MILLIMAN REPORT

Shareholder Value Reporting in Europe: Solvency II Based Metrics

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1. Executive summary

INTRODUCTION

In previous years we have commented on how we have observed a shift in companies publicly disclosing supplementary reporting metrics related to Solvency II. In this report we provide a summary of the Solvency II based metrics that a sample of around 20 companies disclosed as at year-end 2023 and consider if the approaches adopted when determining these metrics have changed since year-end 2022.

Financial markets in 2023 saw central banks maintain a tight monetary stance to combat high inflation, leading to a persistently high interest rate environment, as well as the recovery of equity markets and hence year-end 2023 results reflect how firms have performed when faced with this market environment. This report considers what key themes can be drawn from how firms in our sample have reported their performance over 2023.

Following on from this, we consider a breakdown of the movement in Solvency II Own Funds over 2023, on an aggregate basis, for firms in our survey using their year-end 2023 results. This analysis categorises the movement into ‘high-level buckets’ which can be broadly grouped into two classes: anticipated and unanticipated items.

We then consider expanding this analysis to look at results from the previous six year-ends and what, if any, conclusions can be made with regard to the anticipated items, noting that market performance over the past six years has seen significant fluctuations.

Finally, we touch upon recent regulatory developments in relation to Solvency II: the ongoing review of Solvency II (the **Solvency II Review**) by the European Insurance and Occupational Pensions Authority (**EIOPA**) as well as the UK Government’s (in particular by HM Treasury (**HMT**) and the Prudential Regulation Authority (**PRA**)) review of Solvency II in the UK, following the UK's exit of the European Union. We also briefly cover developments in International Financial Reporting Standards (**IFRS**) and International Capital Standards (**ICS**s) in relation to reporting on value metrics, with 2023 being the first year where IFRS 17 comes into force.

THEMES ARISING FROM YEAR-END 2023 RESULTS

The financial markets and economic landscape experienced significant changes in 2022, with continued evolution throughout 2023. Central banks maintained a tight monetary stance to combat high inflation, leading to a persistently high interest rate environment.

This environment influenced insurance product demand and competition from other saving vehicles; while demand for annuities and pension risk transfer (**PRT**) increased, other product lines saw mixed impacts. It also influenced policyholder behaviour, increasing surrender rates in certain geographies. Firms faced pressure to adapt to these evolving conditions, leading to strategic shifts and adjustments in their approach to both new and existing business.

We consider how firms have reported their performance over 2023, focusing on several key areas:

- Financial markets: including management actions related to asset portfolios
- New business growth: including trends and strategies adopted to navigate the market landscape
- Strategic decisions: focusing on any major changes in the direction and operations of firms
- Changes in policyholder behaviour impacting the business: particularly in lapse experience
- Assumption setting: used in financial projections
- Payments to shareholders: including dividends, share buybacks, and other forms of capital return.

In addition, IFRS 17, effective from January 1 2023, has resulted in some changes to the value metrics disclosed by European insurers. In particular, it has led to the widespread adoption of the contractual service margin (**CSM**), or an adjusted CSM, as a key new business metric. Most firms now disclose IFRS 17 KPIs, although the impact of this on the reporting of shareholder value or capital generation metrics vary, with some like Swiss Re discontinuing previous value reporting frameworks, while others maintaining their focus on existing metrics like Solvency II and Operating Capital Generation.

YEAR-END 2023 RESULTS

In our previous publication, 'Shareholder Value Reporting in Europe – Solvency II Based Metrics'[1] (**2020 Shareholder Value Report**), we observed that companies had started to disclose Solvency II earning metrics such as 'Solvency II Capital Generation'. However, 'Solvency II Capital Generation' remains a nonstandard term, and many of the companies in our sample disclosed similar metrics with various names and slightly varying definitions (which were set out in that report).

Having reviewed year-end 2023 disclosures, we have found there to be no material changes in the approaches adopted by companies in our sample since year-end 2022.

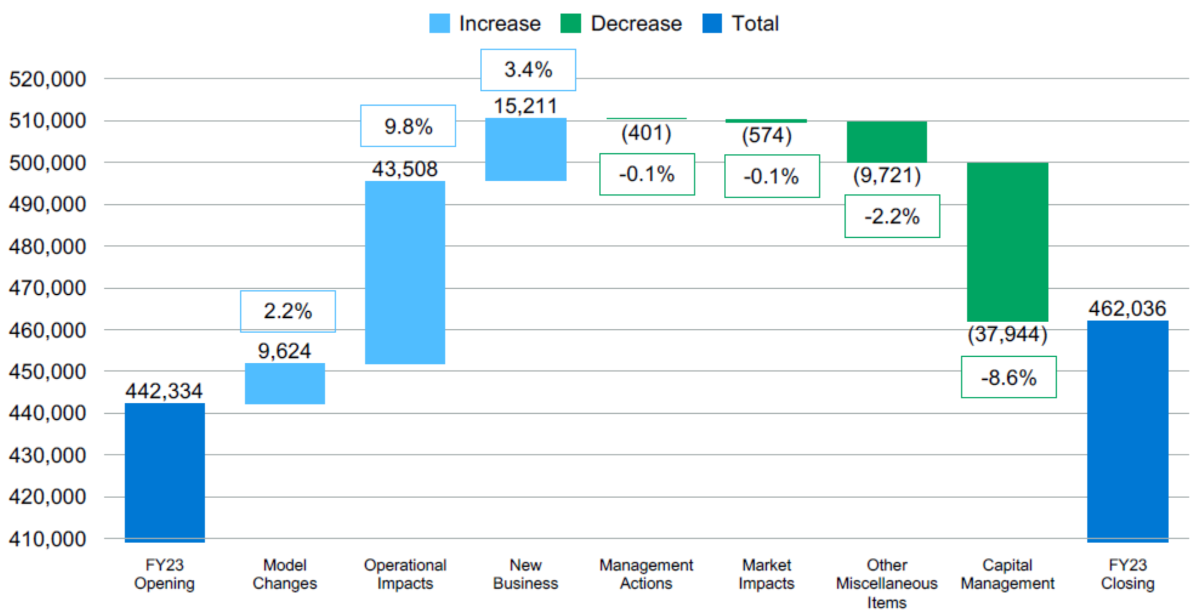
We previously noted that, for our sample of companies, the level of disclosure remains greatest for companies headquartered in the Benelux region as well as a number of those headquartered in the UK. This remains true of year-end 2023 disclosures.

In considering the value of the disclosed metric at year-end 2023 compared with 2022 for our sample companies (as shown in Figure 10 below), we note that around 75% of the firms observed an increase in the amount of their capital generation metric over the year. For those reporting a reduction in the level of capital generated, the percentage was an approximate 80% reduction across sampled firms compared to the previous year, except for one firm.

As part of our analysis of firms' year-end 2023 disclosures, we also considered a breakdown of the movement in Solvency II Own Funds over 2023 on an aggregate basis. In Figure 1 we set out our analysis based on the following 'high-level buckets':

- Model changes
- Operational impacts
- New business
- Management actions
- Market impacts
- Other miscellaneous items
- Capital management (which includes payment of dividends).

FIGURE 1: AGGREGATE EVOLUTION OF OWN FUNDS OVER 2023 FOR COMPANIES IN OUR SAMPLE (EUR M)



1. Burgess, S., Burston, D., Reynolds, S., & Wrobel, L. (November 2020). Shareholder Value Reporting in Europe – Solvency II-Based Metrics. Milliman Research Report. Retrieved 12 February 2023 from https://www.milliman.com/en-GB/insight/shareholder-value-reporting-in-europe-solvency-ii-based-metrics-november-2020.

Note:

1. The majority of firms included in Figure 1 report results in euros. For the handful of other firms we have converted results as at 31 December 2023 using publicly sourced exchange rates which may introduce small currency differences.

Given the non-standardised nature of the disclosures around the movement in Own Funds across firms in our sample, a number of simplifications and judgements have been required to arrive at the breakdown in Figure 1. However, although there are adjustments, the analysis provides a useful insight into the key drivers of firms' performance over 2023.

A key anticipated item of any movement in Own Funds over the year is 'Operational Impacts'. Ideally 'Operational Impacts' would provide some indication of the level of capital generation that arises 'naturally' from the existing business on the balance sheet at the start of the period. However, in the absence of the majority of firms in our sample disclosing this level of granularity when reporting the breakdown of movement in Own Funds, this category includes other items such as non-economic experience variances and non-economic assumption changes. Overall, 'Operational Impacts' contributed a 9.8% increase in Own Funds over 2023.

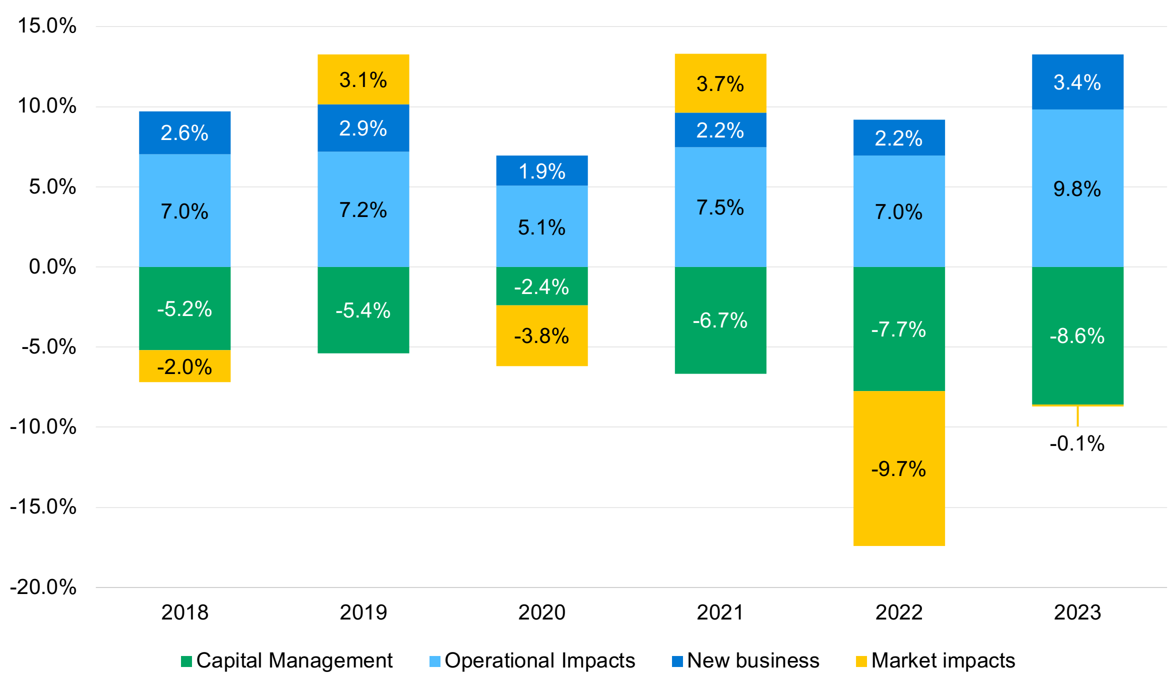
COMPARISON OF EXPERIENCE OVER RECENT YEARS

Expanding on the year-end 2023 movement in Own Funds analysis, we have considered how results over 2023 compare with recent years.

We have limited this expanded analysis to consider year-end 2018 to year-end 2023. Nearly every firm included in our survey disclosed a breakdown of Own Funds for each year of the analysis, and the criteria determining whether a firm has been included is solely driven by whether a firm discloses a sufficient level of detail in its public disclosures.

We have focused on the 'high-level buckets' of the movement in Own Funds which could be considered to be anticipated rather than those which are unanticipated. Figure 2 shows the results for the anticipated items.

FIGURE 2: EVOLUTION OF CAPITAL GENERATION DRIVERS FOR ANTICIPATED ITEMS



Note:

1. The figures for years 2018 to 2022 in Figure 2 may differ from the figures in the Shareholder Value Report published in previous years due to changes to the high-level bucket categorisations of some of the items.

Looking at the results over the six years:

- **Operational impacts**: The contribution to the movement in Own Funds from this item seems broadly stable year-on-year, with 2023 being higher than in other years. Although some companies observed higher surrenders due to rising interest rates, this was outweighed by expected in-force contributions, higher release in risk margin from UK companies due to the RM reforms under Solvency UK, and increases in mortality assumptions for UK annuity businesses.
- **New business**: New business contribution is slightly higher compared to previous years. This is driven by the growth in PRT transactions and individual annuity sales in the UK and very favourable new business development from Munich Re and Swiss Re.
- **Market impacts**: From 2018 to 2022, the observed impact fluctuations seem broadly in line with market performances for each year, i.e. 2018, 2020 and 2022 markets typically performed poorly or were volatile, whereas 2019 and 2021 were more stable or showed signs of recovery compared with the prior year. 2023 has been a year of high interest rates, tightened credit spreads, recovery in equity markets and high inflation, each having a varying impact on Own Funds. On aggregate, this has resulted in a small negative market impact over 2023, and also the smallest market impact over the last five years.
- **Capital management**: This item was broadly stable over the six-year period, except for 2020 as a result of COVID-19. In 2023, this item has been the highest to date in our analysis, which reflects that the capital position of many companies has remained strong after improving from a significant reduction in the SCR in 2022 (due to higher interest rates and lower asset values). This left companies at the top of the comfortable range for paying dividends.

REGULATORY DEVELOPMENTS

After years of review by various regulatory bodies, we are now starting to see these efforts culminate in finalised versions of standards on both a local and international basis.

While developments continue in the regulatory space which may also have an impact on the shareholder value metrics adopted by firms in future years, the adoption of more stable versions of Solvency II, Solvency UK, IFRS 17 and ICS will help provide clarity and consistency for stakeholders going forward.

Solvency II

After years of effort, the review of the Solvency II Directive is now nearing an end, having reached a significant milestone in January 2024 whereupon agreement was reached on the proposed amendments between the European Commission (**EC**), Council of the European Union and the European Parliament.

The provisional amendments were then approved in the European Parliament's sessions in April 2024.

With the review process now drawing to an end, the European Council and the Parliament will now have to formally adopt the texts. These reforms could therefore become effective for EU member states from 30 June 2025, with insurers having to apply these amended standards by 1 January 2026. However, it is possible there are further delays that could set this back.

