

Hot topics for life insurers

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Life insurers need to remain on top of an ever-changing landscape of regulatory changes, new developments and key trends. In this paper, Milliman consultants have summarised and provided insight on key topics relevant to the UK life insurance market for 2022 and beyond.

The topics have been grouped into general areas of interest relevant to firms selling various types of business.

These areas are:

- **General issues**, relevant to all UK life insurers, including:
 - The UK Review of Solvency II
 - Climate change and environment, social and governance (ESG) considerations
- **Unit-linked**, relevant to insurers with unit-linked business, including:
 - Potential capital management options
 - Challenges related to the symmetric adjustment
 - Update on contract boundaries
 - Launch of the Long-Term Asset Funds (LTAFs)
 - Update on packaged retail and insurance-based investment products (PRIIPs)
- **With-profits**, relevant to insurers with with-profits business, including:
 - Dealing with gone-aways in with-profits funds
 - Nonprofit conversion in a low interest rate environment
 - Recent with-profits restructuring
- **Annuities**, relevant to insurers with annuities, including:
 - Specific considerations for annuity writers as part of the UK Review of Solvency II
 - The Effective Value Test (EVT) under stress
 - The Continuous Mortality Investigation (CMI)
- **Protection**, relevant to insurers with protection business, including:
 - Interest rate risk management
 - Reinsurer counterparty/concentration risk
 - Other relevant issues to insurers with protection business

General issues

The following sections cover topics which are broadly applicable to firms holding all types of life insurance business. These topics are:

- The UK Review of Solvency II
- Climate change and ESG considerations

UK REVIEW OF SOLVENCY II

The UK government, in particular HM Treasury (HMT), and the Prudential Regulation Authority (PRA), have started to review the current application of Solvency II in the UK and to make amendments to the regulatory environment to tailor it to the UK insurance market. The review and subsequent amendments have arisen, and will continue to arise, from a number of different initiatives by HMT and the PRA, with further releases expected in the coming months and years. Only a limited number of aspects of the review or the possible amendments resulting from them have been fully confirmed at the point of writing, and there is still much uncertainty over what the future UK insurance regulatory landscape will look like.

HMT launched its [Call for Evidence](#) in October 2020 to gather views on the potential reforms of Solvency II and the future regulation of the UK insurance market. The Call for Evidence remained open until February 2021. On 2 July 2021, a follow-up paper was released by HMT summarising the [responses](#) received to the Call for Evidence on the Review of Solvency II.

Following on from HMT's Call for Evidence and its responses, the government has asked the PRA to model different options to better understand the potential impact of any reforms. To achieve this goal the PRA launched its [Quantitative Impact Study \(QIS\)](#) on 20 July 2021, followed by its [Qualitative Questionnaire](#) on 13 August 2021. The QIS exercise focusses on gathering data in the following areas:

- The Risk Margin
- The Matching Adjustment (MA)
- The calculation of the Transitional Measure on Technical Provisions (TMTP)

The deadline for submitting a response to the QIS exercise and the Qualitative Questionnaire was 20 October 2021, with completion of the exercise voluntary for firms.

Milliman consultants have published a series of more detailed papers on the UK Review of Solvency II, including:

- A paper summarising the information published to date as part of the [UK Review of Solvency II](#)
- A paper on the [PRA QIS Exercise](#), what it covers and what it will mean for firms
- A paper focussing on the [Qualitative Questionnaire](#) which accompanies the QIS exercise,

In summary, the QIS tests:

- Two alternative approaches to the Risk Margin calculation, one of which would reduce the Risk Margin for all insurers (the "Risk Tapering" approach), and another which would be likely to reduce the Risk Margin significantly for long-tailed business (the "MOCE" approach)
- Two scenarios related to the MA, under both of which the Fundamental Spread would become predominantly linked to a combination between the level of asset credit spreads and historical market credit spreads
- The impact of the alternative Risk Margin and MA scenarios when recalculating the TMTP

While the industry has generally welcomed signals that the Risk Margin would be reformed, there has been some concern relating to certain aspects of the QIS, for example that the scenarios related to the MA would lead to higher and more volatile capital requirements for annuity writers. However, the PRA has been at pains to emphasise that the scenarios tested do not represent specific policy proposals.

CLIMATE CHANGE RISK AND ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS

The trend towards investors demanding ESG fund options and for ESG considerations to be taken into account when investment decisions are made has continued over the past year. This places pressures on insurance providers (particularly those with investment-based policies such as unit-linked and with-profits policies) to ensure that their products and disclosures meet this demand.

As highlighted in the letter from the Financial Conduct Authority (FCA) to the chairs of Authorised Fund Managers (AFMs),¹ ESG and sustainable investment funds are the fastest growing area of the European funds market. The FCA letter aims to provide guiding principles to AFMs for the design, delivery and

disclosure of ESG investment funds, in response to having received a number of poorly drafted applications for funds with a sustainability or ESG focus. The principles are, however, merely guidance to help AFMs comply with existing legal requirements within the context of sustainable and ESG funds.

These principles entail ensuring that any ESG-related terms used in association with a fund fairly reflect the materiality of these ESG considerations when managing the fund, ensuring that appropriate resources are used to achieve ESG objectives, and that ESG-related disclosures should be prepared for consumers on an ongoing basis.

The FCA acknowledges the challenges associated with this rapidly growing area, for example in improving ESG data and metrics. There is currently no consistent classification of ESG factors, and therefore the way in which these factors are defined can vary considerably across market participants. Currently the EU taxonomy regulation² is the furthest developed attempt to provide a common language to identify the environmental sustainability of economic activities and is supported by disclosure requirements which also aim to achieve a degree of standardisation for social and governance matters. This is certainly an area that is attracting growing regulatory attention in the UK; the government has convened the Green Technical Advisory Group to oversee the introduction of a green taxonomy in the UK and, in the Chancellor's Mansion House speech,³ the introduction of economy-wide sustainability disclosure requirements and sustainable investment labels were announced, to allow consumers to compare the sustainability of their investments and streamline existing reporting requirements. In addition, the FCA recently launched a "digital sandbox," which allows firms to test and develop ESG-related products, with a focus on how technology can enable more transparent disclosure and help consumers understand the ESG characteristics of products available in the market. Such measures should go some way towards reducing these taxonomy challenges.

