Bank of England PRA

Chief Risk Officers of life insurance firms
writing bulk purchase annuities

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Dear [Chief Risk Officer]

Solvency-triggered termination rights clauses in bulk purchase annuity transactions

The Prudential Regulation Authority (PRA) has recently completed a thematic review of UK life insurers' use of solvency-triggered termination rights clauses (STTRs) in bulk purchase annuity (BPA) transactions. I am writing to share the PRA's view of the potential risks arising from the use of these clauses and our assessment of how firms are mitigating the risks involved. As the Senior Manager responsible for identifying, assessing and mitigating risks within an insurer active in the BPA market, and a source of independent challenge, we consider that you are well placed to assess the extent to which the points raised below are relevant to your business and review how they are being addressed.

Context

In recent years, we have seen a growing demand for STTRs to be included in the terms of BPA buy-in transactions. STTR clauses provide pension scheme counterparties with the option to terminate a BPA buy-in arrangement in the event of the insurer's solvency position breaching a pre-defined threshold for a given period of time ('Cure Period'). In the event of an STTR termination, the clauses provide for the relevant liabilities of the insurer to be recaptured by the pension scheme, along with a proportion of the assets used by the insurer to back the liabilities ('Termination Payment').

Our 2025 supervisory priorities letter[1] flagged STTRs as an example of how the BPA market is continuing to evolve. Based on information provided to us by firms, we estimate total exposure of life insurers to STTRs, through BPA contracts with an STTR clause in force, to be c.£50 billion. Individual firm exposures vary, but in some cases represent material proportions of firms' Matching Adjustment portfolios. The clauses could bring inherent risks to insurers' balance sheets which would need to be managed concurrently in a period of stress. As we note below, there are a range of potential mitigation practices and techniques available to firms, and it is important that firms assess the risks involved in the use of these clauses and take steps to manage the risks and uncertainties they can introduce.

Our review sought to better understand the potential risks associated with the use of STTR clauses and how relevant firms are managing those risks, and we engaged with a number of market participants to support this work.

Key Findings

In summary, we consider that the use of STTR clauses introduces various potential risks for insurers in the event the clauses are triggered. These risks include impacts on the composition of firms' remaining asset portfolios, their liquidity positions, and the management of their Matching Adjustment portfolios. In addition, firms might face operational challenges if these clauses are triggered in a stress situation. These challenges could be exacerbated if there are any contractual ambiguities in STTR clauses which might come to the fore in stressed market conditions, or where STTR clauses might interact with collateral available to a firm under Funded Reinsurance contracts. It is important that firms consider these risks carefully to ensure the financial and operational implications are managed appropriately.

Our review found that many firms were mindful of some of these potential risks and had taken steps to manage them, for example through preserving flexibility on the assets returned under an STTR clause, and through contractual provisions relating to when a clause is triggered and the period available to cure any breach or to return assets under the contract. However, most firms need to do more to demonstrate they have adequately considered the full range of risks involved. For example, firms could do more to set appropriate aggregate exposure limits, and to plan for the financial and operational issues which might arise in adverse scenarios where a number of STTR clauses might be triggered simultaneously or where a firm might be seeking to take other recovery actions.

The annex to this letter provides further detail on our assessment of the potential risks and how these are currently being mitigated by firms.

[1] Insurance Supervision: 2025 priorities

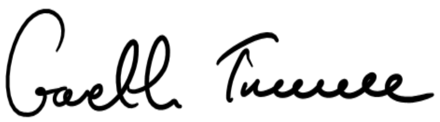
Next Steps

We ask you to consider the points raised in this letter and the annex in relation to your business and take any appropriate remedial actions. As part of its regular supervision, the PRA will engage with relevant firms, on a case-by-case basis, to understand how they intend to respond.

The competitive nature of the BPA market at present may also increase pressures on firms' risk management standards and practices including further developments in the use of STTR clauses. The PRA plans to undertake a follow-up review in 2026 to assess how market practices for STTR clauses have evolved and the extent to which firms' risk management approaches have developed in response, with a particular focus on the elements outlined in this letter.