Solvency UK

The review of the Solvency II for the UK insurance market, known as Solvency UK, has been led by HMT as part of the UK Government.

After its consultation, HM Treasury set out a draft reforms package in a Supervisory Instrument in June 2023, which included reforms to the Risk Margin and certain aspects of the Matching Adjustment (**MA**).

Solvency UK will be delivered through both HMT as well as more granular reforms set out by the Prudential Regulation Authority (PRA). The PRA has concluded two consultation periods that followed consultation papers (**CP**s) CP12/23 and CP19/23 issued in 2023, leading to the following policy statements (**PS**s):

- PS2/24, which proposed the changes initially proposed under CP12/23, with a few modifications, including giving more time for an insurance group to consolidate its internal models after an acquisition, removing a requirement to disclose Residual Model Limitation capital add-ons and increasing the threshold for a firm above which Solvency UK will apply.

- PS3/34, which addressed CP14/22, which set out the proposed changes to the reporting and disclosure requirements under Solvency UK, as well as the reporting and disclosure aspects of CP12/23. The final policy largely includes the proposals outlined in the consultations, with some amendments to the proposed reporting templates – namely, not introducing some templates proposed under CP14/22 and simplifying others.
- PS10/24, which addressed CP19/23 and included refinements around investment flexibility, credit ratings under the MA, the attestation process and liability eligibility.

The reforms to the Matching Adjustment under PS10/24 became effective on 30 June 2024. Solvency UK will become fully effective on 31 December 2024.

Insurance Capital Standard

The Insurance Capital Standard (ICS) is nearing the conclusion of a five-year monitoring period that commenced in 2020. An indicative version of the final set of the ICS technical specifications was shared in June 2024, in particular taking into account the findings from the public consultation on the 2023 version of the ICS.

The Solvency UK and Solvency II standards have now largely been finalised, providing clarity on the likely comparability on these regimes to the final ICS. However, the Aggregation Method (**AM**) approach for group capital within the US and other related jurisdictions is still being developed and so the assessment of whether this approach can be deemed outcome-equivalent to the ICS is still pending.

In 2026, the IAIS will launch a self-assessment to be completed by IAIS members in assessing their progress in implementing the ICS before engaging in more in-depth assessments these implementations in 2027.

2. Introduction

In previous reports, we discussed how the use of the level of Solvency II Own Funds (and its change over time) appears to have become a more widely publicly disclosed metric than an embedded value metric.

In this publication (in Sections 3 and 4 below) we consider the key themes arising from year-end 2023 results for the firms in our sample. We explore this for a number of different areas, such as the movement in financial markets over the year as well as new business and policyholder behaviour.

Following on from this, we set out whether the approaches adopted by companies when disclosing supplementary reporting metrics have changed over 2023 (since those previously reported in the **2022 Shareholder Value Report**[2]), as well as the change in the values of such metrics.

We then move on to explore, at an aggregate level, the movement of Solvency II Own Funds over the year for companies in our survey, and consider how this movement can be split into key drivers that may be expected to happen again in the future – for example, the contributions of existing and new business – and those that may be considered to be one-offs e.g. model or methodology changes, or capital management actions such as the issuance or repayment of debt and payment of dividends.

In Section 5, we extend the movement in Own Funds analysis presented in the previous section and consider results for the five year-ends prior (i.e. year-end 2018 to year-end 2022) for the firms in our sample. Using these results across the six year-ends, we then consider what, if any, trends can be identified for each of the key drivers, with particular focus on those drivers which can be considered to be 'anticipated'. Following on from this, we estimate for each year-end a payout ratio and an expected capital generation metric based on the back-book and consider what conclusions can be drawn from these results.

We end, in Section 6, with briefly considering how the regulatory landscape is changing – specifically with a focus on EIOPA's ongoing Solvency II Review as well the UK government's own review of Solvency II – because both reviews may have an impact on the metrics disclosed for both reporting and transaction purposes. We then briefly cover developments in ICS in relation to reporting on value metrics.

2. Burgess, S., Egoshina, T., Reynolds, S., Stansfield, I., & Wrobel, L. (November 2023). Shareholder value reporting in Europe: Solvency II based metrics. Milliman Research Report. Retrieved 4 September 2024 from https://www.milliman.com/en/insight/shareholder-value-reporting-in-europe-solvency-ii-based-metrics-2023.

3. Themes arising from year-end 2023 results

Following an increase in interest rates in 2022, companies have been adapting to new macroeconomic conditions and to the impact it has on them and their customers. In this section we consider how firms in our sample have reported their performance over 2023.

In considering how firms have performed over 2023, we have evaluated a number of different areas. Specifically, we have considered:

- Financial markets
- New business growth
- Strategic decisions
- Changes in policyholder behaviour impacting existing business e.g. lapse experience
- Assumptions setting used in projections
- Payments to shareholders, including dividends and buybacks
- IFRS 17 and the impact it has had on disclosures.

FINANCIAL MARKETS

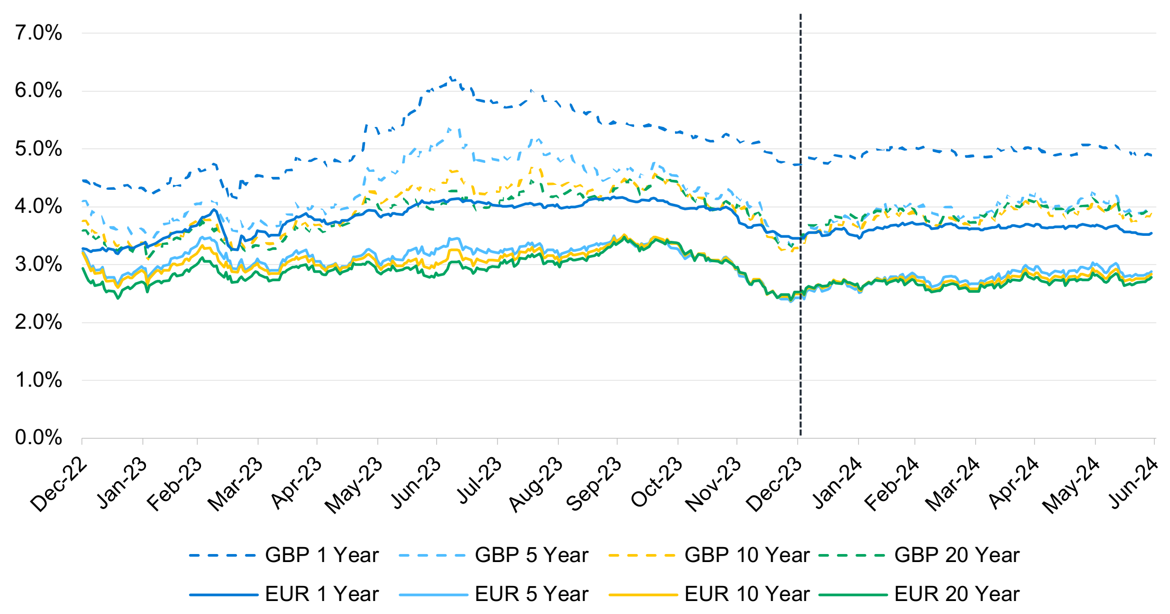
2022 was a year marked by significant changes in the financial markets and the economic landscape continued to evolve throughout 2023. Central banks maintained a tight monetary stance to combat high inflation, resulting in a continued high interest rate environment.

These conditions continued to have an impact on the cost of living and the demand for insurance products, and also increased competition from other saving vehicles. The effects were mixed across different products though demand for annuities and pension risk transfer (PRT) generally increased.

On the geopolitical front, ongoing wars and political uncertainty added to the financial markets' volatility. Firms sought to protect themselves through broad diversification in their investments and insurance businesses.

Figure 3 to Figure 6 illustrate the movements in some of the key financial metrics over 2023 and since the end of the year.

FIGURE 3: RECENT TRENDS IN GBP AND EUR LIBOR SWAP RATES



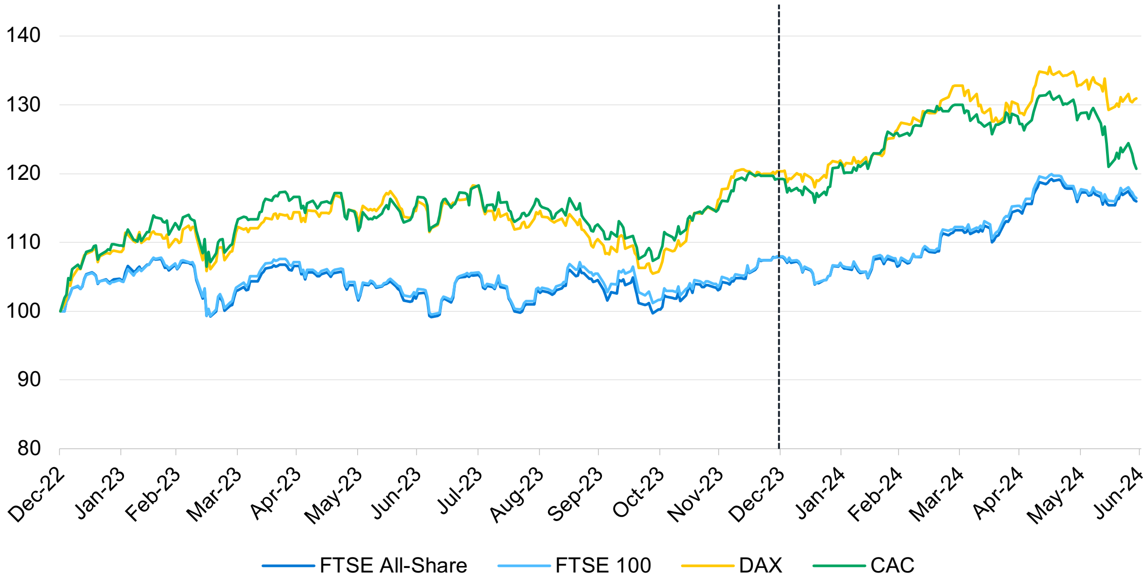
Source: Bloomberg

Figure 3 shows that the high interest rate environment continued during 2023 following the large rises in late 2022. The first half of 2023 saw rising interest rates, particularly in the GBP markets which then began to fall during the second half of the year. The EUR interest rates displayed more stable trends but still reflected market volatility.

Firms generally reported that high interest rates benefited activities through higher returns on investments and provided relief for those offering products with guaranteed minimum rates. However, some firms found that their life and savings products suffered due to higher competition from banking products.

The high interest rate environment also boosted annuity business and PRT deals, particularly in the UK, which benefitted from higher crediting rates and funding ratios. It has driven high demand in the bulk purchase annuity (**BPA**) market in 2023.[3]

FIGURE 4: RECENT EQUITY MARKET PERFORMANCE



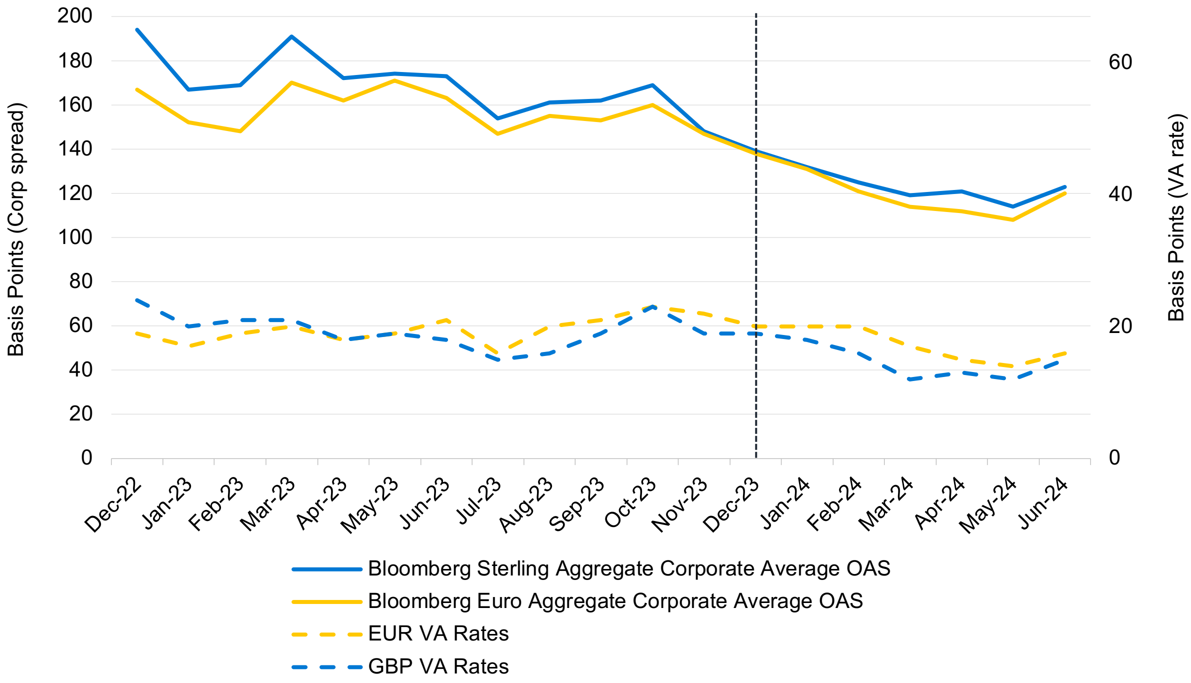
Source: Bloomberg

Note: Indices above are the gross total return indices and have been rebased to 100 as at 31 December 2022.

Figure 4 illustrates relative stability in the European equity markets over 2023, culminating in a general upward trend towards the year's end. Firms in our survey recorded a positive impact on their performance in 2023 largely driven by higher investment returns.

3. We consider developments in the global pension risk transfer market in our paper. Milliman (November 2023). Global pension risk transfer market outlook. Milliman report. Retrieved 13 August 2024 from https://uk.milliman.com/en-GB/insight/global-pension-risk-transfer-market-outlook.