In addition to implications on investments, the growth of interest in ESG obliges insurers to consider the impacts on risk management, strategy and operations, particularly in light of the various upcoming requirements for insurers around climate change (often seen as one key components of ESG), such as the PRA's requirements under SS3/19⁴ and HMT's upcoming requirements for climate-related public disclosures,⁵ whereby climate-related disclosures which are aligned with the recommendations of the Task Force on Climate-Related Financial Disclosures⁶ (TCFD) will be required across the UK

¹ See <https://www.fca.org.uk/publication/correspondence/dear-chair-letter-authorized-esg-sustainable-investment-funds.pdf>.

² See https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en.

³ See <https://www.gov.uk/government/news/chancellor-sets-out-how-uk-financial-services-can-create-prosperity-at-home-and-project-values-abroad-in-first-mansion-house-speech>.

⁴ See <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319>.

⁵ See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf.

⁶ See <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>.

economy by 2025. Put simply, insurers need to ensure that their practices are ethically sound from an ESG perspective.

As well as the upcoming regulatory drivers, failure of insurance providers to consider ESG matters could lead to increased lapse risk, as policyholders become more conscious of the ESG credentials of assets held in policyholder funds, for example due to changing sentiment around investing in certain sectors, or due to concerns around the risks that climate change poses to asset values. Whilst unit-linked and with-profits providers may outsource the investment management of the assets within their funds, they remain responsible for managing the risks

associated with these investments and ultimately bear the risk of increased lapses. Many small and medium-sized insurance providers often rely on their external asset managers to ensure that their investments are environmentally and ethically sound, but insurers need to engage with their assets managers to ensure that this is the case for them.

In addition, there could be an opportunity cost if those managing investments do not consider new investment opportunities in green initiatives which could have huge potential for growth. The industry is starting to see ESG and climate-conscious products coming to market. For example, Prudential has introduced its “PruFund Planet” funds which are part of the Prudential With-Profits fund. Prudential says that the funds invest in a “*broad spectrum of positive outcomes from protecting to improving the planet; and covering areas such as clean technology and renewable energy to social enterprise.*” We expect to see such products become more common over the coming years.

These initiatives indicate some progress towards developing accepted terminology and standards with respect to defining sustainability concepts and disclosing sufficient information to investors to facilitate understanding of the sustainable and ESG features of a particular fund. Such developments will go some way to mitigating the risk that reputational or conduct issues could arise if firms are not clear on their definitions of ESG, their ESG strategy and how they measure success in terms of meeting their sustainability aims.

Given the increased focus on climate change risks and ESG matters we expect that it will be necessary for insurers to take various actions, including:

- **Incorporate ESG into internal and external reporting:** To comply with upcoming requirements, firms should be establishing clear public ESG disclosures. For example, this may include publishing TCFD disclosures as proposed in the FCA’s consultation paper CP21/17.⁷ ESG reporting should also be considered at the individual fund level, for example unit-linked and with-profits providers may consider adding references to ESG factors in fund fact sheets and annual reports.
- **Review fund investment strategy:** To review the current investment strategy of funds, for example to consider whether policyholders would have an expectation that a certain proportion of investments are in ESG assets, whether certain ESG investment metrics should be introduced and whether the ESG investment approach taken by the wider company is appropriate for all groups of policyholders, such as policyholders within a ring-fenced with-profits fund or Matching Adjustment fund.
- **Ensure a climate change risk framework is in place:** At a minimum it should be in line with the requirements in SS3/19. This encompasses elements of governance, risk management, scenario analysis and disclosure. For example, from a governance perspective ensuring that the board of directors is able to understand and assess risks relating to climate change and ESG issues, through board education and provision of relevant risk metrics and opinions, and ensuring that the board can articulate how climate change risk is factored into the company’s business strategy.
- **For with-profits business, updates to the Principles and Practices of Financial Management (PPFM):** Current PPFMs should be reviewed and updated to improve transparency of the approach to such issues. Whilst most PPFMs currently describe the investment strategy as one that aims to maximise returns subject to certain considerations, it is likely to be appropriate to draw out ESG factors as a further consideration.

Unit-linked business themes

In this section we cover topics relevant for insurers providing unit-linked business. These topics are intended to be of relevance to all life insurers with unit-linked business including the life insurance arms of asset managers. These topics are:

- Potential capital management options
- Challenges related to the symmetric adjustment
- Update on contract boundaries
- Launch of the LTAFs
- Update on PRIIPs

POTENTIAL CAPITAL MANAGEMENT ACTIONS

Through our work with unit-linked clients, we have seen firms use a number of different capital management tools. They include:

- **Reviewing and revising lapse rate assumptions:** Increasing the best estimate long-term lapse rate assumption in light of experience studies or updated expert judgement on future experience will result in a quicker runoff of business and therefore a smaller present value of future cash flows. This typically will increase the best estimate liability (assuming the business is profitable) but reduce the Solvency Capital Requirement (SCR) and Risk Margin and, all else being equal, result in a higher

⁷ See <https://www.fca.org.uk/publication/consultation/cp21-17.pdf>.

solvency coverage ratio. This holds true assuming that the decreases in SCR and Risk Margin are greater than any increase in a (negative) best estimate liability in respect of the non-unit fund. This action is only feasible where the experience analysis and expert judgement supports an increase, and some firms may need to decrease these assumptions.

- **Enhanced modelling of dynamic policyholder behaviour:** This involves making allowance in models for the ways in which policyholders might behave in a stressed scenario. After a mass lapse event, for example, would remaining policyholders be more likely to stay longer and thus reduce the long-term lapse rates in the mass lapse stress?
- **Developing management actions to be included in the best estimate liability (BEL) and SCR calculations:** Such actions would need approval and should reflect actual actions the business would be willing to take at a certain point in time, or if a certain scenario were to develop.
- **Mass lapse reinsurance:** This can be used to protect against the negative impact of a policyholder mass lapse event and can provide capital relief where the mass lapse stress is the biting lapse stress under the SCR. Mass lapse reinsurance can be used to trigger payments by the reinsurer when a significant lapse occurs over a defined period within a certain band. The period is generally one year, to coincide with the period used under the SCR stresses, and the band usually involves an attachment point (say 25%) and a detachment point (say 40%, which is the Standard Formula SCR mass lapse stress for retail business and therefore typically the maximum capital benefit which can be obtained).⁸ This in effect reduces the mass lapse stress from 40% down to 20% and reduces the overall capital required, provided that the insurer can demonstrate that the reinsurance represents a genuine transfer of risk. This capital management tool provides an SCR benefit only for the duration of the reinsurance contract (which may be as short as one year), and thus may only have a limited additional benefit in terms of reducing the Risk Margin. It should be noted that any use of reinsurance will, however, introduce additional risks such as counterparty risk.
- **Contract boundary reinsurance:** This is used to monetise future profits which are not recognised under Solvency II because they fall outside the contract boundary. It would typically be structured as a loan from the reinsurer to the insurer, which is then repaid by the insurer out of the profits that arise beyond the contract boundary. The benefit on the balance sheet therefore comes from the provision of the loan, which has a positive impact on Own Funds (as opposed to an SCR reduction).

