

Bank of England PRA

Approach to life insurance stress test 2025

July 2024



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Contents

Contents	1
Executive Summary	2
1: Introduction	5
2: Solvency UK	6
The Matching Adjustment and investment flexibility	7
3: Purpose and objectives of the life insurance stress test	9
4: Key components of the stress-testing framework for life insurers	11
Scope and participation	11
Frequency and timings	12
Modelling insurers' balance sheets in stress	12
Scenario design	13
Publication of Results	17
Reflecting changes in the regulatory framework	18

Executive summary

The UK life insurance sector plays a vital role in supporting the real economy, providing insurance coverage to critical sectors, and facilitating important economic activity through the pooling of risk, provision of retirement income, and as a provider of long-term investment.

The Prudential Regulation Authority's (PRA) aim is for the UK insurance sector to be able to provide financial protection and security to its policyholders in both good and bad times, and to ensure that the sector can contribute to the growth of the economy in a sustainable manner.

This document sets out what the PRA seeks to achieve through stress testing the UK life insurance industry, and its approach for achieving this. It is aimed at PRA-regulated insurers as well as other stakeholders who have an interest in the UK life insurance industry, including academics, analysts, investors and pension scheme trustees.

Stress testing exercises give the PRA valuable insights into the financial resilience of the sector and its firms, beyond those that can be obtained from a firm's solvency and risk management reports. The exercises can highlight vulnerabilities and risks that might not be easily visible in more stable times. At an individual firm level, stress tests inform the supervisory view of the adequacy of a firm's risk management systems. At a sector level, these exercises help the PRA to assess sector resilience and to be better prepared to respond in the event of similar scenarios occurring. Publication of stress test results also helps inform other stakeholders about the resilience of the sector and any potential vulnerabilities.

The PRA has carried out sector-level life insurance stress tests (LIST) since 2019 and published an assessment of the sector's resilience in 2023.¹ In 2025, the PRA's stress testing framework will be enhanced with the publication of individual firm results. This will provide market participants with additional transparent, independent measures of a firm's resilience and facilitate market education and discipline.

The PRA's 2025 life insurance stress test has three objectives:

- to assess sector and individual firm resilience to severe but plausible events;
- to strengthen market understanding and discipline through individual firm publication;
- and

¹ www.bankofengland.co.uk/prudential-regulation/letter/2023/ist-2022-report.

- to improve insight into risk management vulnerabilities.

Unlike the PRA's annual cyclical scenario bank stress test, the PRA life insurance stress test will not be used to inform the setting of capital requirements or buffers. UK insurers' capital requirements are determined by the Solvency II (in future, Solvency UK) framework, and firms set their buffers above these requirements based on their own risk appetite. The stress test is expected to test a severe scenario, and therefore the PRA does not expect all firms to necessarily show Solvency Capital Requirement (SCR) coverage of 100% or more following the stress scenario. This is not a pass-fail exercise.

The PRA anticipates running life insurance stress tests every two years. The PRA's current intention is that firms in scope of future exercises will be notified twelve months prior to launch.

The 2025 LIST will apply to UK life insurers active in the bulk purchase annuity (BPA) market with the largest annuity portfolios (see Section 4). These insurers play an important economic role by providing certainty of long-term retirement income for millions of policyholders. These firms also provide insurance coverage to defined benefit pension schemes, to help these schemes manage their financial position. BPA transfers have grown significantly in recent years and commentators expect them to accelerate further over the coming years, with c.£600 billion expected to be transferred over the next decade, according to some market observers.² Such a shift would represent a significant structural change in the level of retirement protection provided directly by the UK life insurance sector, and so transparency about the financial resilience of this sector is ever more important.

Because these insurers also invest in assets to support their long-term policyholder liabilities, they are also increasingly important as providers of UK long-term investments. As their liabilities grow, and as Solvency UK reforms take effect, the UK life insurance sector is expected to expand the range and complexity of assets it invests in. Some insurers active in this market have also made use of more complex and innovative reinsurance strategies including 'asset-intensive' or 'funded' reinsurance (FundedRe).