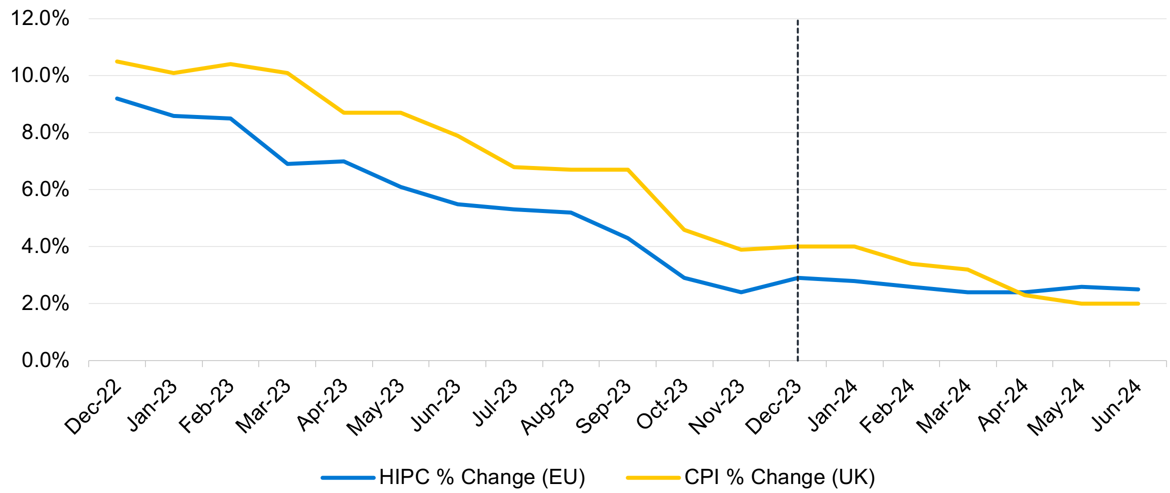
FIGURE 5: RECENT TRENDS IN CORPORATE SPREADS AND VA RATES (BPS)



Source: Bloomberg; Barclays and EIOPA

Figure 5 demonstrates that credit spreads generally tightened throughout 2023 and this trend continued into 2024. Concerns about the US banking sector did lead to a move to invest in higher quality assets in the first quarter of 2023, benefiting sovereign yields but increasing risk premiums. However, generally, firms reported lower credit-related losses, reflecting the overall positive impact of the tighter credit spreads on financial performance.

FIGURE 6: RECENT TRENDS IN INFLATION



Source: ECB data Portal, Office for National Statistics (UK)

High inflation continued to negatively impact firms' performance in 2023, with the Property & Casualty sector particularly hard hit by rising claims costs. Insurers responded by increasing premiums and reserves and implementing process efficiencies. Additionally, competition from inflation-indexed government bonds, especially in Italy, influenced market conditions. However, investments in inflation-linked bonds proved beneficial to insurers.

NEW BUSINESS

In 2023 sustained high interest rates and inflationary pressures on policyholders continued to heavily influence the volumes of new business written and the profitability of that new business. The observed impact varied by product type and geographical region.

With respect to new business volumes, several companies included in our analysis saw a decline in demand for certain savings products, in particular citing increased competition with short-term banking products and government issued savings products. Unit-linked savings products, single premium savings business, and retail investment products in particular faced lower sales volumes and/or deposits, with companies noting the ongoing challenging macroeconomic environment. For example, AXA reported a 5% fall in the volumes of unit-linked savings business written in 2023 as measured using the present value of expected premiums for new business (**PVEP** or **PVNBP**), and Allianz, Generali and Munich Re all disclosed a fall in the level of sales of single premium business.

The challenging conditions for the savings and investment market presented an opportunity for certain insurers, with those who could redesign their savings products to better meet changing public demand, or offer improved guaranteed returns reporting higher new business volumes. In addition, whilst many firms faced challenges from increased competition from the banking sector, it was observed that those insurers with an affiliated bancassurance arm observed an increase in new business volumes for these products, potentially as the banking 'partner' did not compete with them. For example, Zurich’s disclose higher sales of retails savings products in Brazil and Spain via its joint ventures with Banco Santander and Banco Sabadell respectively.

There was also a higher demand for inflation or index-linked products in response to the high levels of inflation and volatile markets, with Aegon reporting strong sales in its indexed universal life product and index-linked annuities, and Swiss Re noting higher demand for inflation-linked savings products.

Whereas savings and investment business faced a lot of challenges in 2023, the high interest rate environment was beneficial for certain retirement business with higher observed new business volumes for individual annuities (that provide more attractive cash flows for policyholders), and an increase in BPA deals in the UK and US (that continued to benefit from improved funding positions for pension schemes). For example, Aviva, L&G and Scottish Widows reported a 17%, 50% and 183% growth in PVNBP for individual annuity business respectively. The higher demand for individual annuities came at the cost of lower demand for alternative retirement products (e.g. drawdown products, equity release mortgage products, retirement planning) with Aviva, for example, reporting a 48% reduction in the volumes (as measured using PVNBP) for equity release business.

Whilst the demand for protection products is less responsive to higher interest rates than annuity business, several companies did report a greater demand for protection products in 2023. Mapfre, for example, reported an 8% increase in the volumes of protection business written as measured using its present value of new business income (**PVNBI**) metric.[4]

The level of expected profitability of new business was impacted by the high interest rate environment with varying impacts on different product types. Higher interest rates should improve the potential profitability of savings products, particularly those with guarantees. This was observed in our sample, with Allianz reporting an increase in the new business margin for its guaranteed savings and annuities (to 5.8% from 1.8%) and capital efficient products (5.8% from 3.9%), and Generali and Mapfre also reporting an increase in the new business margin on their savings business (to 4.4% from 4.2%, and to 2.2% from 1.7%, respectively).

The reported profitability on unit-linked savings business in our sample was more mixed; Allianz reported an increase to 4.4% (from 2.7%), whereas Generali reported a decrease to 4.7% (from 5.6%) driven by changes in the business mix sold and higher management fees.

The profitability of L&G’s institutional annuity business (i.e. BPA business) decreased in 2023 to 7.4% (from 8.9%), perhaps reflecting the growing competitiveness of the BPA market in the UK. With regards to retail annuity business, L&G reported an increased in 2023 to 7% (from 6.3%), whereas Aviva reported a reduction in the profit margins for this type of business.

4. Mapfre defines its PVNBI metric as follows: for life insurance business, the present value of received and expected premiums from new business; in the case of mutual funds, contributions received in the year; and in the case of pension funds, contributions received in the year and expected from new business. It is broadly consistent with a PVNBP metric, and used in Mapfre’s reporting to calculate the profit margin of its core business lines (VNB/PVNBI).

Mixed results were observed in 2023 for the new business margin on protection business for the companies included in our sample. Several companies reported an increase in new business profitability, including Generali (10.2% from 8.4%), Allianz (8% from 6%) and L&G's US protection business (11.4% from 10.6%). On the other hand, some of the companies in our sample reported a reduction, including Mapfre (16.8% from 19.0%) and L&G's UK protection business (2.8% from 5.4%).

Whether or not firms observe an increase or decrease in the overall value of new business[5] depends both on the volumes of business written of different types of business, and any changes to the profitability of these product groups. Several companies included in our sample cited changes to a less favourable business mix (i.e. to a mix where product lines that have, generally, lower profitability) as a primary reason for a reduction in the value of new business. For example, whilst Allianz had a 15.9% increase in its US life insurance business volumes, its new business margin for this sector fell by 1.8% driven by a change to a less favourable business mix, with the value of new business falling by 10.1% for this business line. Similarly, significantly higher volumes of annuity business written by Aviva resulted in a higher value of new business for this product group despite lower margins.

In its analysis of change of Own Funds, Munich Re noted a significant new business contribution to Own Funds that had more than doubled relative to that in 2022 (from EUR 2.1 billion in 2022 to EUR 4.6 billion in 2023), citing strong profitable new business growth in life and health reinsurance business, especially in its North American financial reinsurance business. Similarly, for Swiss Re the new business contribution to Own Funds had more than doubled relative to that in 2022 (from EUR 1.4 billion in 2022 to EUR 3.7 billion in 2023) with them citing a number of reasons for the growth, including strong new business performance for PRT in the UK and the US, and bancassurance sales in China.

Finally, those companies that experienced a growth in PRT transactions or individual annuity sales in 2023, primarily those based in the UK (Aviva, L&G, M&G and Scottish Widows), reported an increase in value of new business written for these business lines, driven by the large volumes of business written (despite a reduction in the new business margin in some cases).

In summary, with regards to new business profitability:

- High interest rates improved the profitability of savings products, particularly those with guarantees for several companies in our sample.
- For other product lines (unit-linked savings, protection, retail annuity business) profitability showed mixed results for the companies included in our sample.
- The profitability of UK institutional annuity business (i.e. BPA business) decreased in 2023 for some firms, perhaps reflecting the growing competitiveness of the BPA market.

With regards to the value of new business:

- Several firms in our sample reported a reduction in the value of new business due to a less favourable business mix in 2023 relative to the prior year (i.e. a shift towards lower profitability product types or markets).
- The growth in PRT transactions and higher volumes of retail annuity business contributed to a higher value of new business for some insurers, despite reductions in profitability.

STRATEGIC DECISIONS

2023 saw many firms in our sample continue to make strategic decisions demonstrating their increased focus on core markets. This was reflected in the some of the M&A activity reported by firms.

For example, Aegon announced the sale of its UK individual protection book in April 2023 to Royal London. The firm reported that this move supported its business strategy to concentrate on its core Workplace and Retail platform activities in the UK. Also in 2023, Aegon announced that it had completed the divestment of its businesses in Poland and Romania to Vienna Insurance Group AG Wiener Versicherung Gruppe (**VIG**). This represented the final step by Aegon to complete the full sale of its insurance, pension and asset management business in Central and Eastern Europe.

5. The value of new business is, generally, new business volume written x profitability. In 2023 this was measured by different companies using different approaches: market consistent embedded value, Solvency II new business value, or IFRS new business CSM. For the purpose of this report we refer to each of these measures as the value of new business.

In the same vein, Groupama disclosed in May 2023 that the group sold its insurance activities in Turkey to AXA. The firm reported that owing to hyperinflation, significant capital injections would have been required to support the business, and instead the group decided to exit the business in order to focus on its investments in other European countries.

Also, Generali completed the disposal of Generali Deutschland Pensionskasse AG (**GDPK**) to Frankfurter Leben in December 2023, following the approval by the German Federal Financial Supervisory Authority (**BaFin**) and the relevant German antitrust authorities. The firm disclosed that this transaction was in line with its business strategy which seeks to improve the profile and profitability of its Life business.

In contrast, AXA announced that its sale agreement with Athora in relation to the purchase of a closed life and pensions portfolio from AXA Germany had been terminated on a mutually agreed basis. AXA will instead retain this portfolio, which the firm reports is well capitalised and duration matched. The Group reported that the termination is not expected to impact the financial targets in the firm's latest strategic plan.

As well as more traditional M&A transactions, Athora reported that it has closed its acquisition of Premium Pension Institution in the Netherlands as well as completed two PRT transactions in the Netherlands.[6]

As well as acquisition activity, a number of firms disclosed their decisions to strengthen or extend existing partnerships as a way of supporting their business strategy in 2023.

For example, Allianz disclosed that its acquisition of 50% of the shares of Incontra Assicurazioni S.p.A., Milan, a non-life insurance business, was intended to strengthen the firm's bancassurance partnership with UniCredit.

Achmea also reported that its strong partnerships with Garanti Bank in Turkey and 365Bank/Slovakia Post contributed to its developments in progressing its business strategy in 2023. Achmea's further strengthening of its partnership with Rabobank in various areas aimed at commercial growth contributed to these developments as well. The firm also reported growth in its mortgage portfolio via Achmea Bank partly due to partnerships with MUNT and a.s.r.

A number of firms reported launching new products or adapting existing products (where possible) to allow for the relatively high interest rates now being experienced as well as more general market conditions leading to a squeeze on the costs of living.

AXA reported on a new product initiative where it has developed a large savings offering in Spain which it views as meeting the evolving demand – against a background of high interest rates – ranging from structured notes to a new single premium lifetime savings product with guaranteed rates.

CNP disclosed a number of areas where it has considered the high interest rate environment. More generally it disclosed a marketing policy in respect of savings/pensions products which it has tailored to not just the macroeconomic environment but also sustainability issues. More specifically, it reported a growth in sales of its Consórcio contracts, which it considers to be an attractive alternative to consumer credit, via its partnership with Caixa Econômica Federal. In addition, the firm reported on the introduction of three new products specifically designed for vulnerable populations, especially in Italy and Brazil.

CNP also reported on its development of a digital insurance product sold through the Caixa Tem app, as part of its partnership with Caixa Econômica Federal. This forms part of the firm's wider strategy to penetrate new market types, using configurable apps which the firm indicates leverage AI solutions to provide a catalogue of services and which the firm anticipates can be rolled out quickly as and when new market opportunities occur as affinity insurance.

Following on from this, a number of other firms in our sample reported their decision to further leverage their use of data and analytics as well as new technologies, and automation with a view to widening their customer base, enhancing the customer experience, and increasing efficiency.

6. We consider developments in the global pension risk transfer market in our paper. Milliman (November 2023). Global pension risk transfer market outlook. Milliman report. Retrieved 13 August 2024 from https://uk.milliman.com/en-GB/insight/global-pension-risk-transfer-market-outlook.

For example, Ageas disclosed that new B2B2C[7] digital channels launched in India have allowed the firm to provide coverage to more than 500k new customers that previously it was not able to reach. AXA was another firm which reported its business strategy included increased automation and the use of data and artificial intelligence. SCOR also reported on its further deployment of digital services to help differentiate its product offering.

Achmea disclosed that it has taken steps to phase out its legacy IT systems in 2023 as well as with its planned migration to the cloud. It has disclosed that around 45% of its systems now operate on Microsoft Azure Cloud.

Finally, Zurich has disclosed that it has invested significantly to digitalise the business over the last three years. This means, for example, that 89% of its retail quotes are now digitalised. The firm also reported that it is leveraging AI in more than 160 use cases to provide advanced data insights in order to assist its underwriters, risk engineers and claims adjusters to make better-informed decisions.

POLICYHOLDER BEHAVIOUR

In 2023 sustained high interest rates and challenging economic conditions for policyholders continued to impact policyholder behaviour in terms of product demand and persistency experience.