⁸ See page 10 of EIOPA Consultation Paper on draft Supervisory Statement on the use of risk mitigation techniques by insurance and reinsurance undertakings.

- **Sharing of income with other companies within the insurer's wider group:** This can also help to reduce capital requirements. Through redirecting a proportion of charges received from policyholders to group entities, part of the income is recognised as an expense in the projection of cash flows, and thus the negative non-unit BEL, Risk Margin and SCR will typically reduce. The redirection of charges is often undertaken in exchange for the group covering the expenses of the insurer or as payment for outsourced services provided by another member of the group.

CHALLENGES RELATED TO THE SYMMETRIC ADJUSTMENT TO THE EQUITY RISK CHARGE

The symmetric adjustment for equity risk aims to mitigate pro-cyclicality by decreasing the Standard Formula equity stress when equity markets are already falling and increasing the stress when equity markets are rising. We have, however, observed that some firms do not find that the symmetric adjustment always works as intended in that they often experience a decrease in the solvency coverage ratio when equity markets are rising, and vice versa, causing unintended balance sheet volatility and a lack of alignment between the insurer's solvency position and what the insurer might perceive as its economic value.

This effect arises because, when equity markets rise, the increase in the equity risk SCR arising from the rise in the symmetric adjustment can offset the Own Funds benefit from the increased value of funds under management, and vice versa.

The index also introduces basis risk in that the equity index used in the calculation of the symmetric adjustment will often differ significantly from the equity exposure of an individual insurance company. Therefore, the effectiveness of the measure can be limited.

The PRA did review the calculation of the symmetric adjustment prior to the UK's withdrawal from the EU. As outlined in [PS27/20](#), "The Bank of England's amendments under the European Union (Withdrawal) Act: Changes before the end of the transition period," the calculation of the symmetric adjustment has been updated to use an equity index which is intended to be representative of the equities typically held by UK insurers⁹ (as opposed to EU insurers), which could reduce basis risk for UK firms. Firms have been required to use the symmetric adjustment calculated using this new index since 31 March 2021.

The symmetric adjustment is also subject to a floor or cap of +/-10%, which may not always be appropriate and which can increase challenges for insurers trying to manage their solvency positions. During the first few months of the COVID-19 pandemic, for example, the symmetric adjustment was floored at -10% but the symmetric adjustment preapplication of

⁹ See CP13/20, UK withdrawal from the EU: Changes before the end of the transition period for full detail of changes.

the floor was frequently lower. The European Insurance and Occupational Pensions Authority (EIOPA) has proposed¹⁰ that, for EU firms, the corridor be increased from +/-10% to +/-17%. Whilst it is unclear whether the PRA is considering such an option for the UK market, some European commentators¹¹ have objected to these proposals on the grounds that a widening of the corridor will increase the basis risk issue for firms and increase the volatility in solvency coverage.

Evidence shows therefore that, whilst the symmetric adjustment might be justified in that it is beneficial from a macroeconomic perspective in terms of reducing procyclicality, at the firm level volatility is introduced. Indeed, internal models typically do not make allowance for a symmetric adjustment or similar mechanism and so this volatility is primarily a consideration for firms using the Standard Formula.

In terms of unit-linked business specifically, whilst unit-linked funds are required to apply the symmetric adjustment when applying the equity stress, the aim of the measure to avoid procyclical investment behaviour is not hugely relevant to unit-linked business, given that the policyholders bear the investment risk. Thus capital charges are unlikely to affect their investment behaviour. Insurance Europe, for example, has therefore advocated making the application of the symmetric adjustment optional.¹²

CONTRACT BOUNDARIES UPDATE

In Europe, EIOPA published a [Consultation on the Revision of the Guidelines on Contract Boundaries](#) in July 2021. This consultation proposes new guidelines for unbundling insurance contracts for the purpose of contract boundaries. The amended Guideline 5 within this consultation paper clarifies that *“Insurance and reinsurance undertakings should consider that a contract can be unbundled for the purpose of contract boundaries if and only if two (or more) parts of the contract are equivalent in terms of risk to two (or more) contracts that could be sold separately.”* Equivalent in risk means that there is no material difference in insurance or financial risk borne by the firm. However, if all parts of the contract have the same contract boundary, then there is no need to unbundle.

EIOPA expects that unit-linked products are the products most likely to be impacted by this change. EIOPA states that where there is premium dependency between two parts of a contract, the contract should be unbundled for the purposes of setting contract boundaries. The example it offers is of a contract with a general account and a unit-linked part where the policyholder can choose which part of the policy to pay premiums into. As the risk of each part is equivalent to two separate contracts, the policy should be unbundled. Conversely, where risk dependencies exist, the policy should not be unbundled, for

example a unit-linked policy where the mortality cover depends upon the value of the unit fund.

In the UK, the PRA has not released anything specific on contract boundaries, although they are briefly referenced in the responses to the [HMT Call for Evidence on the Review of Solvency II](#). Under question 29, "other areas to consider for review," several respondents were reported to have raised the issue of contract boundaries. However, the report does not specify the particular issues raised. Given these responses, we expect that the PRA will consider the issues raised in the future.

LAUNCH OF LONG-TERM ASSET FUNDS

In May 2021, the FCA launched a [consultation](#) on proposals for a new category of fund, the Long-Term Asset Funds (LTAFs). The aim of launching the LTAFs is to provide a fund structure through which investors can invest efficiently, and more confidently, in less liquid assets. The hope is that the existence of these funds will support wider economic growth and a "big bang"¹³ in long-term UK assets, particularly to support investment in businesses and infrastructure projects from a wider array of investors.

Aside from offering an alternative investment opportunity to retail investors, the LTAF is attractive to unit-linked funds and defined contribution (DC) schemes that have long investment horizons. These illiquid assets can offer high expected returns to investors, making LTAFs an area of potential interest and growth for firms. The UK Department for Work and Pensions (DWP) recently found that two-thirds of DC schemes do not invest in illiquid assets, while the remaining third invest between 1.5% and 7%.