To meet the objectives of the stress test and capture the risks in the growing BPA market, the 2025 exercise will contain one core and two exploratory scenarios.

The core scenario will set out a financial market stress, building on the previous PRA life insurance stress test carried out in 2022. The scenario will assess sector and firm resilience, as well as provide transparency to market participants on the core components of the

² See the January 2024 LCP report on predictions for the pension risk transfer market. Available at: www.lcp.com/our-viewpoint/2024/01/lcp-s-predictions-for-the-pension-risk-transfer-market-in-2024.

Solvency UK regime, and how they evolve in stress. The results of the core scenario will be published at an individual firm level.

The core scenario will be supplemented by two exploratory scenarios. These are designed to investigate and assess emerging risks, to support the industry's development of modelling capabilities, and to enhance future stress test exercises. By definition, emerging risks can be characterised by a lack of relevant or credible historical data, and an absence of market standards or agreed common methodologies for quantification. This makes any cross-firm comparisons challenging. For this reason, publication of the exploratory scenario results in LIST 2025 will be at an aggregate level only, and not at an individual firm level. Sector-level findings can support capability building and the development of best practice, which would allow the PRA to include these risks in future core scenarios. For LIST 2025, the exploratory scenarios will contain an asset-type concentration stress and a FundedRe recapture stress.

Alongside this approach document, the PRA is publishing the draft LIST instructions and templates,³ and issuing a request for technical input for the participating firms. Comments are requested on these documents by 6 September 2024. The PRA plans to launch the exercise and publish the final scenario design and calibrations in January 2025. The results of LIST 2025 will be published in Q4 2025.

³ The LIST 2025 Scenario Specifications, Guidelines and Instructions, quantitative templates and requirements for the Results and Basis of Preparation report are available at:

www.bankofengland.co.uk/prudential-regulation/publication/2024/july/list-2025.

1: Introduction

- 1.1 A stress test examines the potential impact of a hypothetical adverse scenario on the health of the sector and individual institutions within it. The PRA has been carrying out sector-level life insurance stress tests since 2019 and last published an assessment of the sector's resilience⁴ in 2023.
- 1.2 In accordance with the Government's response⁵ to its Solvency II review consultation in November 2022 (November 2022 statement), the PRA is updating its approach to sector-level life insurance stress tests. In particular, the new supervisory measures described in the November 2022 statement will (once in place) allow the PRA to publish individual firm stress test results.
- 1.3 This document sets out the main elements of the stress testing framework for the 2025 life insurance exercise. This approach was informed by discussions with the PRA's Insurance Practitioner Panel⁶ and a stress testing subject expert group⁷ which included representatives from the insurance industry and experienced users of insurers' disclosures, including rating agencies, equity analysts and pension trustee advisors. The approach adopted for the 2025 exercise builds on previous exercises, while ensuring the industry has time to develop the necessary capabilities for future enhancements.
- 1.4 Following any lessons learnt from LIST 2025, the PRA will engage with the industry on a longer-term approach to apply to LIST exercises from 2027. The PRA anticipates running life insurance stress tests every two years, with exercises expected to be run in 2027, then subsequently in 2029, etc.
- 1.5 The PRA-led exercises are intended to complement rather than replace firms' internal stress testing. The PRA expects firms to run scenarios that are most relevant to their particular business model as part of their own risk and solvency assessment (ORSA) process.⁸

⁴ Available at: www.bankofengland.co.uk/prudential-regulation/letter/2023/ist-2022-report.

⁵ Available at: www.gov.uk/government/consultations/solvency-ii-review-consultation.

⁶ Available at: www.bankofengland.co.uk/prudential-regulation/practitioner-panel. The Insurance Practitioner Panel is a dedicated forum to discuss the PRA's policies and practices related to the insurance sector and to represent the interest of the practitioner.

