BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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Longevity Risk Transfers

This letter sets out the PRA's views on the general issues arising from longevity risk transfers, and clarifies the PRA's expectations on UK insurers and reinsurers carrying out these transactions as either the buyer or the seller of longevity protection.

Longevity risk is the risk that policyholders, pension scheme members or other underlying beneficiaries, in aggregate, live longer than expected. The main life insurance products exposed to this risk are immediate and deferred annuities, although certain health contracts and possibly with-profits funds may also be exposed. In addition, there is likely to be some exposure to longevity risk in an insurer's own staff pension scheme (if defined benefit). There is also growing longevity exposure among general insurers in relation to periodic payment orders.

We recognise that there has been an active market in the transfer of longevity risk for a number of years. Solvency II potentially provides firms with an additional incentive to undertake transactions to transfer longevity risk by way of reinsurance. However, we would be concerned if firms became active in this market for reasons other than seeking genuine risk transfer.

An insurer accepting risk from, transferring risk to, or hedging risk with, a single or small number of counterparties (or connected counterparties) may expose itself to possibly significant levels of counterparty risk. Solvency II introduces specific risk management rules which require insurers and reinsurers to have an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis, the risks facing them both now and potentially in the future (see Rule 3.1 of the PRA Rulebook: Solvency II Firms – Conditions Governing Business). The PRA accordingly expects firms to monitor, manage and mitigate these concentration risks. This includes risks which are covered by the Solvency Capital Requirement (SCR) as well as those which are not. In practice this means that holding capital under the SCR in relation to counterparty default risk may not be sufficient in and of itself to mitigate this risk - additional measures besides capital may be necessary. For more information we direct firms to our letter dated 6 November 2015.

In order to supervise firms' risk management practices, the PRA expects to be notified of longevity risk transfer and hedge arrangements and the firm's proposed approach to risk management well in advance of completing such a transaction. This expectation applies where a firm is buying or selling longevity protection. As well as allowing us to gain a fuller picture of the market, this would also allow us to understand the potential build-up of risk concentrations as a result of these transactions. This will enable supervisors to consider whether the risks of the proposed transaction are being appropriately managed and that the transaction has an underpinning rationale that is consistent with good risk management principles.

Yours sincerely

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