The FCA also proposed amending the permitted links rules, which will enable unit-linked funds and pension schemes to consider investment in LTAFs. The 35% limit on illiquid assets has now been removed where an LTAF forms part of the fund's investment through a carve-out in the permitted links rules.

To address consumer protection questions, the FCA convened the Productive Finance Working Group. The group is considering how to ensure that the wider ecosystem can operationally support the LTAF as a nondaily dealing fund, and in June released a [working paper](#) to HMT. This revealed that finding a suitable fund structure remains the main challenge, as well as discussion around fee disclosure requirements and the removal of the performance fee from the charge cap. The Working Group will continue to draw conclusions and has recently issued a press release setting out the group's recommendations for addressing the barriers to investment in less liquid assets.

¹⁰ See page 28 of EIOPA's Opinion on the 2020 review of Solvency II.

¹¹ See page 24 of the Insurance Europe position paper at <https://www.insuranceeurope.eu/publications/1638/views-on-eiopa-039-s-opinion-on-the-2020-review/download>.

¹² See <https://www.insuranceeurope.eu/publications/1638/views-on-eiopa-039-s-opinion-on-the-2020-review/download>.

¹³ See <https://www.gov.uk/government/news/prime-minister-and-chancellor-challenge-uk-investors-to-create-an-investment-big-bang-in-britain>.

The FCA released a policy statement¹⁴ (PS21/14) in October finalising the rules for LTAFs, with further consultation expected in 2022 on the potential to widen the distribution of LTAFs further.¹⁵ Appendix 1 of PS21/14 contains the final rules and guidance, which came into force on 15 November 2021.

PS 21/14 also covers feedback on the amendments to the permitted links rules. The FCA says that it remains “*open to potentially extending the distribution of the LTAF where investors in a long-term unit-linked product have either professional support on fund selection or are guided through an appropriate choice architecture.*” In terms of wider overhaul of the permitted links rules however, it says that this remains to be determined.

PRIIPS UPDATE

In July 2021, the FCA published consultation paper [CP21/23, “PRIIPs – Proposed Scope Rules and Amendments to Regulatory Technical Standards,”](#) seeking stakeholders’ views on proposed amendments to existing EU regulation¹⁶ covering key Information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs).

The proposals include changing the Regulatory Technical Standards (RTS)¹⁷ laid down in regulation [EU 2017/653](#) to mitigate the potential for inappropriate performance scenarios and Summary Risk Indicators (SRIs) being presented in the KID. Specifically, the FCA proposes to remove the performance scenarios from KIDs; instead, PRIIPs manufacturers would be required to describe narratively the factors that could materially influence future performance. Additionally, it is proposed that PRIIPs manufacturers upgrade their products’ SRIs if they believe that the rating produced by the RTS methodology is too low.

For unit-linked firms required to produce KIDs in respect of their funds, the removal of the performance scenarios will reduce the workload and cost involved in producing a KID for a given product. However, the change does put significant responsibility on firms to decide what to include in the narrative disclosures. Furthermore, the proposals from the FCA do not address the underlying cause of the problems with the SRI methodology, and it is unclear whether the FCA intends to amend the methodology for calculating the SRI in the longer term.

Further more detailed information and discussion of the proposals can be found in Milliman’s paper “[FCA consultation on proposed rules and amendments to PRIIPs regulation.](#)”

¹⁴ See <https://www.fca.org.uk/publication/policy/ps21-14.pdf>.

¹⁵ See <https://www.fca.org.uk/news/press-releases/fca-finalises-rules-new-type-fund-designed-invest-efficiently-long-term-assets>.

¹⁶ Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products. See <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014R1286>.

With-profits business themes

The following topics are likely to be of relevance to firms holding with-profits business. These topics are:

- Dealing with gone-aways in with-profits funds
- Nonprofit conversion in a low interest rate environment
- Recent with-profits restructuring.

DEALING WITH GONE-AWAYS IN WITH-PROFITS FUNDS

The issue of gone-away policyholders in with-profits funds is one that has been in the spotlight for quite some time. However, practice still varies quite considerably among insurers as to how this issue is being addressed. In January 2021, the government response to the consultation on expanding the Dormant Assets Scheme¹⁸ confirmed that with-profits fund assets would be excluded at this time, and so the expectation is that insurers themselves can (and should) manage the issue of gone-aways within their own with-profits funds.

This article covers the different categories of gone-away policyholders, noting that there is likely overlap between these groups, and what insurers may do to address the associated issues.

Uncontactable policyholders

These are policyholders in respect of which firms do not hold an up-to-date address. There can be many possible reasons for this, including:

- Industrial branch business where the original details may have been held as paper records or with no address ever recorded.
- Historical business transfers (with associated administration systems changes) or inadequate data management, resulting in contact details being lost over time.
- Policies with limited or no customer contact points, for example where whole of life policies have passed their last premium date.
- Policyholders have changed address but have not provided the new address to the insurer.

There are several options available for tracing uncontactable policyholders, for example the DWP offers a tracing and prepaid letter forwarding service, or the policyholder’s bank may hold an up-to-date address if premiums are still being paid by direct debit. Indirect approaches such as media advertising campaigns may be used. There are also many specialist tracing companies in the market that may not have been available when tracing was last considered by the insurer.

¹⁷ The PRIIPs RTS sets out the detail of and methodology for the information which must be disclosed in the KID.

¹⁸ See <https://www.gov.uk/government/consultations/consultation-on-expanding-the-dormant-assets-scheme>.

One of the key considerations in these tracing exercises is who will cover the costs of the exercises if this is not clarified by an expense deal with the with-profits fund. The tracing costs may be expected to be met by the inherited estate of the fund; however, for proprietary firms, if addresses have been lost by the insurer it may be considered more appropriate for the shareholder to meet some or all of the costs of the tracing exercise. There is also the question of whether it could be permitted to deduct the cost of tracing from the eventual claim payment itself, although it is not apparent that this approach has been taken by with-profits firms to date or that it would be permitted by the FCA.

Some of the specialist tracing companies also offer payment on a “success fee” basis so that fees are only paid for the policies that are successfully traced. However, this structure is unlikely to be offered for so-called “lost causes” such as industrial branch business with no address records whatsoever.

The key challenge once policyholders have been traced is to then convince those policyholders to take their funds. For some methods of tracing, a forwarding address won't be provided to the insurer, but the policyholder will instead be contacted. Thus there is a reliance on the policyholder re-establishing contact in response. This can be challenging as policyholders are wary of scams, particularly if they do not remember taking out their policy or if it has transferred to a different insurer.