⁷ As part of the PRA / ABI Insurer engagement, the PRA has established a stress testing subject expert group to gather a broad range of information on and options for the development of the life insurance stress test. More information on the subject expert group is available at: www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/solvency-uk-pra-abi-insurer-engagement.

⁸ November 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-orsa.

2: Solvency UK

- 2.1 LIST 2025 will be the first life insurance stress test run under the new Solvency UK regime. Solvency UK is the new UK prudential regime for insurers, following reforms implemented by the government and the PRA as part of the Solvency II Review.⁹ The objectives of the Solvency II Review were to (a) spur a vibrant, innovative and internationally competitive insurance sector; (b) protect policyholders and ensure the safety and soundness of firms; and (c) support insurance firms to provide long-term capital to support growth.
- 2.2 The reforms are being implemented through a combination of legislative changes and changes the PRA has made to its rules and policy materials.¹⁰ The reforms have resulted in simplifications to a number of areas within Solvency II, a significant cut to the risk margin,¹¹ improved scope for investment flexibility through measures around the Matching Adjustment (MA) (see the Matching Adjustment and investment flexibility section below), and measures to encourage entry to the UK market.
- 2.3 The reforms to the risk margin and MA will affect life insurers' overall financial resource requirements and allow a wider set of investment options to be eligible to receive a matching adjustment benefit, with the aim of promoting growth in the economy and facilitating the UK insurance sector's competitiveness. At the same time, the reforms will include new supervisory measures designed to maintain high standards of policyholder protection. The PRA-led stress tests, with the publication of individual firm results, are one of these key measures as set out in the November 2022 statement.

⁹ www.gov.uk/government/publications/solvency-ii-review-call-for-evidence.

¹⁰ Following consultation on the approach to adapting Solvency II for the UK market, the PRA published an explanation of the final policy and final rules in the following policy statements:

- PS2/24 – Review of Solvency II: Adapting to the UK insurance market www.bankofengland.co.uk/prudential-regulation/publication/2024/february/review-of-solvency-ii-adapting-to-the-uk-insurance-market-policy-statement;
- PS3/24 – Review of Solvency II: Reporting and disclosure phase 2 near-final www.bankofengland.co.uk/prudential-regulation/publication/2024/february/review-of-solvency-ii-reporting-disclosure-phase-2-near-final-policy-statement; and
- PS10/24 – Review of Solvency II: Reform of the Matching Adjustment www.bankofengland.co.uk/prudential-regulation/publication/2024/june/review-of-solvency-ii-reform-of-the-matching-adjustment-policy-statement.

¹¹ Risk margin is an addition to the Best Estimate Liabilities which aims to ensure that insurers have sufficient assets to transfer those liabilities to another insurer if required.

