if prudent • No borrowing allowed • Unsellable assets should be held to maturity
	• Risk Margin	• Impact from the transition of the changing capital requirements to the risk margin • Updated Risk margin calculation for Insurance Groups to be on an unconsolidated basis .i.e. no diversification benefits between legal entities
	• Standard Approach BEL	• For European business, the discounting will follow the Solvency II curve
BSCR	• Lapse and Expense risk charges	• 'Other insurance risk' charge broken down into separate lapse and expense risk components
Asset Approvals	• Asset Modeling Requirements and Restrictions	• Other investment grade fixed income assets require prior approval from the BMA, as per subparagraph (14), • Treat Other investment grade fixed income assets as unsellable, unless approved by BMA to be treated as sellable • Requirement to explicitly model assets with optionality or behavioral components • An additional spread cap was introduced on assets acceptable on a limited basis for use in the SBA.

Innovation

Deep-Dive into Sidecars

Sidecars

Sidecars provide a collaborative reinsurance solution which enable the sharing of risks while expanding capacity. These vehicles have become popular in the life space in recent years as a means for transferring insurance risk to capital markets.

What is a sidecar?

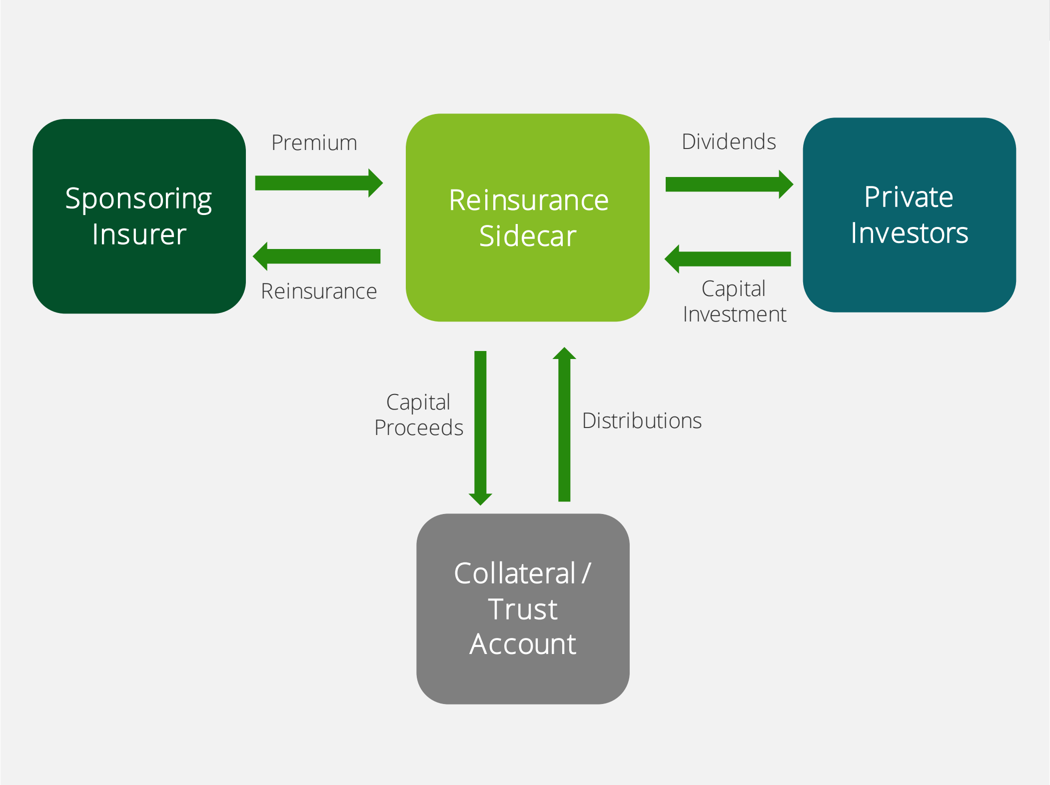
A sidecar is a **financial structure** set up by a (re)insurer to obtain additional reinsurance capacity by **attracting external investors.** Primarily used to respond to market opportunities or if there are specific high-risk exposures that the insurer wants to offload from their balance sheet.

Sidecars are typically **Specialist Purpose Vehicles (SPVs)** that reinsure specific risks or portfolios.

Investors and asset managers are increasingly attracted to sidecars as an **investment vehicle** within the insurance industry.

Although sidecars have traditionally been associated with P&C in Bermuda, the L&A segment only recently identified sidecars as risk-sharing vehicles that utilize third-party capital to improve metrics.
Athene set up the first life/annuity sidecar in Bermuda in 2019 (ACRA I). Since then, L&A sidecars have been steadily increasing. PE insurers (AEL, Athene, and Global Atlantic) are the most active, though Prudential, RGA and MetLife are keeping pace.

Basic Structure of Sidecars



Sidecars

We have seen a growing interest in this space as sidecars present a unique opportunity to blend numerous capabilities and create value

What makes sidecars an attractive opportunity?

Knowledge

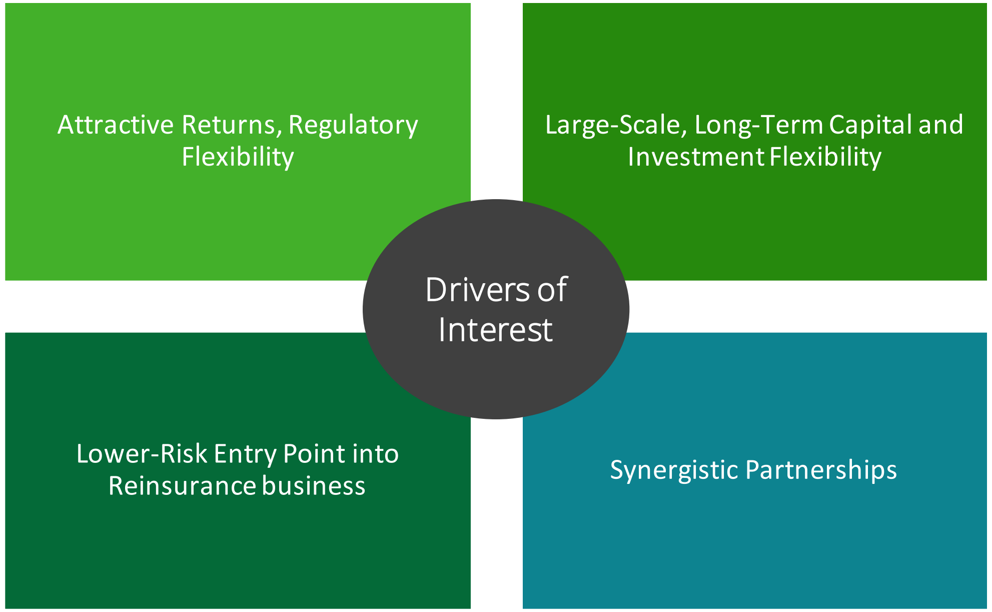
A successful sidecar couples deep (re)insurance underwriting and operational knowledge with investment management and servicing expertise.

Capital pools

Sidecars allow insurers to tap into capital pools outside their traditional reinsurance partners, potentially at more attractive terms, especially during hard market conditions when traditional reinsurance capacity is limited.

Unique pool of investors

Similarly, sidecars allow reinsurers to transfer risk to a unique pool of investors who provide capital for a bespoke arrangement, with a specified length, offering a structured approach to managing risk and attracting investment.



Questions?