It should be noted that success rates from tracing exercises can be very varied depending on the business and so, while undertaking a tracing exercise is important, it is likely some gone-away policies will remain. It may also be sensible to periodically repeat tracing exercises on policies as policyholders can reappear, for example if they were out of the country at the time the last tracing exercise was undertaken.

Unclaimed matured policies

These are policies that have passed their maturity date, but the beneficiaries haven't claimed their funds, and up-to-date contact details are not available.

A particular example of this is Child Trust Funds (CTFs) that are beginning to mature, but early data indicates many maturities have not resulted in any action from the holders of these CTFs. These policyholders are particularly challenging to trace given their age, as it is unlikely there will be substantial financial history available to be used for tracing. The policy values are also small and so tracing costs can be high by comparison.

Following tracing and attempts to reunite policyholders with their funds, good practice may be to start to write off some of these funds so that they can be distributed to the remaining policyholders in the with-profits fund. A fairly simple way to do this is to write these funds off over a chosen time period, that is, the BEL held for these policies may be reduced proportionately based on the period since maturity. These reduction assumptions could be linear or they could be more

complex, based on experience data. The possibility that with-profits policies may be brought within the scope of the Dormant Assets Scheme in the future adds to the uncertainty.

Incurred but not claimed – deaths

Policyholders who have died but their policies have not been claimed are not so easily identified, as there is no fixed date at which insurers would expect them to be claimed. It may be possible to consider the age profile of the policies still marked as in-force. For example, there may be a disproportionate number of policyholders over the age of 100. Alternatively, claim rates could be compared to industry mortality tables, with material divergence from them (without a reasonable explanation based on the population) potentially indicating a material volume of incurred but not claimed deaths.

Similar to unclaimed matured policies, having identified that death claims are lower than expected deaths, good practice would be to reduce the BEL to allow these funds to be distributed to the remaining policyholders in the with-profits funds. A reasonably common but simple approach is to write off all unclaimed policies once the holder of these policies reaches a suitably high age, say 100. However, this approach may not allow for funds that are expected to be unclaimed to be recycled for distribution to other policyholders soon enough, particularly for closed with-profits funds in fast runoff.

More sophisticated approaches may be taken, such as deriving assumptions for the likelihood that a claim will ever be made for different cohorts, based on experience of the difference in claim rates observed compared with those expected from the industry mortality tables. This process can be used to allow for expected future claim rates, not only for those policyholders already expected to have died, and would reduce the potential issue of writing these policies off too late, creating a tontine risk.

Summary

In summary, the problem of gone-aways is not itself going to go away.

Insurers need to be proactive in attempting to trace uncontactable policyholders to either reunite policyholders with their funds, or to accept that those policyholders are unlikely to be found. This will allow assumptions to be made about the likelihood of future claims from gone-away policies, and to write off a proportion of these policies to allow the funds to be distributed to the remaining policyholders.

The challenge in writing off gone-away policies is often taking the first step to make some allowance within the BEL. Once assumptions have been made about the proportion of gone-away policies to write off, these assumptions will simply form part of the regular assumption-setting processes already undertaken. The assumptions can be adjusted over time for new information, just as with any other assumption made in valuing the business.

Finally, not having such processes and assumptions in place can cause significant delays in restructuring a with-profits fund where the value of the estate needs to be locked in. This is particularly true where a process such as a scheme of arrangement is to be used, as the regulators and the High Court will also expect reasonable endeavours to have been taken to find uncontactable policyholders to allow them the opportunity to vote.

NONPROFIT CONVERSION IN A LOW INTEREST RATE ENVIRONMENT

Many with-profits funds are now in runoff, and with the various issues that arise as funds decline in size or with sunset clauses potentially approaching, insurers are now considering how to approach the termination of their with-profits funds. One possible method is conversion from with-profits to non-profit; however, this approach is not without its challenges, particularly in the current low interest rate environment.

One of the key issues to address when converting to non-profit is arriving at an appropriate cost of capital rate. Following conversion, the increased capital requirements associated with the policies would be borne by shareholders or, in the case of a mutual company, the mutual's main fund. Compensation is therefore required to allow for the opportunity cost of backing these capital requirements with low-risk investments, and this is typically allowed for by applying a cost of capital rate when determining the conversion terms. The rate chosen is critical, particularly for a mutual where a balance needs to be struck among the interests of different groups of policyholders, and the chosen rate can have a significant impact on the value of the policyholders' converted non-profit benefits.

As a result, one may ask, is it possible to offer a non-profit sum assured that is attractive to policyholders in current conditions?

To examine this, the expected maturity value of a with-profits policy has been compared to the sum assured that could be offered on an equivalent non-profit policy. If a policyholder were to surrender today, assuming that their with-profits policy is a single-premium endowment with an outstanding term of 10 years, an asset share of £10,000 and a share of the estate of 20% of the asset share, the policyholder would receive £12,000 (assuming that the fund has an immaterial SCR and therefore assets do not need to be held back from being distributed in order to support capital requirements). Let's assume now for this example that this policy is in a with-profits fund that has just reached the point at which the with-profits policies within the fund may be converted to non-profit under the fund's sunset clause. In this case, the £12,000 surrender value could be used by the insurer to purchase a non-profit single-premium endowment with a term of 10 years, to effect the conversion from with-profits to non-profit.

¹⁹ Assuming fixed interest assets earn 1.5% p.a., equities earn 4.5% p.a., an equity backing ratio of 33% and a tax rate of 20%.

To assess whether this conversion would be attractive to policyholders, the sum assured that could be offered at different levels of shareholder return can be compared to the amount a policyholder would have expected to receive when their with-profits policy matured after 10 years.

Assuming an investment return of 2% p.a.¹⁹ could have been achieved by holding a mix of equity and fixed interest assets within the with-profits fund, the policyholder would expect to obtain a maturity value of £14,616 from their with-profits policy after 10 years.

By way of comparison, the non-profit sum assured that could be offered using the £12,000 surrender values to purchase a non-profit single-premium endowment has been calculated, assuming Own Funds are held at 130% of SCR, assets are invested in gilts earning 1% p.a. and expenses of £40 p.a. are incurred, growing with inflation. Whilst these assumptions are illustrative in nature, plausible variations in them do not alter the broad conclusions. In addition, tax and lapses have not been included within the calculations for this simple example.