The Matching Adjustment and investment flexibility

- 2.4 The MA is a fundamental feature of the Solvency UK prudential regime. Insurers can apply to use MA for long-term, guaranteed business such as annuities, where the cashflows are largely predictable.
- 2.5 The MA is a mechanism that allows insurers to recognise upfront as capital resources a proportion of the investment return (in excess of the risk-free rate) that they project to earn over the future lifetime on the assets matching their MA liabilities. The MA calculation is set in legislation using assumptions about how much of the investment return on those matching investments can be earned with a high degree of confidence, and how much risk insurers retain during the life of these investments.
- 2.6 The rationale for the MA is that insurers with long-term liabilities (such as annuities) are typically buy-and-hold investors; provided they match the cash flows of their investment assets to those of their liabilities, they should rarely need to sell assets prior to maturity. They are not therefore exposed to changes in the market price of credit risk in the same way as other investors.
- 2.7 The MA provides a strong incentive for life insurers to invest in assets that closely match their liability cash flows, which helps to protect policyholders and reduce prudential risks. Where assets are included in insurers' MA portfolios, their regulatory solvency positions are not affected by short-term volatility in credit spreads on these assets, reducing the need for them to sell assets as market prices fall.
- 2.8 Under the Solvency UK regime, MA assets have to meet eligibility criteria, which are specified in legislation. For example, the asset cash flows must match the cash flows on the insurers' liabilities, and the vast majority of these asset cash flows must be fixed. The Solvency UK reforms give insurers more flexibility to use a wider range of assets in their matching adjustment portfolios. This includes widening the eligibility requirements to include assets with highly predictable cash flows, subject to some limits. The reforms also remove the limit on the amount of MA that may be claimed from sub-investment grade (SIG) assets.
- 2.9 The MA is applied as an increase to the liability discount rate; it is calculated by deducting a Fundamental Spread (FS) from the credit spread on the assets backing MA liabilities, based on a formula specified in legislation. The FS captures the risk of default or downgrade of an asset, with the size of the allowance depending on the asset's credit rating. This credit rating can either be a rating provided by an external credit rating agency or a rating assigned by the insurer, where the insurer has satisfied itself that its internal credit assessments are of a comparable standard to an external credit rating. The FS is intended to support policyholder protection by making allowance for the risks (predominately credit risks) retained by an insurer on the assets

matching its liabilities. Under Solvency UK, insurers can make additions to the standard allowance for the FS where they consider the basic FS to be insufficient. Additionally, PRA rules require firms that invest in assets with 'highly predictable' (rather than 'fixed') cash flows to apply an addition to the FS, in order that the FS reflects the additional cashflow uncertainty risks retained by the firm.

- 2.10 The Solvency UK reforms also include additional supervisory measures to hold insurers to account in maintaining safety and soundness and policyholder protection. The reforms require senior managers to attest to the PRA that the MA being claimed can be earned with a high degree of confidence and that the FS reflects compensation for all retained risks. The enhanced life insurance stress test with individual firm results publication is another such measure. The publication of individual firm results will provide additional information on the resilience of individual firms, strengthening market discipline. It will also deliver greater transparency around how insurers' balance sheets and core components of the regulatory regime, including MA benefit, evolve through financial market stress.
- 2.11 Since the standard FS allowance is calculated using a formula based on an asset's credit rating, a life insurer's solvency capital position may change in a stress depending on:
- a) whether the ratings applied to assets in insurers' MA portfolios appropriately reflect the underlying credit quality of the insurers' assets;
 - b) the level of losses experienced by an insurer in the event of different default or downgrade scenarios; and
 - c) what additional allowances an insurer might have made where they consider the standard FS allowance is an insufficient allowance for the risks they have retained.

One important purpose of the life insurance stress test is therefore to assess the resilience of life insurers' balance sheets under different credit risk default and downgrade scenarios.

3: Purpose and objectives of the life insurance stress test

- 3.1 The life insurance stress test supports the PRA's statutory objectives to maintain safety and soundness and policyholder protection. The stress test provides a quantitative, forward-looking assessment of the resilience of the sector and vulnerabilities of the individual firms within it.
- 3.2 The publication of individual firm results will provide stakeholders with a transparent independent measure of firm resilience. It will improve the ability of market participants to compare the strengths and weaknesses of different business models in a common economic scenario. It will also help other stakeholders such as defined benefit pension scheme trustees and their advisors to make informed judgements about counterparty risk when contemplating a transfer of pension liabilities to the insurance sector. For insurers, greater transparency could impact their cost of capital, opening opportunities for firms with more robust financial positions to benefit from the expanding market.
- 3.3 The publication of stress test results helps to promote informed choices by customers and capital providers alike by enhancing the availability of consistent and comparable risk-based information across the market. This in turn supports the PRA's secondary objective to facilitate effective competition between regulated firms, reducing the potential for weaker providers to compete unfairly. It also supports the PRA's secondary objective for international competitiveness and growth, by maintaining trust in the long-term sustainability of the sector and by helping to ensure that the UK life insurance sector has the financial resilience to provide long-term investment to support economic growth.
- 3.4 Stress test results also provide richer evidence to inform supervisory judgements, including insights into firms' risk management. The PRA will follow up any such findings in our assessment of key risks at firms and in setting supervisory priorities and work plans. As a result, the PRA anticipates stress testing will help to expand and enhance the risk management capabilities of firms.
- 3.5 The three objectives of the 2025 stress test are:
 - to assess sector and individual firm resilience to severe but plausible events;
 - to strengthen market understanding and discipline through individual firm publication; and

- to improve insight into risk management vulnerabilities.

