Policy Statement | PS1/20

Solvency II: Longevity risk transfers – simplification of pre-notification expectations

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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 3/19 ‘Solvency II: Longevity risk transfers – simplification of pre-notification expectations’. It also contains the PRA’s final policy in an updated version of Supervisory Statement (SS) 18/16 ‘Solvency II: longevity risk transfers’ (see Appendix).

1.2 This PS is relevant to UK firms that fall within the scope of the Solvency II Directive and to the Society of Lloyd’s.

Background

1.3 In CP3/19 the PRA proposed to:

- update SS18/16 to change its expectations for how firms notify the PRA of new longevity risk transfer arrangements and to highlight an additional key risk (basis risk) which should be included in firms’ assessments of the residual risks these transactions give rise to; and

- streamline the notification process by enabling firms to report these using a template.

Summary of responses

1.4 The PRA received one response to the CP. The respondent was welcoming of the overall proposals and intention of the CP. The response highlighted areas where the proposed reporting template may be unclear and expressed reservation about basis risk being singled out for specific additional focus. Further details on the response, and the PRA’s feedback and final decisions are set out in Chapter 2.

Changes to draft policy

1.5 After considering the response, the PRA has decided to make two clarifications to the draft policy:

- to amend the headings used in the reporting template, providing more clarity on how firms should complete them, including explanatory footnotes; and

- a change to the phrasing on how firms should include basis risk in their risk assessments of longevity risk transfers.

1.6 The PRA considers that there will be negligible impact on firms, including mutuals, to which this PS applies. The changes made have been to clarify the original proposals and will not bring about any material change in the effort or detail that will be required from firms in meeting expectations when compared to the cost benefit analysis presented in the CP.

Implementation

1.7 This policy will take effect on the publication of this PS. From that point, firms will be expected to notify the PRA of new longevity risk transfers according to the text of the revised SS. If firms are unsure about whether a new transaction should be defined/considered large or complex, they should discuss this with their usual supervisory contact in advance of the deal execution.

1.8 The policy set out in this PS has been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect.

1.9 In the event that the UK leaves the EU with no implementation period in place, the PRA has assessed that the policy would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 ‘The Bank of England’s amendments to financial services legislation under the European Union (Withdrawal) Act 2018’ for further details.

1.10 The final SS attached to this PS should be read in conjunction with SS1/19 ‘Non-binding PRA materials: The PRA’s approach after the UK’s withdrawal from the EU’.

2 Feedback to responses

2.1 The PRA has a statutory duty to consult when introducing new rules and, when not making rules, has a public law duty to consult widely where it would be fair to do so. Where the PRA has consulted, it will consider the representations and in general terms publish an account of them along with its responses.

2.2 The respondent provided comments on basis risk and the reporting template.

Basis risk
2.3 The PRA proposed that firms include basis risk in their risk management frameworks. The respondent highlighted that they viewed it inappropriate to single out basis risk in the text of the SS and suggested this be reworded so that basis risk be considered alongside other risks in relation to the risk appetite accepted by firms.

2.4 The PRA agrees that there are other risks that should be considered by firms, and has decided to re-word the proposed text to clarify that basis risk is one of a number of residual risks that firms should consider. However, due to the fact that a clear articulation of basis risk was a frequent area of weakness observed in the PRA’s reviews of how firms managed longevity risk transfers, the PRA considers it appropriate to be highlighted as a key example.

Reporting template
2.5 The PRA proposed a template for firms to report transactions which were not determined to be large and/or complex. The respondent highlighted potential ambiguity in the ‘quota share’ terminology, which had the potential to confuse longevity risk transfers with transfers of both longevity and asset risk.

2.6 After considering this request, the PRA has decided to make some minor amendments to the template to make the requested information clearer, and has added some brief explanatory notes in order to clarify the terminology. The overall nature and scale of information the template seeks to give the PRA sight of has not changed.

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Appendix