The table in Figure 1 shows the sum assured that could be offered on the non-profits policy for different levels of shareholder return, and the reduction in benefit when compared to the expected with-profits maturity value.

FIGURE 1: SUM ASSURED BY SHAREHOLDER RETURN

Shareholder return p.a.	Sum assured	Change in policyholder benefit
0%	£12,848	-12.1%
3%	£12,507	-14.4%
6%	£12,244	-16.2%
9%	£12,039	-17.3%

In this example, even if shareholders did not require any return for providing the capital requirements of the business, policyholders would be required to accept large reductions in benefits if their with-profits policy were to convert to non-profit. Further, if the shareholder return was set to 6% p.a. (in line with the Solvency II Risk Margin) or higher, then policyholders would receive a sum assured only marginally above the current surrender value of the policy.

Whilst it would be reasonable for policyholders to expect some level of reduction in benefit when converting to non-profit in return for the increased benefit certainty, this example illustrates that the capital requirements for a non-profit policy coupled with the current low interest rate environment makes it challenging to offer non-profit conversion terms that represent good value for money to policyholders.

Further consideration of the approaches to resolving with-profits funds can be found in Milliman's paper "[The with-profits end game.](#)"

RECENT WITH-PROFITS RESTRUCTURING

Over the last few years an increasing number of insurers have decided that it would be in the best interest of their with-profits policyholders to cease to maintain the with-profits fund as a standalone fund or sub-fund, in advance of the existing sunset clause. The two main approaches taken by insurers to implement this are: amending the sunset provisions in the existing governing scheme or utilising a scheme of arrangement.

The ability to cease to maintain a with-profits fund by amending the scheme will only be possible if the terms of the existing scheme permit such a change, where it is likely the required process will be prescribed by the scheme itself. The requirements for making such amendments to existing schemes can therefore be quite different between with-profits funds.

A scheme of arrangement is a legal process that is governed by Part 26 of the Companies Act 2006, which requires a policyholder vote followed by the subsequent sanction of the High Court.

The relative advantages and disadvantages of these two approaches are considered below.

Approval of the High Court

Ultimately, a scheme of arrangement can only proceed once it has been sanctioned by the High Court. On the other hand, depending on the provisions of the existing scheme, it may not always be necessary to return to the High Court in order to make certain changes to a scheme.

For example, the scheme which transferred the Refuge Assurance Industrial Branch (RAIB) sub-fund to the Royal London Mutual Insurance Society (Royal London) contained a provision that allowed certain changes to be made to the sunset clause without the need to consult the High Court.

Report of an independent expert

Whilst the Companies Act 2006 does not stipulate that a report by an independent expert must be produced for the High Court under a scheme of arrangement, recent restructurings of with-profits business using a scheme of arrangement have been accompanied by the report of an independent expert; a precedent has now been set. It is likely that both the regulators and the High Court would expect an insurer's application to the High Court to grant an order convening a scheme meeting (a necessary step in the process of a scheme of arrangement where policyholders vote on the scheme) would be accompanied by a report by an independent expert commenting on the fairness of the offer under the scheme. This would likely also include providing a supplementary report from the independent expert commenting (among other things) on the results of the policyholder vote for the sanction hearing for the scheme.

A report by an independent expert may not always be required to amend the terms of the scheme, but where such a report is required the scope will likely be specified in the existing scheme. For example, when the Prudential Assurance Company Limited (Prudential) merged its Scottish Amicable Insurance Fund (SAIF) with its With-Profits Sub-Fund (WPSF) before reaching the conditions specified in the SAIF sunset clause, a report by an independent expert was produced as required by the modification provisions of the existing scheme. However, the scope of this differed from the scope typically seen in reports from independent experts under schemes of arrangement. The independent actuary considered the consequences of the changes to the existing scheme only for the policyholders of SAIF, as consideration of the impact of the changes for the policyholders of the WPSF was not a requirement.

Policyholder vote

For the High Court to sanction a scheme of arrangement, it is first necessary for certain voting thresholds to be met. Policyholders are asked to cast a vote on the offer, and the Companies Act 2006 requires a majority of voting policyholders to vote in favour of the scheme in each voting class, representing at least 75% in value of each voting class. Each voting class contains groups of policyholders with broadly the same rights and/or interests within the context of the scheme of arrangement. Therefore, under a scheme of arrangement the offer being made to policyholders needs to be sufficiently attractive for the policyholder vote to meet these voting thresholds. The policyholder vote also significantly increases the volume of information that needs to be provided to policyholders. This information needs to be clear, unbiased and provided in good time ahead of the vote, so that policyholders can make informed decisions on how to vote based on their personal circumstances.

To make amendments to an existing scheme, it is unlikely that there would be a requirement for a policyholder vote. This can have both advantages and disadvantages. The advantages are that there is no risk of the changes being rejected by policyholders and there is no requirement for policyholders to take action and make a decision on how to vote. The main disadvantage is that it may be difficult to gauge the sentiment of the policyholders in respect of the changes being proposed. However, depending on the materiality of the change, this policyholder feedback may or may not be required in any case.

Scope of amendments

Under a scheme of arrangement, the scope of amendments that can be made is broad as these schemes are effectively offering a compromise to policyholders, redefining previous terms and conditions. It would be possible to make changes to products (such as removing guarantees in exchange for an uplift to policy values) to convert policies to a different form (such as moving from with-profits to unit-linked) or to allow for additional deductions from the estate of the with-profits fund that would not be allowed under existing sunset provisions

(such as a charge for the cost of capital if the responsibility for meeting capital requirements were to be transferred to a different with-profits fund). Given how broad these amendments can be, it is important that customers are treated fairly when changes are made, which is perhaps the key driver for independent experts typically being used when these schemes of arrangement are undertaken.

The scope for such significant changes may be limited under modification provisions in existing schemes, which can reduce the feasibility of using this approach to resolve a with-profits fund in advance of the sunset clause.

Conclusion

Whilst in many ways an amendment to an existing scheme may be viewed as a simpler process, it is not always a possibility as it will depend on the exact terms of the existing scheme. In addition, the schemes are likely to only permit limited changes and, therefore, anything more material would likely require a scheme of arrangement. Thus, careful consideration should be given to which approach best suits the aims of the desired changes, balancing the complexity of the process (including cost implications and whether policyholders need to be engaged to make a decision) with a fair outcome for policyholders.