3.6 Unlike the PRA's annual cyclical scenario bank stress test, the PRA life insurance stress test will not be used to inform the setting of capital requirements or buffers. UK insurers' capital requirements are determined by the Solvency II (in future, Solvency UK) framework, and firms set their buffers above these requirements based on their own risk appetite.¹² The stress test is expected to test a severe scenario, and therefore the PRA does not expect that all firms will necessarily show Solvency Capital Requirement (SCR) coverage of 100% or more following the stress scenario. This is not a pass-fail exercise. Furthermore, to ensure comparability, the stress test design sets limits on the management actions that firms may take. In practice, other management actions may also be available.

¹² SS4/18 – Financial management and planning by insurers sets out the PRA expectations concerning financial management and planning by insurers. Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss418.

4: Key components of the stress-testing framework for life insurers

Scope and participation

- 4.1 In deciding on participation for LIST 2025, the PRA has sought to achieve sufficient coverage to make the test useful for assessing sector resilience, while avoiding placing disproportionate costs on smaller insurers.
- 4.2 The 2025 stress test will apply to those UK insurers who participate in the Bulk Purchase Annuity (BPA) market and who have the largest annuity portfolios.
- 4.3 In a similar way to LIST 2022, LIST 2025 will be run on a solo basis: that is participants will be the PRA-regulated insurance companies who contract directly with policyholders.
- 4.4 Many of the participating entities will be subsidiaries of larger insurance groups and the PRA recognises that disclosure users may also want to understand the impact of a possible stress in the context of these wider groups. The PRA considers that ensuring a successful solo-entity exercise with the publication of individual results in 2025 provides a strong foundation for developing group-level disclosures in future. The PRA will continue to work with stakeholders to extend the stress testing methodologies and approach to cover group-level results in future exercises.
- 4.5 The PRA notified firms in scope of LIST 2025 in January 2024. With the participation of these firms, the PRA expects to cover at least 90% of the annuity liabilities across the sector. These firms are:
 - Aviva International Insurance Limited;
 - Aviva Life & Pensions UK Limited;
 - Canada Life Limited;
 - Just Retirement Limited;
 - Legal & General Assurance Society Limited;
 - Partnership Life Assurance Company Limited;
 - Pension Insurance Corporation plc;

- Phoenix Life Limited;
- The Prudential Assurance Company Limited;
- Rothesay Life plc; and
- Scottish Widows Limited.

Frequency and timings

- 4.6 The PRA anticipates running insurance stress tests every two years. The PRA considers that such frequency strikes the appropriate balance between delivering timely assessments of the individual firm and sector resilience, and the resource costs involved in generating those assessments. This frequency will also allow time between the exercises for the firms to develop models and make other improvements.
- 4.7 The PRA anticipates that the 2025 LIST will be run (from scenario launch to publication) over an eleven-month period, with the exercise being launched in January 2025, concluding by Q4 of the same year. The PRA considers that this is enough time for the PRA and in-scope insurers to conduct appropriate analysis and governance arrangements, while also ensuring the findings remain relevant when published. The PRA will continue to work with industry to look for improvements in the process and firms' capabilities to shorten the cycle in future.