Some of the companies included in our analysis reported that higher interest rates and decreases in disposable income have continued to reduce the demand for savings and investments products, with higher surrenders also observed. High interest rates in 2023 have resulted in strong competition from alternative savings and investment options (such as banking products or government offered savings products[8]) that offer competitive, shorter-term and less risky returns that meet the needs of customers facing significant economic challenges and uncertainty. Some companies reported that the increased competition has impacted the management of the business; for example, increased management oversight of surrender risk monitoring, putting in place additional incentives to retain business, or considering the fierce competition with regards to the setting of guaranteed participation rates.

Of the companies included in our study, Aegon, AXA, CNP, Generali, Swiss Re and Unipol all reported an increase in surrender rates in 2023. The observation is supported by the analysis presented in the EIOPA risk dashboard[9] that indicates a continuing trend of higher lapse rates in 2023, with the median lapse rate increasing to 4.7%, compared with 3.8% in 2022. A wider interquartile range for lapse rates in 2023 was also observed when compared to recent years, with the upper quartile increasing to 6.9% compared to 5.3% in the previous year.

AXA and CNP both reported that higher surrenders were particularly an issue in Italy and France for the savings line of business. Generali also reported that in response to higher surrender rates it had considered several business retention initiatives and updated its best estimate surrender assumptions used in the valuation of the Solvency II technical provisions. Aegon reported that its savings and investments were impacted by policyholders choosing to move towards shorter term and less risky investments given the observed market uncertainty in 2023.

In Italy, a market where there are significant concerns around the life insurance industry's exposure to a mass lapse event, AXA, CNP, Generali, Swiss Re and Unipol all reported an increase in surrenders, particularly for savings business. Analysis by Associazione Nazionale fra le Imprese Assicuratrici (**ANIA**),[10] an association of insurance companies in the Italian market, supports this, showing a significant increase in average lapse rates. The surrender rate shown in this analysis was 10.63% in 2023,[11] an increase of almost 4% compared to the 2022 value (6.71%) and significantly higher than the 5.5% to 6.7% range observed between 2020 and 2022. There was concern in the Italian market that the challenges faced by Eurovita[12] would further damage consumer confidence in Italy's insurance market and increase lapse rates once more. For now, the Eurovita

7. B2B2C stands for business to business to consumer.

8. For example, Italian government bonds (BTP) and Livret A tax free savings accounts in France.

9. EIOPA Risk Dashboard (July 2024). Retrieved 01 August 2024, from https://www.eiopa.europa.eu/assets/insurance-risk-dashboard/July-2024-EIOPA-Insurance-Risk-dashboard-.html#Liquidity__Funding.

10. ANIA (4 February 2024). Trends. Retrieved 1 August 2024 from https://www.ania.it/documents/35135/671719/Newsletter+Vita+flussi+e+riserve_IV+trim.2023.pdf/e2101cd2-2d45-03ca-a79a-4c1e46f8673c?version=1.1&t=1708602195111.

11. The surrender rate presented in the analysis is derived as the ratio between the amounts paid on redemption and the average amount of mathematical reserves.

12. Italy Prosecutors Probe False Accounting Allegations Related to Insurer Eurovita: Source (30 June 2023). Retrieved 1 August 2024 from https://www.insurancejournal.com/news/international/2023/06/30/728118.htm.

resolution plan announced at the end of June 2023[13] seems to have helped provide some assurance and stability to the market, but monthly lapse rates for July to December 2023 were still higher than historical rates, particularly in November 2023.

The Swiss Re Institute reported that unlike Italy that witnessed a sharp rise in lapses, in France and Germany, surrender rates have been managed due to fiscal incentives in place and a relatively high level of profit-sharing reserves supporting back-book crediting rates.[14]

Finally, not all companies included in our sample observed higher lapses in 2023. Munich Re stated that its life insurance companies had not observed the trend of rising surrenders and M&G reported an improvement in persistency.

ASSUMPTION-SETTING USED IN PROJECTIONS

Many firms reported no material changes to their assumptions during 2023. However, several companies disclosed adjustments in response to specific market conditions and emerging trends.

For example, CNP observed a sharp rise in surrender rates in Italy due to rising interest rates, competition from government bonds and a crisis of confidence following Eurovita being put into administration. Year-end 2023 assumptions included adjustment factors reflecting these observations. Generali also updated surrender assumptions in Italy and Germany.

For those insurers that disclosed a change in their mortality and/or longevity assumptions, the changes reflect that, recently, mortality rates have been higher than expected and that this higher level of mortality may persist into the future. L&G revised longevity assumptions for its UK annuity business to reflect recent experience, resulting in a minor reduction in the Best Estimate Liability (**BEL**) gross of reinsurance. More generally, the firm reported that it has observed continued elevated mortality levels in both the UK and US, and noted that this may be due to indirect impacts from COVID-19, deferred diagnostics and treatments, cost of living pressures, and government spending decisions. Similarly, Scottish Widows reported a minor decrease in BEL due to an increase in annuitant mortality assumptions. The group decided to lower future mortality improvements at year-end 2023 due to factors such as increased cancer prevalence in an ageing population and longer NHS[15] waiting times.

Other firms considered the impact of ‘long COVID-19’. For example, Aviva’s mortality assumption changes for assurance contracts resulted in a small loss, with the largest contributor reported as being the introduction of an explicit adjustment for post-pandemic mortality.

It is noteworthy to see a shift in trends regarding longevity expectations in 2023. Whilst the recent disclosures reflect heavier mortality experience in recent years and lower assumed levels of future mortality improvement for some insurers, it remains uncertain how these views on longevity will develop in the coming years (i.e. whether longevity will improve due to ongoing medical advances, or worsen due to the current health and healthcare challenges). We plan to monitor this closely.

PAYMENTS TO SHAREHOLDERS

The majority of companies in our survey declared higher dividends than in the previous year, in line with their intended dividend programmes. This is against a backdrop of a macroeconomic environment which still presented challenges, as discussed earlier, with relatively high rates of interest and levels of inflation.

We reported last year that Achmea was the only company in our sample to not pay dividends over 2022. This followed the approval of a non-distribution of dividends to ordinary shares at the firm’s 2022 Annual General Meeting. In 2023 the firm disclosed the implementation of a new dividend policy. This set out a proposed dividend to be based on a market-based annual dividend yield of 7% of the calculated value of Achmea. Accordingly, the firm paid a dividend over 2023.

In line with our previous observations, a number of firms in our sample launched (or continued with previously announced) share buyback programmes in 2023.

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13. Italy’s Top Insurers, Banks Reach Accord on Eurovita Rescue Plan. Retrieved 1 August 2024 from https://news.bloomberglaw.com/insurance/italys-top-insurers-banks-reach-accord-on-eurovita-rescue-plan.

14. sigma 2/2024: Life insurance in the higher interest rate era. Retrieved 1 August 2024 from https://www.swissre.com/publication-form~ifr~.html?t=2031&id=50266cbf-f3b0-45a5-bb42-1f75f1bc2b8f#PublicationForm.

15. The NHS is the National Health Service in the UK.

For example, in the first half of the year Aegon executed a EUR 200 million share buyback program. The firm reported that this was in line with its intentions to return surplus cash capital to shareholders. A further EUR 1.5 billion share buyback program was announced following Aegon's completion of the transaction with a.s.r.[16] The firm reported that 54% of the share buyback had been completed by the end of 2023.

Also in the year, AXA carried out a discretionary share buy-back program whereby the firm repurchased EUR 1.1 billion of its own shares in order to return excess cash to its shareholders. This was in addition to share repurchases performed in order to eliminate the dilutive impact on the Group's underlying earnings per share from employee share offerings and/or the exercise of stock options.

Other firms announcing share buyback programmes, but which are due to commence in 2024, include BNP Paribas, Allianz, Munich Re and Aviva.

IFRS 17

IFRS 17 came into force from 1 January 2023 and year-end 2023 is the first time companies disclose their financial results on this basis (some companies restated and disclosed their YE 2022 results earlier in the year).

As discussed in our report last year, we expected that as companies and investors start to get more comfortable with the IFRS 17 results and disclosures we may begin to see certain IFRS 17 metrics becoming harmonised, and for these metrics to be used more widely in companies' targets and KPIs.[17]

We have begun to see this trend this year, with the majority of companies in our sample disclosing the contractual service margin (CSM) on new business as a key metric, and a general trend to use it as a main new business value measure. Some firms apply adjustments to the CSM for items such as taxes, non-attributable expenses, IFRS 17 scope, etc. to make it more reflective of their views of the value of new business to the shareholders and market analysts. Many companies also started to present a KPI of normalised growth of new business (based on the CSM metric), where the growth is normalised for experience and other variances, to monitor the performance of new business sales and profitability.

Overall, it appears that the CSM for new business is accepted by the industry as a valuable metric, which benefits from being audited and also can be further adjusted (for scope, taxes, expenses, etc.) and presented in a way which shows the value of new business written to the shareholders and the market.

Companies also provided a reconciliation of IFRS Equity to Solvency II Own Funds, though the granularity of the reconciliation, and where this analysis is presented, e.g. Solvency and Financial Condition Report (**SFCR**), annual reports or investor presentations differs between firms.

Generally, companies in our sample tended to include IFRS 17 based KPIs as important metrics in their market presentations and disclosures, but views on whether IFRS 17 results will be impacting companies focus and strategy differ.

Swiss Re, for example, has announced that, with the adoption of IFRS 17 as of 2024, it will discontinue reporting on Economic Value Management (**EVM**) basis with effect from 1 January 2024. EVM was the Group-proprietary integrated economic valuation and steering framework, consistently measuring economic performance across all businesses.

On the other hand, in its analyst presentation, NN has stated that IFRS 17 has no impact on its strategy, targets or dividend return. Operating Capital Generation (**OCG**) is considered by NN to be a better proxy for cash conversions than IFRS 9/17 profits, and its focus on Solvency II and OCG remains unchanged. Phoenix stated in its IFRS 17 transition disclosures that IFRS 17 has no impact on its strategy or dividends, with no change to its KPIs or targets, and that it would continue to focus on the delivery of cash generation and Solvency II capital resilience.

Many companies in our sample view CSM or CSM plus Risk Adjustment (**RA**) as a stock of future profits, and, on top of disclosing CSM organic growth, some companies provide an often detailed analysis of change on CSM (or CSM plus RA).

16. Aegon completed the transaction to combine its Dutch pension, life and non-life insurance, banking, and mortgage origination activities with a.s.r. in July 2023.

17. Milliman also produced a separate paper on the analysis of IFRS 17 disclosures. Milliman (July 2024). IFRS 17 benchmarking: FY 2023. Milliman report. Retrieved 13 August 2024 from: https://www.milliman.com/en/insight/ifrs-17-benchmarking-europe-fy-2023.

CNP, SCOR, Allianz, Munich Re, Aegon, NN, Aviva, L&G, Phoenix and M&G provide a fairly granular breakdown of the movement in CSM over the year into the following categories:

- Expected return on in-force business
- New business impact
- Operating changes (sometimes further split into assumption changes and experience variances)
- Market impact (with FX impact)
- Release of CSM.

The list does not look that dissimilar to what life insurance companies disclosed in their embedded value reports, and what companies often currently present on analysis of change of Own Funds (see Section 4 of this report). This analysis can provide further insight into profit emergence and can usefully complement other disclosures. Mapfre, for example, also provided reconciliation between Market Consistent Embedded Value (**MCEV**) Value of in-force (**VIF**) and CSM, detailing differences for scope and tax treatment, and also differences in cost of capital, used for VIF and RA calculations, and discount curves.

CNP and SCOR also provided disclosures on IFRS Equity adjusted for CSM, which they referred to as Economic Value.

We will continue monitoring development in the area of IFRS 17 disclosures and KPIs, and whether IFRS 17 and Solvency II related metrics are becoming further aligned in companies' disclosures.

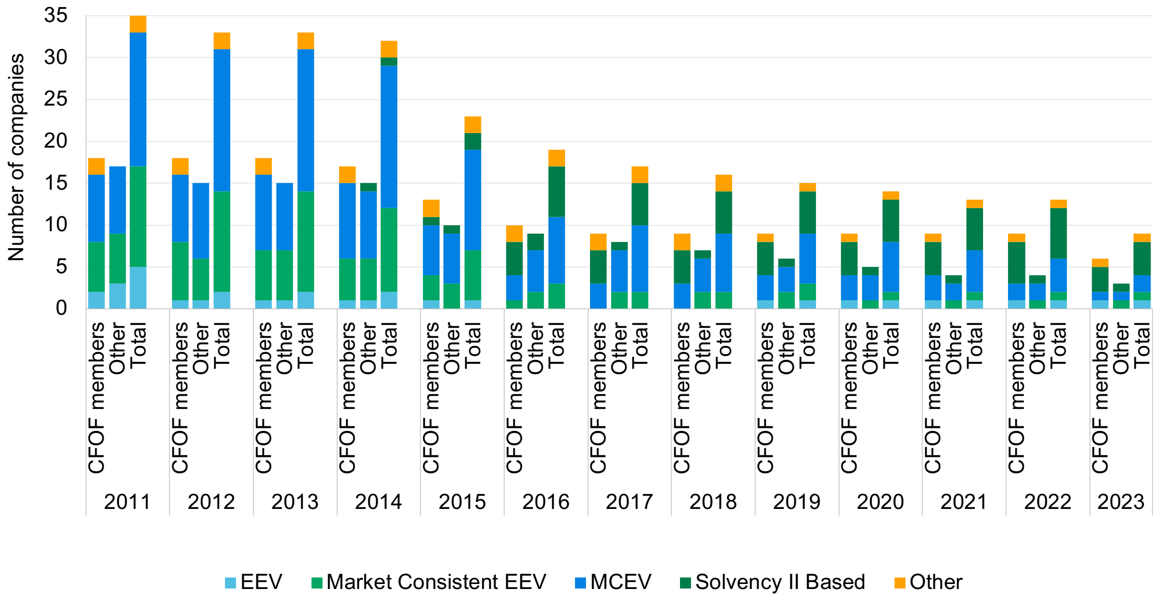
4. Year-end 2023 results

BACKGROUND

In our previous shareholder value related publications, we have noted that since the implementation of Solvency II at the end of 2015/start of 2016, there has been a decline in the number of companies in Europe publicly disclosing embedded value. Whilst this decline seemed to have stabilised in recent years, we have observed a further decrease in firms disclosing this information as at year-end 2023. In contrast we have observed an uptick in the consideration and use of IFRS 17 based metrics (as discussed in Section 3) as firms look to leverage information from this reporting basis potentially to reduce the onus of reporting and increase efficiency.