Annuity business themes

The following topics are likely to be of relevance to firms holding annuity business. These topics are:

- Specific considerations for annuity writers as part of the UK Review of Solvency II
- The application of the EVT under stress, as required under SS3/17, "Solvency II: Illiquid unrated assets"²⁰ (SS3/17)
- The Continuous Mortality Investigation (CMI)

UK REVIEW OF SOLVENCY II

As described above, as part of the UK Review of Solvency II, in order to better understand the potential impact of any reforms, the PRA launched its QIS followed by its Qualitative Questionnaire. The QIS focusses on two key areas: the Risk Margin, and the MA. The MA is likely the area of most interest to annuity firms, including the MA scenarios considered in the QIS and the possible implications on firms' MA portfolios and investment management if these scenarios were to form the basis of changes to the operation of the MA. Milliman consultants have published two papers discussing the options considered by the PRA (one on the [PRA QIS Exercise](#), and the other on the [Qualitative Questionnaire](#) which accompanies the QIS exercise).

²⁰ See <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2020/ss317-update-april-2020.pdf>.

More recently, Milliman consultants held a webinar which discussed, among other topics, the potential impacts of the two MA scenarios considered in the QIS, based on a notional liability portfolio and a conservative and a specialist asset portfolio.

Our conclusion from the analysis is that the first of the two options proposed by the QIS (Scenario A) offers a similar profile for the MA benefit as the current Solvency II framework, but at a reduced level. Meanwhile the second option (Scenario B) keeps the illiquidity component more consistent as credit spreads change, which results in lower levels of MA benefit as spreads widen than with the current Solvency II framework.

Our analysis considers that addressing two of the challenges with the current Solvency II framework is going to be particularly difficult, They are:

- As spreads change, for the MA to better reflect a sharing of that change between the Fundamental Spread and illiquidity
- To maintain mitigation of procyclicality and viability of long-term buy-to-hold investment strategies

However, we note that the PRA has made clear that the options tested in the QIS are to inform policy changes only and should not be viewed as indicative of future policy proposals.

EVT UNDER STRESS

Equity release mortgages (ERMs) are often used as an asset to back annuity liabilities. In order to meet the cash flow fixity criterion that applies to MA portfolios, firms restructure ERMs by securitising the cash flows, creating *senior notes* with fixed cash flows (which contribute to the MA itself), and a *junior note* through which residual ERM cash flows can accumulate.

SS3/17 sets out the PRA's principles for assessing the MA benefit on ERMs. It does this via the EVT, which firms should apply as a diagnostic test to identify where the MA is potentially excessive. The EVT requires a comparison of the value of ERMs plus the MA benefit (the "Effective Value") to an "Economic Value" of the ERMs which uses a prescribed approach (risk-neutral) to the no-negative equity guarantee (NNEG). The NNEG requires a deferment rate and a property volatility parameter, for which the PRA sets minimum or prescribed values.

SS3/17 also requires that, from 31 December 2021 at the latest, insurance firms evaluate the EVT under stressed scenarios as a validation technique on the MA benefit assumed in their SCR calculations. SS3/17 sets out several principles that firms are required to consider when setting the EVT under stress, but nonetheless it is proving to be challenging to implement the requirements around EVT in stress in practice for many firms.

CONTINUOUS MORTALITY INVESTIGATION

One other relevant area for annuity firms is the publication of the 2020 calibration of the CMI's mortality projections model (CMI_2020) by the Mortality Projections Committee²¹ in March 2021. The publication was accompanied by [CMI Working Paper 147](#), as well as by a [frequently asked questions](#) page which provides a brief overview of mortality improvements.

The mortality experience shown in the publication indicates a relatively high increase in the standardised mortality rates in England and Wales because of the coronavirus pandemic. It is not surprising that the 2020 mortality experience is considered an outlier and not indicative of the future path that mortality rates will follow. For this reason, the standard version of CMI_2020 places no weight on the data for 2020 when projecting mortality rates, but firms can choose to take account of data for 2020 fully or partially.

Insurers will face a particular challenge when setting assumptions for the 2021 year-end around the assumptions they make in respect of future changes in mortality rates, as the pandemic has introduced a number of additional areas of significant uncertainty to an area that is already highly uncertain. These additional areas of uncertainty include the direct impact of deaths from COVID-19 and indirect impacts arising from lifestyle changes, economic changes, delayed medical interventions and forward displacement.²²

Protection business themes

In this section we discuss technical issues affecting providers of protection business, for example term assurance, whole life, critical illness and income protection business. These topics are:

- Interest rate risk management
- Reinsurer counterparty and concentration risk
- Other relevant issues to insurers with protection business

It is typical for providers of protection business, particularly long-term protection business, to externally reinsure a high proportion of the claim risk. This is because reinsurers have sufficient volumes and quality of experience data to be able to offer attractive terms to cedants, whereas individual insurers may not have the level of experience data or research and development (R&D) capabilities to allow them to make assumptions around claim levels that are as favourable as those implied by reinsurance premium rates. Reinsurance terms are often sufficiently attractive that they can result in significantly positive reinsurance recoverables for the insurer, in addition to the Risk Margin and SCR benefits of the reinsurance, and the competitive nature of the protection

market means that it can be challenging for insurers without reinsurance in place (particularly monoline providers) to offer attractive pricing.

However, the extensive use of reinsurance does not mitigate all challenges associated with managing a protection portfolio. In particular, reinsurance structured on a "risk premium" basis²³ will reduce the insurer's claim-related risks (i.e., mortality or morbidity risk) but does not pass on market risk or persistency risk to the reinsurer.

INTEREST RATE RISK MANAGEMENT

For long-term protection business (for example non-profit whole life), market risk can be challenging to manage, particularly interest rate risk. The cash flows on protection portfolios can be extremely long-dated, with the duration of premium inflows often being significantly lower than that of future claim outflows and (in the case of business subject to risk premium reinsurance) reinsurance premium outflows. This results in a significant sensitivity of the BEL (net of reinsurance recoverables) to changes in long-term interest rates; in particular, a reduction in long-term interest rates can result in a significant increase in BEL, as well as significant increases to the SCR and the Risk Margin.

Interest rate sensitivity can be a challenge for all insurers, but it is a particular challenge for protection providers owing to the tendency of protection business to have a negative BEL; this means that protection providers do not generally have the ability to build up investment portfolios that are large enough to allow them to use their assets to offset the interest rate sensitivity of their liabilities and capital requirements. Consequently, protection providers may deem it necessary to enter into interest rate hedging arrangements using either interest rate swap or swaption instruments. Interest rate swaps can be relatively simple to manage, but the requirement to post margins can result in significant liquidity implications under which a relatively modest increase in interest rates could exhaust the liquid resources of the insurer. By contrast, an interest rate swaption which protects against falls in interest rates does not have the same liquidity implications, but it does result in an initial outlay which would not be expected to be recouped, and the calibration and management of a swaption portfolio can be complex.