Finally, given the volume of the transactions accumulating and the potential for aggregate risks to increase if STTR clauses become much more prevalent, please notify your supervisor promptly of individual BPA transactions containing STTR clauses entered into from the date of this letter.

Yours faithfully



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ANNEX

Potential risks for insurers from the use of STTRs

STTRs could give rise to a number of key potential risks for insurers:

1. **Liquidity impact of asset transfers on termination.** In the case of an STTR termination, the insurer would need to make a Termination Payment to the pension scheme. Termination Payment values are contractually specified. However, if a Termination Payment is disproportionately comprised of liquid assets or particular asset classes, liquidity risks might arise for the insurer. In particular, a firm's residual portfolio might be insufficiently liquid to meet its needs, potentially leading to the firm having to incur losses through forced sales of assets to generate liquidity or to re-balance its portfolio. Furthermore, in a wider market stress, management actions such as asset sales might be more difficult to achieve or might be possible only at distressed prices.

Liquidity risk for insurers could also be exacerbated by any uncertainty over insurers' ability to deliver illiquid assets to the pension scheme in stress under an STTR clause. Potential impediments could include: a need to receive third party consents; potential difficulties of valuation and rating assessments in stressed conditions; practical challenges in transferring some types of assets (e.g. where restructured); and the potential timescales required to execute transfers. If illiquid assets cannot be transferred and are retained on the insurer's balance sheet at the expense of liquid assets, the insurer's liquidity position could be affected.

2. **Asset concentrations from asset transfers on termination.** In some cases, Termination Payments could also increase asset concentrations for the insurer. If Termination Payments are disproportionately composed of particular asset classes or characteristics, the insurer's residual balance could become more concentrated. This might impact a firm's asset exposure limits or its ability to meet the Prudent Person Principle.[2] Where Funded Reinsurance is used, there is the additional risk that collateral might not be recaptured in a timely manner and/or that it might not be suitable for inclusion in the Termination Payment, which could exacerbate asset concentration risks.

3. **Contractual uncertainty.** Any ambiguity in STTR contractual terms, or the potential for contractual disputes to arise on the interpretation of STTR clauses, could be particularly challenging in a disordered market. For example, if contractual terms are not clear, there could be disputes about asset valuation and quality (especially in

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[2] Solvency II: Prudent Person Principle

relation to illiquid assets), the types of assets that can be transferred, or who should bear any costs incurred as a result of the termination.

4. **Operational challenges in stress.** In any STTR termination scenario linked to an insurer's solvency ratio, an insurer is, by definition, likely to be facing some level of unexpected financial stress which will be consuming senior management time. This might also be happening at a time of wider market stress. In such an environment, insurers could face wider management and resource challenges. Dealing with STTR terminations could add to these challenges and complicate an insurer's ability to execute any planned recovery options, for example, if there was a need to transfer significant volumes of liquid and illiquid assets under an STTR clause according to contractual deadlines in a stressed market.

Thematic Findings

Through our thematic work, we assessed how well insurers are factoring these potential risks into their risk management frameworks and controls over their use of STTR clauses. We observed that some firms have begun developing clearer frameworks for risk exposures and mitigation of risks, but there were limitations in those approaches. We also consider that some of the risks set out above will be difficult to mitigate fully and this should influence insurers' approaches to offering STTRs in large volumes. We summarise below our findings for firms to consider when developing their risk management practices and in considering their appetite for exposure to STTRs.

- **Contractual timings and flexibility over termination portfolios:** We observed that firms had generally sought some contractual flexibility over the asset composition of termination portfolios. This flexibility offers firms scope to shape any Termination Payments in a way that limits adverse impact on their liquidity position or asset concentrations. In some cases, this has been underpinned by the introduction of standard term sheets for STTR contractual terms, covering the asset composition of Termination Payments, with (minor) variations considered only under enhanced governance arrangements. We regard this as good practice. However, we also saw examples of contractual restrictions on the composition of a Termination Payment, such as restrictions on asset classes. Where there are contractual restrictions on the asset composition of Termination Payments, the potential risks can be managed by ensuring that they are materially consistent with the composition of the wider Matching Adjustment (MA) portfolio, allowing for any differences in risk profile between the terminating and residual liabilities. Ultimately, contractual terms should not prevent a firm from shaping a Termination Payment to be consistent with the composition of its underlying asset portfolio.