This can be seen in Figure 7, split between CFO Forum (**CFOF**) members and 'Other' companies, and split by different bases upon which embedded value is calculated.

FIGURE 7: EMBEDDED VALUE REPORTING PRINCIPLES AT YEAR-ENDS 2011-2023



Notes:

1. Swiss Re does not report explicitly under either European Embedded Value (**EEV**) or Market Consistent Embedded Value (MCEV) Principles but under a framework called Economic Value Management (EVM) and has been classed as 'Other'. (As noted in Section 3, Swiss Re has announced that it will discontinue reporting on the EVM basis with effect from 1 January 2024.)

2. Following the demerger of M&G from Prudential plc., Prudential reported under solely EEV Principles in 2019 (where previously it was classed as 'Other' due to adopting a market consistent approach for a specific tranche of UK business).

3. In its 2022 report, CNP disclosed that it has abandoned the MCEV standard in favour of the Solvency II and IFRS 17 standards. It is not entirely clear which framework is used to calculate its value metric. In Figure 7 CNP has been assumed to be 'Solvency II' for 2022. In its 2023 report, CNP set out a value measure based on the IFRS 17 reporting standard. For this reason, CNP does not feature in the 2023 results shown in Figure 7.

As a result of this continued decline in the reporting of embedded value in Europe, we have instead focused on value and capital generation disclosures in recent years.

In this section, we have focused on the value/capital generation disclosures of just over 20 companies in the European market, which span the following countries (based on their headquarters): Belgium, France, Germany, Italy, the Netherlands, Spain and the UK. In selecting these companies, we have focused on group companies and the bigger players which operate in the insurance industry in Europe. These firms are shown in Figure 8.

FIGURE 8: FIRMS CONSIDERED IN OUR SAMPLE*

▪ Achmea B.V.	▪ Hannover Re Group
▪ Ageas SA/NV	▪ Legal & General Group plc
▪ Allianz Group	▪ M&G plc
▪ a.s.r. Nederland	▪ Mapfre Group
▪ Assicurazioni Generali S.p.A.	▪ Munich Re Group
▪ Athora Netherlands N.V. (previously VIVAT N.V.)	▪ NN Group N.V.
▪ Aviva plc	▪ Phoenix Group Holdings
▪ AXA Group	▪ SCOR Group
▪ BNP Paribas Cardif Group	▪ Scottish Widows
▪ Groupe CNP Assurances	▪ Swiss Re Group
▪ Groupe Groupama	▪ VidaCaixa[18]
▪ Gruppo Unipol	▪ Zurich Insurance Group

* During 2023 Aegon N.V. Group re-domiciled to Bermuda. At year-end 2023, the majority of the firm's business is in the Americas. Since our survey is European based, we have not considered the firm's disclosures at year-end 2023 in this paper. However, the firm's results have been included in the historical figures/analysis shown in this paper, where relevant, i.e. pre-2023.

The rest of this section of the paper is split into three parts:

- A recap on the Solvency II related metrics (other than the level of Solvency II Own Funds or Solvency II Coverage Ratio) that companies in our sample chose to disclose in their supplementary disclosures
- Whether the approach adopted by firms in our sample has changed from year-end 2022 to year-end 2023
- A look at the movement in the disclosed metric over the year and, where possible, a discussion of common themes for evolution of the metric over 2023, including:
  - Market movements
  - Operational impacts
  - New business
  - Management actions
  - Dividends/capital management.

As part of this research the main sources of information for each company were the company's annual report, analyst presentations or other investor communications, and its SFCR.

18. VidaCaixa, S.A.U. de Seguros y Reaseguros y Sociedades Dependientes (VidaCaixa).

SOLVENCY II RELATED METRICS DISCLOSED BY COMPANIES IN OUR SAMPLE

Companies continue to disclose Solvency II earning metrics such as ‘Solvency II Capital Generation’, albeit with various names and slightly varying definitions.

As a result, we defined four potential capital generation metrics in the 2022 Shareholder Value Report. These four metrics are shown in Figure 9 – a full definition of these was given in the 2022 Shareholder Value Report.

FIGURE 9: POTENTIAL CAPITAL GENERATION METRICS

Capital Generation Metrics	Full Amount	Part of Amount
No Allowance for SCR	Own Funds Generation	Normalised Capital Generation
Allowance for SCR	Free Capital Generation	Operating Capital Generation

UPDATE ON APPROACH TAKEN BASED ON YEAR-END 2023 DISCLOSURES

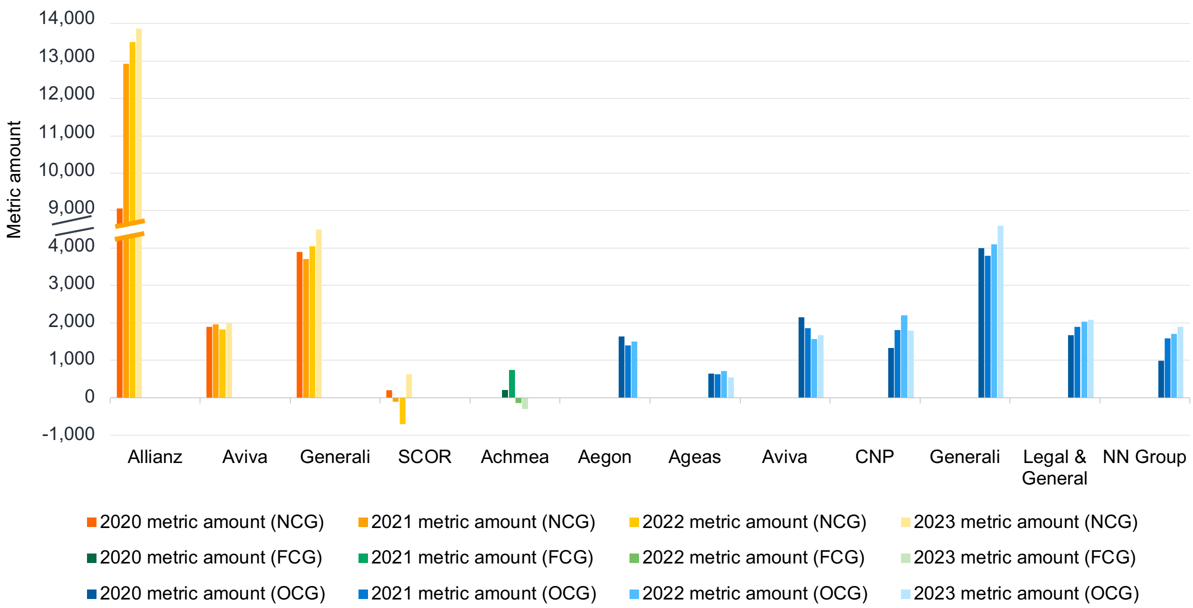
Having reviewed year-end 2023 disclosures, we have found no material changes in the approach adopted by companies in our sample over 2023.

We note that, for our sample of companies, the level of disclosure at year-end 2023 continues to be the greatest for companies headquartered in the Benelux region as well as a number of those headquartered in the UK.

RESULTS AT YEAR-END 2023

In Figure 10, we consider the disclosed metric over the year across our sample companies. The companies have been grouped into the three categories of capital generation metric as set out in Figure 9.

FIGURE 10: METRIC AMOUNT (IN EUR MILLIONS) DISCLOSED AT YEAR-END 2020, YEAR-END 2021, YEAR-END 2022 AND YEAR-END 2023



Notes:

1. The abbreviations in Figure 10 are as follows: Normalised Capital Generation (NCG); Free Capital Generation (FCG); Operating Capital Generation (OCG).

Looking initially at the data in its entirety (as shown in Figure 10), we see that experience in 2023 was mixed, which is similar to that experienced in 2022 and 2021 (noting that this may vary at the firm level). However, around 75% of the firms observed an increase in the amount of their capital generation metric over the year. For those reporting a reduction in the level of capital generated, the percentage was an approximate 80% reduction across sampled firms compared to the previous year, except for Achmea.

For Achmea, whilst the firm reported having achieved a positive contribution to free capital generated by operational activities, this was more than offset by contributions from its reinsurance programme renewal and ‘market developments, model changes and other’. In terms of reinsurance, the firm disclosed that optimising its reinsurance renewal in a hardened reinsurance market had resulted in an increased net retention as well as higher premiums leading to a negative contribution to the metric. Whereas for the negative contribution arising from ‘market developments, model changes and other’ the firm disclosed that this was mainly due to:

- The widening of mortgage spreads, leading to a recalibration of its market risk model and an adjustment of its investment portfolio;
- The sector-wide change in the contract boundary of disability and increase in the risk margin at Achmea Pension & Life; and
- A provision for final agreement on the firm’s unit-linked policies.

Allianz continues to report the largest amount of Normalised Capital Generation for firms in our sample. However, the largest year-on-year increase in the metric was reported by SCOR. This is in part due to SCOR reporting a positive metric in 2023 whereas the firm had a negative value of metric in 2022. In 2021 and 2022 SCOR explicitly reported on the impact of COVID-19 on its Operating Capital Generation in its disclosures, which had served to reduce the metric. In 2023 this item was no longer in its analysis. Also in 2022 the firm reported a significant negative contribution arising from ‘assumption changes and experience variances’ which outweighed the positive contribution arising from new business. In 2023 the negative contribution arising from ‘assumption changes and experience variances’ was less material and therefore other positive factors – including new business – outweighed this item in aggregate.

In nearly all cases for 2023, the metric was positive. The exception to this is Achmea. The reasons disclosed by the firm behind this are covered above.

In the next subsection, we consider a breakdown of the movement in Own Funds over 2023, which is an analysis disclosed by most firms in our sample.

BREAKDOWN OF THE MOVEMENT IN OWN FUNDS OVER 2023

Figure 11 details a proposed 'ideal' breakdown in Solvency II earnings metrics to help explain the key drivers of a firm's performance.

FIGURE 11: SUGGESTED IDEALISED TEMPLATE FOR THE BREAKDOWN IN CAPITAL GENERATION METRIC

1.	Opening adjustments
2.	Existing business contribution, split into:
	a. The expected real-world return[19] on assets in excess of the BEL
	b. The expected real-world spread[20] on assets backing the BEL (including the impact on the BEL)
	c. The impact of the unwinding of the Ultimate Forward Rate (**UFR**) / UFR drag
	d. The release of the Risk Margin (on existing business)
	e. The impact of run-off of the Solvency II transitionals (on existing business)
3.	New business contribution
4.	Impact of management actions (typically relating to actions taken with respect to the SCR such as reinsurance, hedging etc.)
5.	Financing costs
6.	Changes to operating / non-economic assumptions
7.	Operating / non-economic experience variances (where the variances are with reference to the expected return/spread levels in 2a and 2b above)[21]
8.	Changes to non-operating/economic assumptions, including UFR, VA etc.
9.	Non-operating / economic experience variances
10.	Other items, including tax, holding company expenses, pension scheme impacts, merger and acquisition activity, portfolio and business transfers[22]
11.	Capital management, such as the issuance and repayment of debt, share buybacks and dividends
12.	Closing adjustments

Similarly to previous years, we set out a breakdown of the movement in Own Funds over 2023 for companies in our sample on an aggregate basis in order to identify which factors had the most material impact and potentially also the most widespread impact across firms split into the following 'higher-level buckets':

- Model changes
- Operational impacts
- New business
- Management actions
- Market impacts
- Other miscellaneous items
- Capital management (which includes payment of dividends).

Given the non-standardised nature of the disclosures around the movement in Own Funds across firms in our sample, a number of simplifications and judgements have been required to arrive at the breakdown in Figure 12. However, although there are adjustments, the analysis provides a useful insight into the key drivers of firms' performance over 2023.

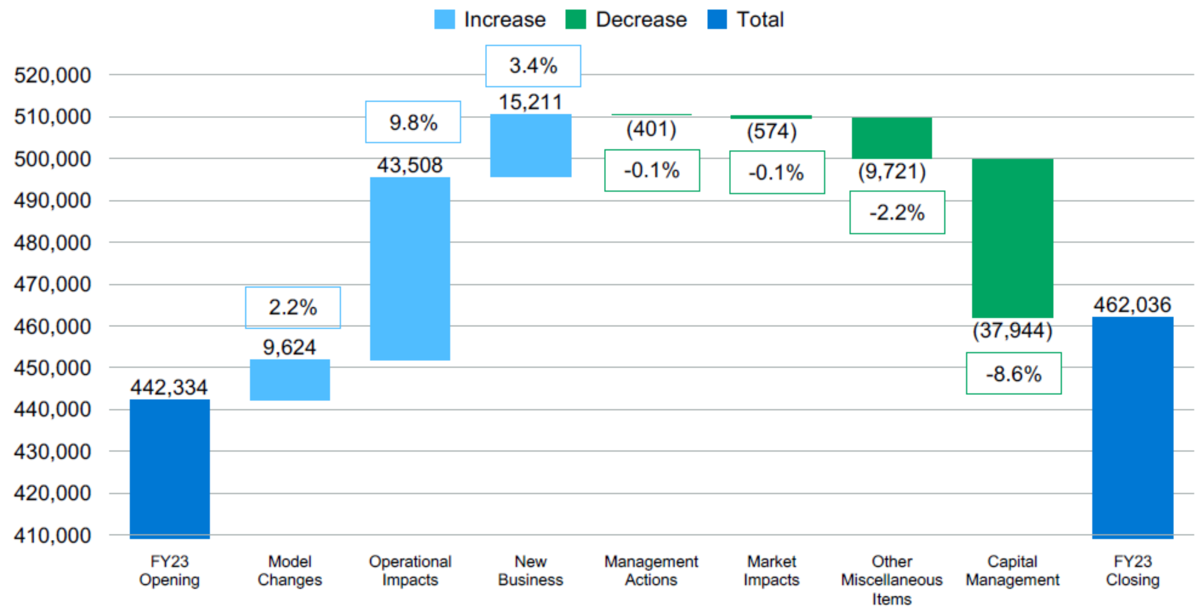
19. If possible, details of the expected real-world returns assumptions should be disclosed.