The management of interest rate risk can be a time-consuming and challenging exercise for the management teams of protection providers, and more generally it is somewhat counterintuitive that the financial performance of such business depends so significantly on the level of interest rates rather than, for example, the quality of the company's underwriting processes or the strength of the company's franchise.

²¹ See <https://www.actuaries.org.uk/learn-and-develop/continuous-mortality-investigation/cmi-news>.

²² Forward displacement refers to an effect whereby the deaths from COVID-19 of individuals in already poor health is thought of as an acceleration of such

deaths, meaning that lower mortality rates would be expected in future as a result of the remaining population being, on average, healthier.

²³ Under risk premium reinsurance, the reinsurance premium for a given policy in a given year is in proportion to the expected claims under the policy during that year.

REINSURER COUNTERPARTY/CONCENTRATION RISK

The use of reinsurance for protection business can result in very significant counterparty and concentration risk to a small number of reinsurers, particularly as reinsurance often provides a solvency benefit through both positive reinsurance recoverables and a risk-mitigating reduction in SCR and Risk Margin. This level of reinsurance can result in a very severe solvency impact in the event of a reinsurer defaulting on its obligations. In light of the solvency and strategic benefit arising from the use of reinsurance, the risk of reinsurer default is likely to be a highly rewarded risk and is also likely to be within the insurer's risk appetite, but nonetheless is something that the insurer will need to monitor closely as part of its business planning, own risk and solvency (ORSA) and recovery and resolution planning processes. In addition, it may become necessary for insurers in this situation to consider expanding the range of reinsurance counterparties with which they transact; however, given the competitive pricing levels in the protection market, this is likely to be challenging if it would mean transacting with a reinsurer offering less attractive reinsurance rates than the insurer's preferred counterparty.

OTHER RELEVANT ISSUES

Other issues facing protection providers include:

- **The impact of COVID-19 on claim levels:** To the extent that insurers are not fully protected by reinsurance, additional death claims arising from COVID-19 are likely to have been a drag on profitability. Even for those protected by reinsurance the impact of high claim rates is likely to have caused liquidity or operational strains in some cases.
- **The impact of COVID-19 on actuarial assumptions:** Protection providers will need to understand the potential impact on future claim levels of COVID-19's direct and indirect effects. This will involve a complex, forward-looking analysis to piece together competing effects, such as:
 - The potential level of future deaths directly linked to COVID-19
 - The impact that COVID-19 has had on other causes of death, for example as a result of delayed or cancelled medical screenings and treatment, and as a result of the impact of the pandemic on mental health
 - The potential impact of long COVID-19 on future mortality and morbidity rates
 - The "forward displacement" effect of COVID-19, whereby the concentrated impact of COVID-19 deaths on groups in poorer health could result in the surviving population having lower mortality rates on average than the pre-pandemic population

- The potential impact of rapidly changing economic conditions on claim inception rates for income protection business, particularly in light of the end of the UK's furlough scheme
- Changes in lifestyle choices as a result of, for example, the much increased proportion of people choosing to work from home

Additionally, there may be a COVID-19-related impact on future persistency rates; as for claim rates, assessing this will involve making judgements around competing effects. For example, an economic downturn may make holding an insurance policy less affordable, but on the other hand people may value insurance that protects them against sickness or death more as a result of COVID-19 than prior to the pandemic.

- **Management of persistency risk:** Lapse risk is likely to be a significant component of the SCR of protection providers, with the biting stress for Standard Formula insurers potentially switching regularly between "lapse down" and "mass lapse," potentially depending on the level of interest rates.²⁴ This dynamic can make the insurer's capital position complex to manage. Level premium reinsurance²⁵ or coinsurance²⁶ allows the insurer to pass on lapse risk to the reinsurer, but such reinsurance coverage is likely to come at a premium that could reduce the insurer's ability to price competitively. This could bring about the potential to consider more innovative forms of reinsurance, such as targeted "mass lapse" or "lapse down" reinsurance.
- **Liquidity risk:** Long-term protection business is generally liquidity-consumptive at the point of sale, as the costs it incurs in meeting its own expenses and commission payments to distributors generally significantly exceed the premium received during the first year of the policy. This brings about the need for the insurer to maintain significant levels of liquid resources if it is selling large volumes of new business without a sufficiently large liquidity-generative back-book.
- **LIBOR-SONIA transition:** The change in the UK Solvency II discount curve from being LIBOR-based to being SONIA-based (effective from 31 July 2021) is likely to have resulted in an adverse solvency impact for providers of long-term protection business, as the discount curve reduced as a result of this change. Moreover, there will have been no offsetting impact available from investments or hedging instruments.

²⁴ A fall in interest rates would be likely to increase the size of the "lapse down" component of the SCR and reduce the size of the "mass lapse" SCR component, and vice versa.

²⁵ Under level premium reinsurance, the reinsurance premium for a given policy remains level throughout the term of a policy.

²⁶ Coinsurance involves sharing an agreed proportion of the office premiums and claims with the reinsurer in return for commission payment(s) from the reinsurer.

How Milliman can help

Milliman has a wide range of experience of working within the UK insurance industry across all types of insurance business. Our consultants and principals hold a number of Chief Actuary and With-Profits Actuary roles and have worked on a range of transactions and optimisation and restructuring projects across the industry. In particular, we have supported firms in the following areas:

- The determination of the Pillar 1 Solvency II balance sheet, including regulatory interpretations
- The production of forward-looking projections
- Development of stress and scenario testing, and risk appetite and limits frameworks
- The completion of the Solvency II Quantitative Reporting Templates (QRTs)

- Drafting and review of the Solvency and Financial Condition Report (SFCR) and Regular Supervisory Report (RSR)
- Drafting and review of PPFMs
- Independent expert assignments for Part VII transfers and schemes of arrangement
- Capital optimisation projects, including implementations of unit matching, mass lapse reinsurance and derivative hedging strategies
- The production of fund illustrations for fund fact sheets
- Independent assessments of clients' compliance against various aspects of UK regulations

If you have any questions or comments on this paper, or on any other issues affecting the UK life insurance industry, please contact any of the consultants below or your usual Milliman consultant.



Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

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