Figure 1: Timeline for LIST 2025



Modelling insurers' balance sheets in stress

- 4.8 The PRA will specify scenario assumptions and a common methodology for firms to follow. The PRA will then rely on the firms to undertake the modelling and analysis required. For most firms, the starting point will be their approved internal model, which is used to recalculate the value of assets and liabilities under different economic conditions. Firms may need to extend or adapt their models, however, 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.

- 4.9 Firms will be expected to set out their modelling approaches and any assumptions made (beyond those set out by the PRA) in a 'Results and Basis of Preparation' qualitative report. This will include explanations of how they have approached any modelling challenges, satisfied themselves that they have met the required quality standard and applied the appropriate governance.
- 4.10 The PRA will perform quality assurance, and validation of firms' stress test submissions, to ensure that the methodology and scenario has been applied appropriately and consistently. Firms will be asked for a resubmission where this is not the case. The PRA does not intend to overlay or substitute firm results with any PRA-modelled results.

Scenario design

- 4.11 Life insurers in scope of LIST manage a number of material risks relating to the management of their annuity liabilities, their investments and their matching adjustment portfolios, including:
- Credit and asset performance risk on their long-term investments. This is made more complex by significant use of firms' own internal ratings for long-dated, credit-risky assets, internal securitisations, and the need to ensure appropriate management of assets with highly predictable cash flows now that these are permitted in MA portfolios under the new Solvency UK regime.
 - Longevity risk, which is often materially reinsured to external counterparties. The PRA's 2022 stress test feedback¹³ concluded that in this previous exercise reinsurer concentrations were well diversified. For this reason, LIST 2025 scenarios will focus on market stresses only, and the level of reinsurer diversification related to longevity will continue to be monitored through regular firm supervision.
 - Dependence on management actions in stress. Life insurers tend to accept certain risks and rely on their ability to execute certain management actions in stress, including portfolio rebalancing. The PRA's 2022 insurance stress test feedback¹⁴

¹³ January 2023: www.bankofengland.co.uk/prudential-regulation/letter/2023/ist-2022-report.

¹⁴ See footnote 13.

noted that concurrent reactions in stress might reduce the effectiveness of an individual firm's assumed management actions, particularly in volatile markets.

- Funded reinsurance (FundedRe). There has been an increased appetite for the use of FundedRe in the life insurance market to support growth in BPA transactions.¹⁵ This can result in an accumulation of counterparty risks on insurance balance sheets that is difficult to measure. The PRA has previously highlighted its concern that rapid growth in volumes and complexity of these arrangements could lead to a build-up of risks across the sector and risks to UK financial stability in the future.

4.12 To capture both current and emerging risks in the BPA market, the 2025 exercise will include one core scenario and two exploratory scenarios. The core scenario will focus on the most material financial risk exposures for the annuity writers, including credit risk. The exploratory scenarios will be designed to build industry's capabilities in the areas of emerging and evolving risks around: (a) asset concentrations, as firms' investments and credit risks change; and (b) FundedRe, given its growing use in the BPA market.

4.13 Having two types of scenarios will provide a richer set of information about the sector's vulnerabilities. The PRA will consider preserving this format for future life insurance stress tests.

Core scenario

4.14 The core scenario is designed and calibrated to assess sector and firm resilience. The purpose of the core scenario is to represent a 'severe but plausible' event for the life insurance industry. The scenario will reflect current material risk factors given insurers' business models today. Future core scenarios will evolve in response to changes in business models, economic conditions and any other factors that could change the material risks that affect life insurers.

4.15 For LIST 2025, the core scenario will consist of a financial market stress developing over three stages, similar in design to LIST 2022 (see LIST 2025 Scenario Specification, Guidelines, and Instructions¹⁶ for further details). The stages are designed to provide transparency to market participants on how the main components of the Solvency UK regime evolve in stress. The PRA intends to publish the core scenario results for each individual firm.

¹⁵ Speech by Charlotte Gerken: www.bankofengland.co.uk/speech/2023/april/charlotte-gerken-speech-bulk-annuities-conference.