20. This expected real-world spread is the expected return over the risk-free rate used in the calculation of the BEL so would include the volatility adjustment and matching adjustment, if they are relevant for the company.

21. Some companies (and even the PRA) have suggested grouping the impact of changes in operating assumptions and operating variances into one source, but we believe that splitting them out, where possible, provides useful additional information.

22. Shareholder transfers from with-profits funds may also be included for companies with participating business.

FIGURE 12: AGGREGATE EVOLUTION OF OWN FUNDS OVER 2023 FOR COMPANIES IN OUR SAMPLE (EUR M)



Note:

1. The majority of firms included in Figure 12 report results in euros. For the handful of other firms we have converted results as at 31 December 2023 using publicly sourced exchange rates which may introduce small currency differences.

It should be noted that the results shown in Figure 12 reflect a weighted average approach, i.e. firms in our sample that have a larger Own Funds amount (and hence potentially may have a larger contribution to the high-level buckets) have a greater weight in the results compared to those firms that may have a smaller (relative) amount of Own Funds.

Figure 12 shows that total capital generation as measured by growth in Own Funds over the year, before capital distributions such as dividends, subordinated debt repayments and share buybacks, was a positive return of 13.0%, with positive operational impacts outweighing negative impacts from other sources. Capital distributions then reduced Own Funds by 8.6% to end with a 4.5% year-on-year increase.

The sections below provide further details of the items reported by companies in our sample in each of the categories listed above.

COMMON THEMES FOR BREAKDOWN OF THE MOVEMENT IN OWN FUNDS OVER 2023

Model changes

In our categorisation this includes both model and methodology changes. Companies in our sample disclosed both negative and positive impacts, resulting in an aggregate positive contribution of 2.2%.

Allianz reflected a large positive impact from model changes, mainly driven by regulatory changes which required inclusion of entities that were formerly included through book-value deduction.

Generali reflected a negative impact from regulatory changes, mainly stemming from the lower eligibility of the subordinated debt previously held by Cattolica as Basic Own Funds and other life model changes agreed with the regulators in Italy, France and Germany.

AXA disclosed a small positive impact mainly from a change in the EIOPA reference portfolio and Interbank Offered Rate (**IBOR**) transition.

Most of the UK companies in our survey reported a positive impact from model changes, which may be due to the Risk Margin and Transitional Measure on Technical Provisions (**TMTP**) Solvency UK reforms[23] covered in Section 6 of this report, as was the case for Scottish Widows who reported a material positive impact from model and regulatory changes.

Operational impacts

The following components could be included under 'Operational impacts':

- The impact of the unwinding of the UFR / UFR drag
- The release of the RM (on existing business)
- The impact of run-off of the Solvency II transitionals
- Changes to operating / non-economic assumptions
- Operating / non-economic experience variances (where the variances are with reference to the expected real-world return/spread levels).[24]

It would be most useful for firms to provide some indication of the level of capital generation that arises 'naturally' from the existing business on the balance sheet at the start of the period. The majority of firms in our sample did not disclose this level of granularity when reporting the breakdown of movement in Own Funds. Therefore, the 'Operational Impacts' category includes other items such as non-economic experience variances and non-economic assumption changes.

Overall 'Operational impacts' contributed a 9.8% increase in Own Funds over 2023, higher than previous years. This is partly driven by the release of the RM observed in UK firms reflecting the favourable reforms in Risk Margin under Solvency UK.

The companies in our sample all disclosed a positive operational impact over 2023, with the exception of Achmea, which disclosed a small negative operational impact. The overall negative operational impact reported by Achmea is driven by changes in expense, mortality and lapse assumptions, higher than expected storm impacts within the Dutch and Greek non-life insurance portfolio, higher than expected claim behaviour in the motor portfolio, and previous year adjustments on the Dutch health insurance portfolio.

Munich Re cited a large positive operating impact from its expected in-force contribution, alongside positive operating variances from in-force business with major losses in Property & Casualty reinsurance coming in below expectations, though this was slightly offset by a small negative impact from reduced transitional measures.

Similarly to 2022, Generali presented a considerable level of granularity in breaking down their operational impact, citing large positive own funds generation for Life and Non-Life business and a smaller negative contribution from Holdings & Financials. The contribution from non-economic variances was also negative, driven by the higher surrender experience and update to surrender assumptions in Italy and France, as well as the contraction of surplus funds in France and Germany.

Similarly to Generali, AXA also disclosed positive Own Funds generation from Life & Savings and Property & Casualty, and a negative impact from Holding, Banking & Asset Management, along with a small negative operating variance mainly driven by higher expenses and lower surplus funds.

New business

This category reflects the impact on Own Funds of writing new business over 2023.

Overall, 'New business' contributed a 3.4% increase in Own Funds over 2023 from the opening position (noting that some firms in our sample would include new business as part of a wider item in its movement in Own Funds, typically 'Operating Impacts').

23. We have included the impact from the Risk Margin and TMTP Solvency UK reforms under the 'Model Changes' bucket where possible, which is the case for M&G, Phoenix and Scottish Widows. For Aviva and Legal & General, this is included under 'Operational Impacts' as the split for model and regulatory changes is not available.

24. Considering the impact of each of these components (in isolation) on Own Funds: the impact of the unwinding of the UFR / UFR drag and the impact of the run-off of the Solvency II transitionals would be expected to reduce Own Funds; the release of the RM would be expected to increase Own Funds; and, changes to operating / non-economic assumptions and operating / non-economic experience variances could serve to either increase or reduce Own Funds.

As discussed in Section 3 of this report, the change in firms' overall value of new business depends both on the volumes of business written of different types of business, and any changes to the profitability of these product groups.

Generally, firms in our sample reported levels of new business contribution to Own Funds similar or somewhat lower compared to last year's, with Munich Re and Swiss Re being notable exceptions. Both firms more than doubled their new business contribution, with Munich Re and Swiss Re reporting increases in new business contributions (from EUR 2.1 billion to EUR 4.6 billion and from EUR 1.3 billion to EUR 3.4 billion respectively).

Other reinsurers in our sample (those who disclose this metric) reported a decrease in the contribution to Own Funds from new business, after reporting material increases in 2022.

As last year, Phoenix reported new business strain primarily driven by the BPA transactions it completed during the year, where the capital strain reflects the assets received on day 1 adjusted for the impact of subsequent asset trade ups in the year.

Management actions

A couple of companies in our sample provided disclosures around specific management actions taken during 2023.

Similar to last year, the impact of 'Management actions' on Own Funds is very small, contributing a 0.1% decrease in Own Funds over 2023 from the opening position.

Phoenix Group continued to implement a range of management actions over 2023, which increased Solvency II surplus but decreased Own Funds, with the most significant items relating to the implementation of longevity reinsurance and capital synergies arising at the group level from the funds merger of Phoenix Life Assurance Limited, Standard Life Assurance Limited and Standard Life Pension Funds Limited into Phoenix Life Limited.

Market impacts

The following components could be included under 'Market impacts':

- Expected real-world return on assets in excess of the BEL
- Expected real-world spread on assets backing the BEL (including the impact on the BEL)
- Changes to non-operating/economic assumptions, including the impact of any changes to Solvency II parameters provided by EIOPA such as the UFR or VA
- Non-operating / economic experience variances.

As discussed previously in this report, market movements had varied impacts on companies' Own Funds. Companies in our sample disclosed both negative and positive impacts, resulting in a small aggregate negative contribution of 0.1% to Own Funds over 2023.

The companies in our sample all disclosed a moderately negative or moderately positive market impact over 2023, with the exception of a.s.r. and L&G, both of which disclosed larger negative market impacts of -15.7% and -11.3% of the opening Own Funds respectively. It should be noted that some of the negative impact reported by a.s.r. is due to operational developments, as a.s.r. combined market and operational impacts as part of a wider item in its movement in Own Funds. a.s.r. reported that the negative market impact is driven by revaluations of real estate and credit spread widening. L&G attributed the negative market impact to higher rates on the mark to market valuation of assets, partially offset by other, smaller variances such as credit spread dispersion in sub-investment grade assets, and inflation.

Most of the UK companies in our sample reported negative market impacts, with companies generally attributing these to adverse market movements.

Other miscellaneous items

In our categorisation this includes such items as tax, changes in eligible Own Funds restrictions, pension scheme impacts, merger and acquisition activity, and portfolio and business transfers.

Overall 'Other miscellaneous items' contributed a 2.2% decrease in Own Funds over 2023 from the opening position.

Similar to last year, this category has not been a significant driver of the change in Own Funds this year. M&A activity was the main contributor to this category in 2021, while there has not been significant M&A activity over 2022 and 2023. Allianz did however disclose a small negative impact in 2023 from the acquisition of Innovation Group.

Capital management

In our categorisation this includes capital management actions such as the issuance and repayment of debt, share buybacks and the payment of dividends, as well as the payment of financing costs (such as interest on outstanding debt).

For Aviva and Phoenix, this item also includes corporate centre costs and corporate and head office costs incurred in the year. In the case of Aviva this was aggregated with other debt costs, whereas Phoenix's disclosures allowed this item to be quantified separately from its debt interest and dividend costs. Both firms reported, in aggregate, that this category provided a negative contribution to the movement of Own Funds during 2023.

As discussed in previous sections, the majority of companies in our survey announced dividends higher than in 2022. On top of that, most firms announced (or continued) share buy-back programmes. This is supported by the overall trend of an increase in Own Funds over 2023.

Dividends and share buybacks form the majority of the capital management impact, which on aggregate for the companies in our sample reduced Own Funds by 8.6% – the highest payout over recent years.

Despite the macroeconomic environment which still presented challenges, companies continued to pay dividends in line with their policies and many announced a commitment to progressive dividend policies.

5. Comparison of experience over recent years

In this section we expand on the movement in Own Funds analysis set out in Section 4, which looked at the breakdown in isolation over 2023. More specifically, we have considered how results over 2023 compare with prior years.

Although Solvency II was implemented on 1 January 2016, the level of disclosures as well as the quality of disclosures by firms in our sample has greatly increased since year-end 2016 and year-end 2017. In particular, providing a breakdown of the movement in Own Funds was far less common in year-end 2016 disclosures for firms in our sample compared with disclosures since year-end 2017, where it has now become more commonplace. Furthermore, the level of granularity within the movement of Own Funds has increased in more recent years compared with earlier analyses at year-ends 2016 and 2017.

As a result, in expanding our analysis to include previous years' experience we have limited it to considering year-end 2018 to year-end 2023, so that nearly every firm included in our survey disclosed a breakdown of Own Funds for each year. This makes the expanded analysis more robust in that it is not unduly influenced by changes in the number of firms being included year-on-year.

Figure 13 shows the number of firms included in each year's analysis. The criteria determining whether a firm has been included is solely based on whether a firm discloses a sufficient level of detail in its public disclosures, i.e. a movement in Own Funds over the year of sufficient granularity.

FIGURE 13: NUMBER OF FIRMS INCLUDED IN MOVEMENT IN OWN FUNDS ANALYSIS

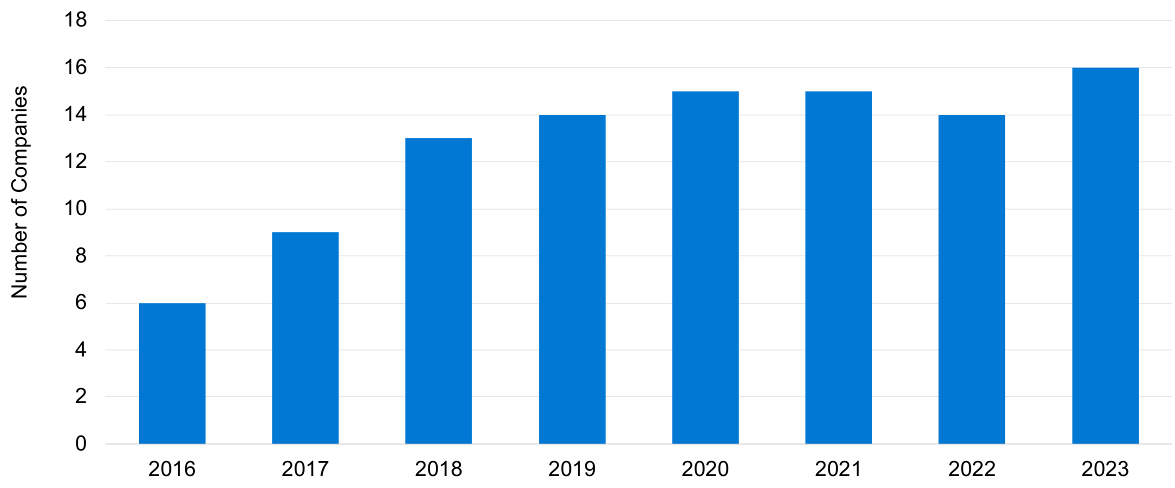
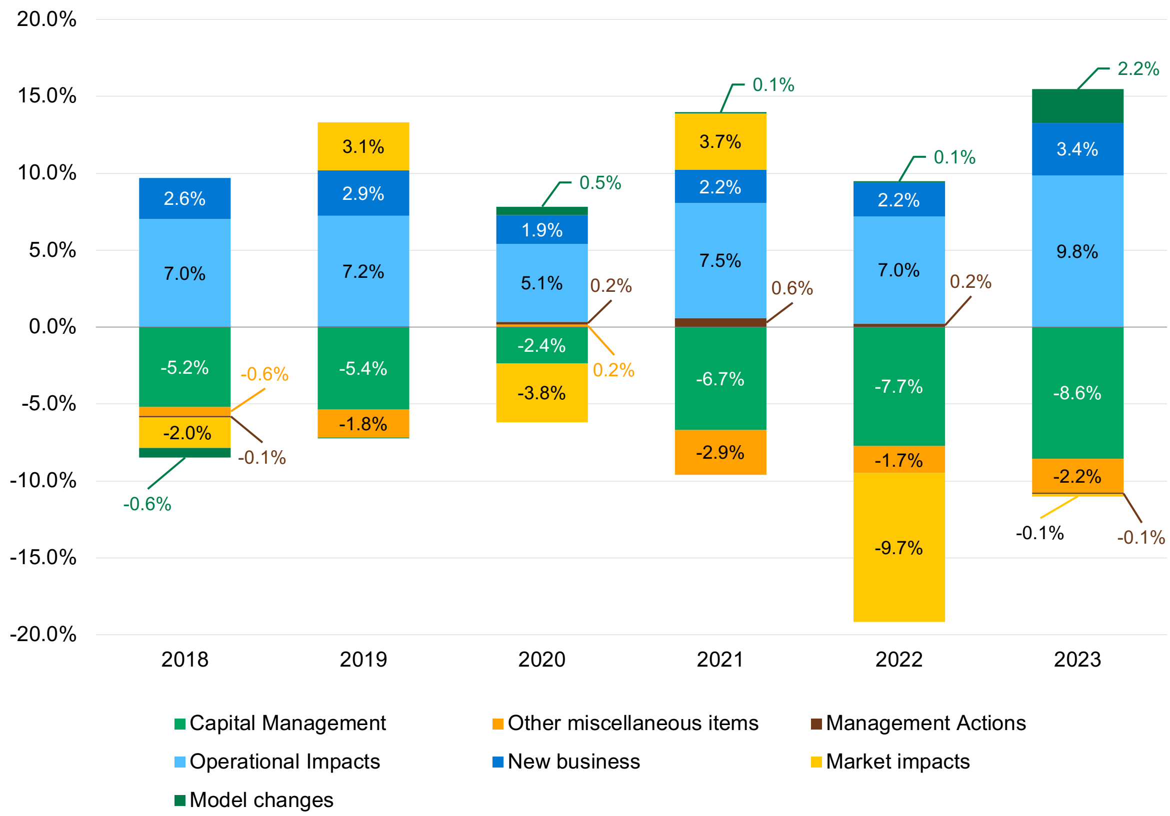


Figure 14 shows the combined results for year-end 2018 to year-end 2023, split according to the seven 'high-level buckets' set out in Section 4.