As well as contractual flexibility, we also observed some good practice in relation to how firms structure STTR contractual timings to help manage risks, such as aligning STTR terms to the expected period to buy-out for the pension scheme, and basing Cure Periods on the time needed to execute management actions.

- **Exposure risk appetites/limits:** We observed that some firms have set STTR exposure limits. However, these focused mostly on liquidity factors and would benefit from further development to ensure that the limits are grounded in scenario analysis of both the associated liquidity impact and the impact on asset concentrations. In setting STTR exposure limits, effective scenario analysis includes:
    - assuming concurrent terminations across a firm's portfolio of STTR BPA deals.
    - making prudent assumptions in relation to the ability to transfer illiquid assets in practice, recognising and reflecting the particular challenges in this area noted earlier in this letter.

  We have not seen adequate evidence that this approach has been widely adopted by firms to date.

  In addition to exposure limits, firms also manage the likelihood of STTR terminations through contractual triggers and timescales, such as the Cure Period duration and the solvency threshold. It is important that firms consider their appetite for STTR terminations and calibrate these triggers and timescales appropriately.

- **Funded Reinsurance:** Where liabilities with STTR are backed in part by Funded Reinsurance arrangements, we observed how firms have considered the sequencing and interaction between such Funded Reinsurance and a potential STTR termination.

  In line with the expectations of SS5/24 ("Funded Reinsurance")[3], we consider that allowing for receipt of "worst case" Funded Reinsurance collateral is a prudent assumption in the context of STTR exposure limits. It is important that firms reflect the impact of having to retain any collateral which could not be included in a Termination Payment.

- **Resolvability:** We observed insufficient evidence that the potential impact of STTR clauses on firms' resolution planning was being comprehensively considered. For example, firms had not considered how mass STTR terminations could introduce diseconomies of scale that might adversely impact the viability of liability run-off.

- **Contract assurance:** It is important that firms gain as much assurance as possible in advance that contractual terms can be relied upon to operate as intended and

[3] SS5/24 – Funded reinsurance | Bank of England

have clear dispute resolution mechanisms, including in circumstances where firms might amend their own arrangements (e.g. entering a Funded Reinsurance arrangement) after a BPA deal has been executed. Nevertheless, given the untested nature of STTR clauses, we consider that even accounting for such mitigation, there will remain residual risk for firms, which supports a need for prudence.

- **Implementation planning:** Operational risk around executing STTR terminations at a time of likely severe stress may be mitigated in part by advance planning. Good practice that we have observed included maintenance of an STTR termination plan that covers matters such as preparatory actions; notification requirements; and actions in case of termination, including timings and responsibilities, with enhanced planning at a solvency level well above the STTR trigger point. We have also observed good practice where such implementation plans are tested through "war-gaming"/dry-runs.

Matching Adjustment

Firms are also reminded that, to meet Matching Adjustment 2.2(4)(b) of the PRA Rulebook and paragraph 3.13 of SS7/18 ("Solvency II: Matching Adjustment"), the contribution of a MA portfolio to any Termination Payment should be limited to the amount of assets held in that MA portfolio in respect of the terminating contract. Including that contract's contribution to the Solvency Capital Requirement (SCR) in the cost neutrality assessment would be appropriate only in exceptional circumstances.

In assessing the potential impact of STTRs on their ability to meet the MA eligibility conditions, we encourage firms to consider carefully issues such as: the amount payable by the MA portfolio under each STTR, the impact of STTR terminations on the MA portfolio (both for individual and multiple termination events), the risk of detrimental impact for any policies remaining in the MA portfolio after a termination has being exercised (again both for individual and multiple termination events) and the extent to which the MA portfolio would be reliant on any support from the non-MA portfolio.