¹⁶ www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2024/list-2025-scenario-specification-guidelines-and-instructions.pdf.

Exploratory scenarios

- 4.16 Exploratory scenarios allow the PRA to investigate emerging risks or vulnerabilities of insurer business models. These may often be in areas where modelling capabilities are still developing, and running a scenario as part of the stress test can help drive further improvement.
- 4.17 In general, the PRA expects the results of exploratory scenarios to demonstrate a range in the capability with which the firms can model and assess these risks. For this reason, the exploratory scenario results and findings will be disclosed only at sector level. The PRA will engage with firms individually and collectively to share good practices identified in the exercise.
- 4.18 Findings from the exploratory scenarios will inform the PRA's supervisory work and future stress test design and disclosure: specifically, depending on how the industry evolves, the exploratory scenarios in LIST 2025 may have features that are adapted and incorporated into future core scenarios.
- 4.19 For LIST 2025, the exploratory scenarios will cover:
- asset type concentration stress; and
 - FundedRe recapture stress.

Asset type concentration stress

- 4.20 As the BPA market grows, the PRA considers that insurers' investments and credit risks are likely to continue to broaden to new asset types. Solvency UK reforms also have the potential to further accelerate the change in firm's asset exposures.
- 4.21 As a result, in future stress tests, the PRA may specify stresses at the level of individual assets. This will allow assessment of idiosyncratic risks, concentrated exposures and uncertainties around firms' ability to earn the MA. The PRA's engagement with the firms highlighted that the industry does not currently have a comparable and consistent framework to assess such risks. As a stepping stone to this ambition, the LIST 2025 exercise includes an exploratory feature on asset concentration, with findings published at sector level.
- 4.22 Insurers will be asked to assess the impact of an additional downgrade stress to the asset type most material to their MA benefit (excluding corporate bond and sovereign assets). This will provide insight into a firm's reliance on a particular source of MA and their vulnerability to possible idiosyncratic risks, beyond a general economic downturn.

4.23 This scenario will also provide information on insurers' capability to apply shocks to specific assets. It will support development of the necessary modelling frameworks to assess such risks in a comparable and consistent manner across the sector.

FundedRe recapture stress

- 4.24 In recent years, the PRA has seen a growing appetite for the use of FundedRe arrangements in the UK life insurance market to support the writing of BPA business.
- 4.25 In November 2023, the PRA published a consultation paper¹⁷ setting out proposals on how the PRA expects firms to manage the risks associated with FundedRe at both an individual transaction and an aggregate level. This included an expectation that firms place limits on activity necessary to ensure sound risk management. The PRA expects to publish its final policy in July 2024.
- 4.26 Given the potential firm-specific and systemic risks, the PRA has made clear that it will monitor market practice as it evolves and keep under review whether there is a need for further policy and supervisory measures. The Financial Policy Committee has also welcomed the PRA's work in this area.¹⁸
- 4.27 The PRA intends to use the LIST 2025 exercise as a complementary way to test firms' ability to safely recapture the transferred risks under stressed conditions. For the 2025 exercise, firms will be required to show the impact of recapture under stress of all FundedRe arrangements with their most material counterparty.
- 4.28 As with the asset concentration stress, the PRA intends to build its insight into firms' potential vulnerabilities, and their capability to model collateral pools and the impact of recapture. This is why the FundedRe recapture stress is treated as an exploratory scenario in 2025, with findings published at sector level.
- 4.29 The PRA recognises that many stakeholders are interested in the industry's use of FundedRe. The PRA intends for the FundedRe stress to become a regular feature of life insurance stress tests with publication at the individual firm level in future exercises.

¹⁷ www.bankofengland.co.uk/prudential-regulation/publication/2023/november/funded-reinsurance-consultation-paper.

¹⁸ See pages 22-23 of www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2023/fpc-summary-and-record-december-2023.pdf.