FIGURE 14: EVOLUTION OF CAPITAL GENERATION DRIVERS



Note:

1. The figures for years 2018 to 2022 in Figure 14 may differ from the figures in the Shareholder Value Report published in previous years due to changes to the high-level bucket categorisations of some of the items.

Looking at the results over the six years:

- **Operational impacts**: The contribution to the movement in Own Funds from this item seems broadly stable year-on-year, with 2023 being higher than in other years. Although some companies observed higher surrenders due to rising interest rates which decreased Own Funds, this was outweighed by expected in-force contributions, higher release in risk margin from UK companies due to the RM reforms under Solvency UK, and increases in mortality assumptions for UK annuity businesses.
- **New business**: New business contribution is slightly higher compared to previous years. This is driven by the growth in PRT transactions and individual annuity sales in the UK and very favourable new business development from Munich Re and Swiss Re (as discussed earlier in this Report in Section 4).
- **Market impacts**: Over the five years from 2018 to 2022, the observed impact fluctuations seem broadly in line with market performances for each year, i.e. 2018, 2020 and 2022 markets typically performed poorly or were volatile, whereas 2019 and 2021 were more stable or showed signs of recovery compared with the prior year. 2023 has been a year of high interest rates, tightened credit spreads, recovery in equity markets and high inflation, each having a varying impact on Own Funds. On aggregate, this has resulted in a small negative market impact over 2023, one of the smallest contributions of all the categories, and also the smallest market impact over the last five years.
- **Capital management**: This item has also been the highest to date in our analysis, with capital generation allowing companies to sustain their target level of dividends. It also reflects that the capital position of many companies has remained strong after improving from a significant reduction in the SCR in 2022 (due to higher interest rates and lower asset values), leaving many companies at the top of the comfortable range of their solvency ratio for dividend payout.

- **Management actions**: Whilst the impact from this item is variable year-on-year, overall it has a small impact each year, with 2021 being higher than in other years mainly due to the contribution from Allianz as a result of a reinsurance transaction.
- **Model changes**: The impact from this item is variable year-on-year, with the impact in 2023 larger than in previous years mainly due to regulatory changes.
- **Other miscellaneous items**: The impact from this item is variable year-on-year. This may be expected given that this category includes M&A activity. There has been a drop-off in M&A activity in the European insurance market in 2023, and as a result, the impact from this item in 2023 was not significant.

Based on results shown in Figure 14, we have calculated the implied total return ‘pre-dividend’ and ‘post-dividend’ in Figure 15. The ‘pre-dividend’ return has been calculated including all items set out in Figure 14, except for the effect of capital management. This has been assumed to be a proxy for a pre-dividend position. The ‘post-dividend’ return has been calculated including all seven items i.e. including capital management.

FIGURE 15: TOTAL RETURN IMPLIED BY CAPITAL GENERATION DRIVER ANALYSIS

TOTAL RETURN	2018	2019	2020	2021	2022	2023
‘Pre-dividend’	6.4%	11.5%	4.0%	11.0%	-1.9%	13.0%
‘Post-dividend’	1.2%	6.1%	1.7%	4.3%	-9.7%	4.5%

The implied ‘pre-dividend’ return varies over the six-year period considered, with the volatility arising largely from the contribution of market impacts. Higher than in previous years return in 2023 is also driven by higher than typical for previous years’ operational impact.

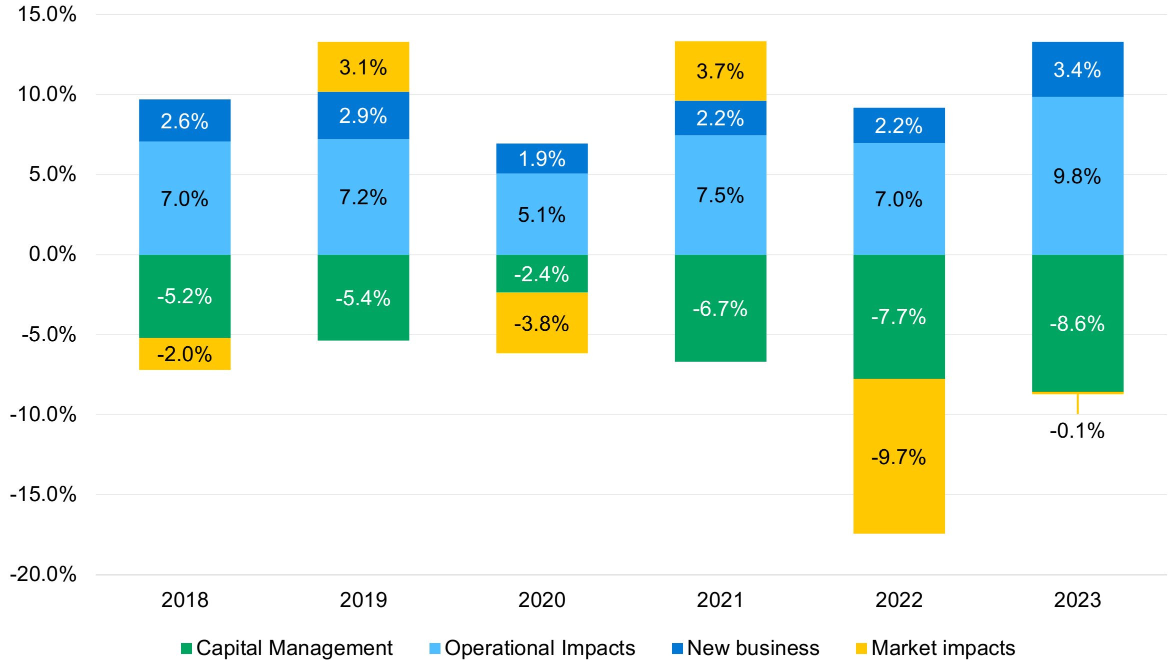
In terms of the seven ‘high-level buckets’ set out in Section 4 above, Figure 16 shows the judgement we have made.

FIGURE 16: CATEGORISATION OF HIGH-LEVEL BUCKETS INTO ANTICIPATED VERSUS UNANTICIPATED

CATEGORY	ANTICIPATED / UNANTICIPATED?	REASONING
Model changes	Unanticipated	Typically modelling changes are not anticipated year-on-year
Operational impacts	Anticipated	A contribution from the operations of existing business to Own Funds would be anticipated
New business	Anticipated	If a firm is open to new business, some contribution to Own Funds would be anticipated
Management actions	Unanticipated	Typically all of the actions taken by management throughout the year cannot be anticipated at the start of the year
Market impacts	Anticipated	Although the exact impacts will be unknown at the start of the year, a contribution from market movements would be anticipated
Other miscellaneous items	Unanticipated	Typically miscellaneous items are not anticipated year-on-year
Capital management	Anticipated	Although some components of capital management may be unanticipated, there may be some that can be anticipated e.g. payment of dividends

Figure 17 shows the results, as shown in Figure 14, but only for the anticipated items (as classified in Figure 16).

FIGURE 17: EVOLUTION OF CAPITAL GENERATION DRIVERS FOR ANTICIPATED ITEMS



Note:

1. The figures for years 2018 to 2022 in Figure 17 may differ from the figures in the Shareholder Value Report published in previous years due to changes to the high-level bucket categorisations of some of the items.

Based on these four 'anticipated' drivers, we have considered whether the 'dividend payout' can be estimated as a function of the earnings made over the year, i.e. considering the capital management driver as a function of the other three drivers.

In previous analysis we suggested that market impacts may have a limited bearing on the level of dividends being paid out and calculated a payout ratio as: Capital management contribution / (Operational impacts + New business), i.e. ignoring market impacts. In using this approach, the effect of capital management had been assumed to be a proxy for the payment of dividends.

In addition, we have considered the expected capital generation based on the back-book alone i.e. ignoring new business. In considering this metric we looked at which 'one-off' items could be removed from the 'Operational impacts' bucket, along with market returns over the period, to derive an estimate. In adopting this approach we recognise that there is a high degree of subjectivity as well as limitations given the level of disclosure of firms' results, which also varies across firms in our survey. Results for these metrics expanded for 2023 are shown in Figure 18.

FIGURE 18: PAYOUT RATIO AND EXPECTED CAPITAL GENERATION BASED ON BACK-BOOK

ITEM	2018	2019	2020	2021	2022	2023
Payout ratio	54%	53%	34%	69%	84%	65%
Expected back-book capital generation	8.6%	9.1%	7.3%	10.2%	10.5%	12.9%

Note:

1. The figures for years 2018 to 2022 in Figure 18 may differ from the figures in the Shareholder Value Report published in previous years due to changes to the high-level bucket categorisations of some of the items.

Results in Figure 18 show that, over the period 2018 to 2021, the payout ratio is around 50% (if we average the results in 2020 and 2021, which we thought could be considered to offset each other due to the extra restrictions that were placed on firms in terms of paying out dividends in 2020). However, 2022 appears to be an exceptional year compared to the recent years, with payout ratio materially exceeding the ones observed until then. As discussed earlier, in 2022 firms paid dividends at a level similar or higher than in previous years, as a sharp rise in interest rates increased solvency ratios for many firms, which allowed them to pay dividends in line with their capital management policies.

2023 has seen a more modest payout in comparison with 2022, but still considerably higher than the average payout in 2018-2021, as companies generated more capital than in recent years – mainly due to operational impacts. This might represent a ‘new normal’, as most companies announced dividends at a similar, or even higher, level in 2022 and 2023, with some companies also announcing a commitment to progressive dividend policies. We will monitor this going forward, as the trends and companies’ approaches to dividends will become clearer.

In addition, the expected capital generation based on the back-book varies from around 7.0% to 13.0% over the five-year period, so it appears that high single digits or low double digits may be the norm. However, looking to the future, this may change due to the economic environment and if solvency rules change (e.g. in light of the Solvency II Review and/or the HMT review).

The expected back-book capital generation of 12.9% observed in 2023 is higher than in previous years. The disclosures do not provide much insight into the driver for this; however, we observed that a number of the larger companies in our sample reported materially higher capital generation from their Property & Casualty business in 2023, relative to 2022, which is driven by favourable development of loss ratios over the year and increases in premiums in response to inflation. We also note that the existing business contribution for firms may be higher in 2023 due to unwinding reserves at a higher risk-free rate in the current economic environment, relative to prior years.

6. Regulatory developments

In this section, we provide a brief summary of recent regulatory developments in the European insurance market, focusing mainly on how they may shape shareholder value reporting going forward. More specifically, we consider:

- EIOPA's Solvency II review
- Reviews by the UK government, in particular by HM Treasury (HMT or the Treasury) and the PRA, of the current application of Solvency II in the UK
- The implementation of the Insurance Capital Standard.

We note that these topics are more generally considered in other Milliman papers and shall indicate where this is the case. Milliman has previously published a number of papers covering the following regulatory developments in more detail, as well as an analysis of their expected impact on firms, and we have indicated where this is the case.

The impact of IFRS 17 has been considered separately in Section 3.

SOLVENCY II

After years of effort, the review of the Solvency II Directive is now nearing an end, having reached a significant milestone in January 2024 whereupon agreement was reached on the proposed amendments between the European Commission (EC), Council of the European Union and the European Parliament.

To provide a recap on the progress made in the lead-up to this year:

- In December 2020, EIOPA published its opinion on the Solvency II Review.
- Following this, in September 2021 the EC announced its proposals to reform Solvency II. Over the summer of 2022, as part of the legislative procedure, the European Parliament – a rapporteur as well as other Members of the European Parliament (**MEP**s) – and the Council of the European Union provided their responses to the suggested reforms from the EC.
- After more than a year of negotiations, in July 2023, the European Parliament's Committee on Economic and Financial Affairs (**ECON**) approved the proposed amendments to the Directive with 55 votes in favour of the rapporteur's draft report and three against.

Negotiations between the EC, the Council of the European Union and the European Parliament on the provisional amendments made to the Directive ensued. In December 2023, agreement was reached and these provisional amendments were published.

The provisional amendments were then approved in the European Parliament's sessions in April 2024.[25]

With the review process now drawing to an end, the European Council and the Parliament will now have to formally adopt the texts. These reforms could therefore become effective for EU member states from 30 June 2025, with insurers having to apply these amended standards by 1 January 2026. However, it is possible there are further delays that could set this back.