Severity of the scenarios

- 4.30 For the core stress scenario, the PRA will target approximately a 1-in-100 year severity. This scenario will be calibrated with reference to historically observed market shocks as well as taking into account prevailing financial conditions.
- 4.31 The exploratory scenarios do not target any particular level of severity.
- 4.32 The PRA will publish the calibration of the stresses in January 2025, taking into account prevailing economic and financial conditions.

Publication of Results

- 4.33 The PRA plans to take the following high-level approach to the publication of results in LIST 2025:
- **Explanation of regulatory regime:** The PRA's engagement with industry and disclosure users has highlighted the need for education around the features of the regulatory regime and, in particular, around the concept and implementation of the MA. The principle of the MA is fundamental to the UK regulatory regime. Improving market participants' understanding of the MA and the way that it is implemented against a backdrop of broadening investments is important for understanding stress test results and establishing confidence in the insurance sector. As a result, the stress test publication will explain the results of the stress test in the context of the design of the MA and other elements of the regulatory regime.
 - **Scenario and approach:** The PRA will disclose information on scenarios, analytical methodology and any critical assumptions. This will ensure that key stakeholders can engage with the broad analytical approach of the exercise.
 - **PRA assessment of consistency and comparability:** The PRA will assess whether the submissions are sufficiently consistent and comparable, which, together with clarity on the scenario, our approach and objectives, is necessary to ensure that the publication of individual firm results can be properly understood. This may lead to requests for further information and/or resubmissions. The PRA will confirm its final assessment to participating firms shortly before publication.
 - **Results:** The PRA intends to publish results against a set of clear and understandable metrics. These will be at a sufficiently granular level to ensure that the results can be properly interpreted and support effective decision-making by market participants. For example, users of these results will be able to see the sensitivity of insurers' solvency positions to a set of pre-defined common set of risks and uncertainties, in the context of the regulatory regime.

As a result, potential investors and other stakeholders, including trustees of defined benefit schemes considering transfer to an insurer, will be able to make more informed choices in the UK life insurance market. This market discipline, as well as enhancing competition, should also incentivise the risk/reward decisions made by insurers that investors and policyholders expect, supporting policyholder protection.

4.34 The PRA acknowledges that stress tests inherently involve firm-specific, non-public information, and the PRA's approach to disclosure will be governed by what it considers to be the level of detail necessary to achieve the objectives of the stress test and to make sure that the results of the test are properly understood.

4.35 For the results of the LIST 2025 core scenario, the PRA expects to publish as a minimum:

- Information on each insurers' actual portfolio asset composition and risk exposure, including sources of MA, at the starting point. This will allow disclosure users to understand the risk profile of each insurer, providing a necessary context for their stress results.
- Solvency coverage ratio, and its most important components: Eligible Own Funds and Solvency Capital Requirements. These will be provided at the starting point and each stage, with a breakdown showing the most significant risk drivers, at the individual firm level.
- Additional metrics on each MA portfolio, demonstrating how the MA responds to stresses and the impact it has on the overall results.

4.36 The PRA will supplement these metrics with additional narrative based on the qualitative findings. These will focus on the sector rather than individual firms.

Reflecting changes in the regulatory framework

4.37 In the LIST 2025 results, firms will be asked to reflect new features of the Solvency UK regulatory framework in place by year-end 2024. The PRA recognises that there will be challenges in doing so, for example, firms may still be applying changes to their internal models to adapt to the new regime.

4.38 Another example is that, at the cut-off date (year-end 2024), balance sheets may reflect voluntary additions to the fundamental spread for some assets. These additions are to support firms' first attestation on the adequacy of the fundamental spread under the new regime. Firms may be planning further improvements as their approaches are still embedding.

4.39 For these reasons, the PRA will suggest simplifications for the treatment of some of these new regulatory features in the stress scenario. More detail can be found in LIST 2025 Scenario Specifications, Guidelines, and Instructions.¹⁹

¹⁹ www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2024/list-2025-scenario-specification-guidelines-and-instructions.pdf.