Milliman has published a paper summarising the final amendments to the Solvency II Directive.[26] These include:

- The calculation of the **Risk Margin**, including a reduced cost of capital factor and a new lambda factor accounting for the time dependency of risks.
- The calculation of the **SCR**, including a revision of the interest rate risk calibration, a widened Symmetric Adjustment corridor and amendments to the criteria for long-term equities.
- **Long-term guarantee measures**, including the extrapolation methodology used for risk-free rates and an overhaul of the Volatility Adjustment.

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25. European Parliament. Amendments to the Solvency II Directive. Retrieved 13 August 2024 from https://www.europarl.europa.eu/doceo/document/TA-9-2024-0295_EN.pdf.

26. Milliman (February 2024). Amendments to the Solvency II Directive. Milliman briefing note. Retrieved 13 August 2024 from https://www.milliman.com/en/insight/amendments-to-the-solvency-ii-directive.

- Expansion of the scope of **Pillar 2**, including embedding sustainability risks into the risk management framework, consideration of exposure to climate change risks, more direct consideration of macroeconomic conditions and further governance requirements.
- **Pillar 3** amendments, including slightly relaxed reporting deadlines, and a redesign of the SFCR.
- **Proportionality** rules that impose less burdensome requirements on small and non-complex insurers.

As noted in the following section, firms domiciled in the UK are no longer bound by Solvency II. However, UK-based firms which form part of an EU-based group will need to provide results on a Solvency II basis to the group and, as a result, these amendments will be relevant to such firms. Any divergence in approach in the final outcome between the Solvency II Review and the HMT/PRA reviews, e.g. in the calculation of the Risk Margin, may introduce added complexity for such firms.

It will take a few years to assess the full extent of the impact of the Solvency II review on firms. However, in particular, it is clear that the reduction in the Risk Margin for long-term liabilities will reduce the cost of capital significantly for many firms going forward and, all else being equal, will help firms become better capitalised.

SOLVENCY UK

The review of Solvency II for the UK insurance market, known as Solvency UK, has been led by HMT as part of the UK Government, which was granted powers by the UK Parliament to modify retained EU law relating to financial services and markets following the UK's exit from the European Union. This has been complemented by more granular reforms proposed by the PRA.

HMT review

The journey to implement Solvency UK started in April 2022, when HMT issued a consultation on its proposals.[27] The Treasury published its response[28] to that consultation in November 2022, including a summary of the feedback received and a draft reforms package. A policy statement[29] on the Treasury's implementation plan was then published in December 2022.

In June 2023, the Treasury published the draft reforms package from the consultation response as a Supervisory Instrument (**SI**)[30] which included the RM and certain aspects of the Matching Adjustment (MA). These reforms became effective from 31 December 2023.

PRA review

As covered in the shareholder report from last year, Solvency UK will be implemented via a combination of SIs enacted by the Treasury and changes to the PRA rules and other policy material.

As such, the PRA issued two consultations in 2023 following the Treasury's SI in June:

- Consultation Paper (CP) 12/23,[31] which sets out the majority of the PRA's reform proposals, focusses on simplification, improving flexibility and encouraging entry.
- CP19/23,[32] which covers reform proposals for life insurers relating to investment flexibility and the MA.

Milliman has produced a briefing note for both CP12/23[33] and CP19/23[34] on the details of these proposed reforms.

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27. HM Treasury (28 April 2022). Solvency II Review: Consultation. Retrieved 13 August 2024 from https://www.gov.uk/government/consultations/solvency-ii-review-consultation.
28. HM Treasury (17 November 2022). Solvency II Review: Consultation. Retrieved 13 August 2024 from https://www.gov.uk/government/consultations/solvency-ii-review-consultation.
29. HM Treasury (December 2022). Building a smarter financial services framework for the UK. Retrieved 13 August 2024 from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122734/Building_a_smarter_financial_services_framework_for_the_UK_.pdf.
30. HM Treasury (22 June 2023). Draft Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations. Retrieved 13 August 2024 from https://www.gov.uk/government/publications/draft-insurance-and-reinsurance-undertakings-prudential-requirements-regulations.
31. PRA (29 June 2023). CP12/23 - Review of Solvency II: Adapting to the UK insurance market. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2023/june/review-of-solvency-ii-adapting-to-the-uk-insurance-market.
32. PRA (28 September 2023). CP19/23 – Review of Solvency II: Reform of the Matching Adjustment. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2023/september/review-of-solvency-ii-reform-of-the-matching-adjustment.
33. Milliman (7 July 2023). CP12/23 – Review of Solvency II: Adapting to the UK insurance market. Retrieved 13 August 2024 from https://uk.milliman.com/en-gb/insight/cp-12-23-review-solvency-ii-uk-insurance
34. Milliman (16 October 2023). CP19/23 – Review of Solvency II: Reform of the Matching Adjustment. Retrieved 13 August 2024 from https://uk.milliman.com/en-gb/insight/cp19-23-review-of-solvency-ii-reform-of-matching-adjustment

Following the consultation period for CP12/23, the PRA published its first set of Policy Statements (PSs), PS2/24[35] and PS3/24[36] in February 2024.

PS2/24 proposed the changes initially proposed under CP12/23, with a few modifications, including giving more time for an insurance group to consolidate its internal models after an acquisition, removing a requirement to disclose Residual Model Limitation capital add-ons and increasing the size threshold for a firm above which Solvency UK will apply.

PS3/24 addressed CP14/22, which set out the proposed changes to the reporting and disclosure requirements under Solvency UK, as well as the reporting and disclosure aspects of CP12/23. The final policy largely includes the proposals outlined in the consultations, with some amendments to the proposed reporting templates – namely, not introducing some templates proposed under CP14/22 and simplifying others.

The consultation period for CP19/23, the second and final set of Solvency UK reforms proposed by the PRA, closed in January 2024. The PRA published PS10/24[37] in June 2024 to address the second and final set of reforms.

The key developments in PS10/24 included:

- Increased **investment flexibility** for the MA portfolio, including some clarifications regarding assets with 'fixed' cash flows and restructured assets.
- Enhanced **credit ratings** under the MA including considerations for investment in sub-investment grade (SIG) assets.
- Clarifications around the **attestation** of the Matching Adjustment
- Increased **liability eligibility** of the MA.

For further detail, Milliman produced a briefing note,[38] which summarised these reforms, including exploratory analysis into their impact on insurers.

The reforms to the Matching Adjustment under PS10/24 became effective on 30 June 2024. Solvency UK will become fully effective on 31 December 2024.

As mentioned in the previous Shareholder Value Reports, the use of the MA across Europe is mostly concentrated in firms domiciled in the UK and Spain. As the MA is not a key element of the EIOPA Solvency II Review, we may now see the impact of this long-term guarantee measure start to diverge between the UK compared to EU countries.

Other reform measures

As noted in the 2022 Shareholder Value Report, HMT will support the PRA both by ensuring it has the powers necessary to take forward certain additional measures and by being clear that it supports the PRA’s use of these measures to hold insurers to account in maintaining safety and soundness and policyholder protection.

In particular, the PRA may prescribe insurers regular stress testing exercises to test insurers’ resilience to scenarios the PRA will set out, as well as publish individual firm results. The PRA is invoking this power with the Life Insurance Stress Test (**LIST**) 2025.[39] The use of such exercises will likely increase pressure on firms to improve their stress and scenario testing capabilities in the future.

35. PRA (28 February 2024). PS2/24 – Review of Solvency II: Adapting to the UK insurance market. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2024/february/review-of-solvency-ii-adapting-to-the-uk-insurance-market-policy-statement.
36. PRA (29 February 2024). PS3/24 – Review of Solvency II: Reporting and disclosure phase 2 near-final. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2024/february/review-of-solvency-ii-reporting-disclosure-phase-2-near-final-policy-statement.
37. PRA (6 June 2024). PS3/24 – Review of Solvency II: Review of Solvency II: Reform of the Matching Adjustment. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2024/june/review-of-solvency-ii-reform-of-the-matching-adjustment-policy-statement.
38. Milliman (10 July 2024). PRA PS10/24 – Review of Solvency II: Reform of the matching adjustment. Retrieved 13 August 2024 from https://uk.milliman.com/en-gb/insight/pra-ps-10-24-review-solvency-ii-reform-matching-adjustment.
39. PRA (10 July 2024). Life Insurance Stress Test (LIST) 2025. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2024/july/list-2025.

With regard to future developments concerning the Matching Adjustment, the PRA noted that further work is ongoing on some matters related to the MA and that it will keep the implementation of the MA reforms under review going forward. One current area of discussion is the concept of a 'sandbox', which would grant firms an ability to self-certify the application of the MA for newly acquired assets on a temporary basis. The intention behind this measure would be to remove barriers for firms to invest in (limited amounts of) assets that may be suitable for matching liabilities but are not currently deemed eligible. A formal regulatory decision on eligibility would follow.

In July 2024, the PRA published PS13/24,[40] summarising the feedback received on the consultation of the use of Funded Reinsurance, CP24/23,[41] which launched in November 2023. The PRA has now set out its final rules regarding the use of Funded Reinsurance in its supervisory statement SS5/24,[42] as well as a Dear CEO letter[43] that expresses concern than misuse of Funded Reinsurance could expose the UK insurance industry to an unacceptable accumulation of counterparty risk. SS5/24 imposes stricter rules on counterparty exposures, the calculation of the counterparty default risk SCR and governance relating to the use of Funded Reinsurance.

At this stage, it is hard to predict how the suite of proposed amendments made by HMT and the PRA will impact the UK insurance industry in aggregate. In particular, the cumulative impact of the changes arising from the review will vary from firm to firm.

As with EIOPA’s Solvency II review, the reduction in the Risk Margin for long-term liabilities implemented last year will reduce the cost of capital significantly for many firms going forward and, all else being equal, will have helped firms become better capitalised. The reduction in cost of capital is higher under the Solvency UK reforms than under the Solvency II reforms.

Simplified reporting requirements, in particular for smaller firms, will also ease operational burden and costs over the medium term. The significant reforms of the Matching Adjustment open the door for large annuity writers to sharpen their asset portfolios, though, in practice, firms will be wary over the next few years of the requirements introduced alongside these benefits such as investment limits and the potentially onerous attestation process.

It may therefore take some years before broad trends in profitability start to emerge across the insurance sector as a result of the Solvency UK reforms, and any impacts on new business and pricing strategy as a result. That said, some related measures could have a much more immediate impact on business strategies. In particular, the PRA rules on Funded Reinsurance under SS5/24 will hamper the ability, and appetite, of some insurers to write large bulk annuity deals; though it could be argued that this will not have too large a bearing on the otherwise buoyant pension risk transfer market.

INSURANCE CAPITAL STANDARD

The ICS is a global consolidated capital standard applicable to Internationally Active Insurance Groups (**IAIG**s). The ICS is a part of a wider framework of the supervision of IAIGs developed by the International Association of Insurance Supervisors (**IAIS**), aiming to improve the consistency of the supervision of the global insurance industry.

In 2024, the five-year monitoring period for the ICS that commenced in 2020 will conclude, with the ICS being finalised as a group-wide prescribed capital requirement (**PCR**) in December 2024.

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40. PRA (26 July 2024). PS13/24 – Funded reinsurance. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2024/july/funded-reinsurance-policy-statement.

41. PRA (16 November 2023). CP24/23 – Funded reinsurance. Retrieved 13 August 2024 from https://www.bankofengland.co.uk/prudential-regulation/publication/2023/november/funded-reinsurance-consultation-paper.

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Ahead of the adoption of ICS as a PCR, an indicative version of the final set of the ICS technical specifications was shared in June 2024,[44] which took into account:

- The policy changes incorporated into the candidate version of the ICS published in 2023, notable examples including refined valuation methodologies, updated calibrations used in deriving capital requirements, and allowing the use of internal models.
- Findings from the public consultation of this candidate version.
- The ICS economic impact assessment.
- Findings from the last year of monitoring data.

The changes introduced in this set of technical specifications entail refinements across the three components of the ICS (valuation, capital requirement and capital resources) and include the changes to the treatment of the middle bucket of the Market Adjusted Valuation (**MAV**) as well as a simplification of the interest rate risk module.

Another key consideration for the development of the ICS standard over the past year has been comparability to capital regimes in the applicable jurisdictions of the IAIGs. As mentioned previously, the European Parliament has now approved EIOPA's review of the review of the Solvency II regime while the UK is undergoing implementation of Solvency UK.

In the US, the Aggregation Method (AM) for group capital adequacy is currently under development. Once finalised, a comparability assessment of the AM in the US and other related jurisdictions with the ICS will be performed. The IAIS has previously published specific criteria it will use to assess whether the AM can indeed be deemed an outcome-equivalent approach to the ICS and it has also now started a data collection exercise for Volunteer Groups affected by the AM to aid this comparison.

The IAIS has set out a high-level timeline for the development of the ICS going forward:

1. December 2024: Final version of ICS issued. The ICS is adopted as a PCR.
2. 2025: The IAIS will begin developing a detailed ICS implementation assessment methodology to ensure firms demonstrate compliance with the ICS through both quantitative and qualitative means.
3. 2026: The IAIS will coordinate a self-assessment to be performed by IAIS members in assessing their progress in implementing the ICS. This self-assessment will serve as a baseline for future implementation progress monitoring.
4. 2027: The IAIS will commence in-depth targeted jurisdictional assessments of ICS implementation.

While the global insurance industry is gaining momentum towards the adoption of the ICS, a few years remain before we see strict monitoring of compliance with the ICS. This has the advantage that it gives time for jurisdictional capital regimes to align with the ICS as necessary and therefore potentially reduce complexity for the IAIGs.

The implications of the ICS on IAIGs will largely depend on whether their local jurisdiction obtains equivalence. While US firms will have clarity on this sooner, IAIGs in the UK and Europe will await the result of the ICS implementation assessment methodology to be developed in 2025 before receiving confirmation of whether Solvency UK and Solvency II are deemed equivalent. In this case, IAIGs in the UK and Europe would not be required to prepare their results on the ICS basis.

44. IAIS (27 June 2024). IAIS charts course on Insurance Capital Standard (ICS) implementation ahead of adoption in December 2024. Retrieved 13 August 2024 from https://www.iaisweb.org/2024/06/iais-charts-course-on-insurance-capital-standard-ics-implementation-ahead-of-adoption-in-december-2024/.

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