

Bank of England

FundedRe

Industry roundtable 2

29 October 2025



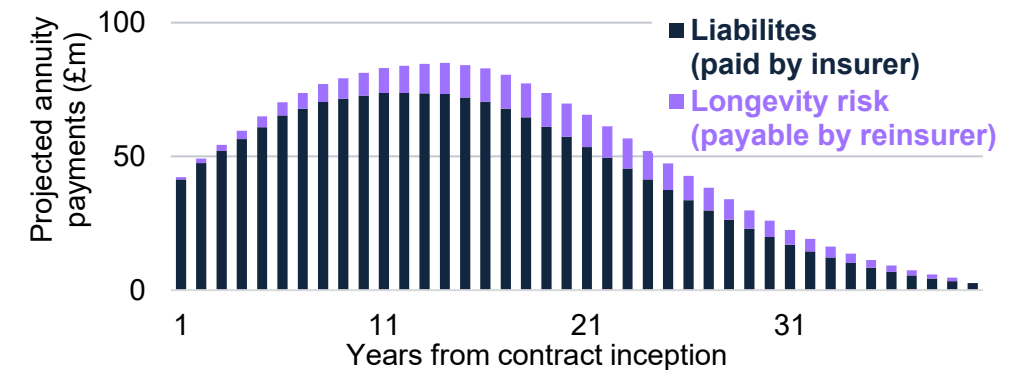


Introduction

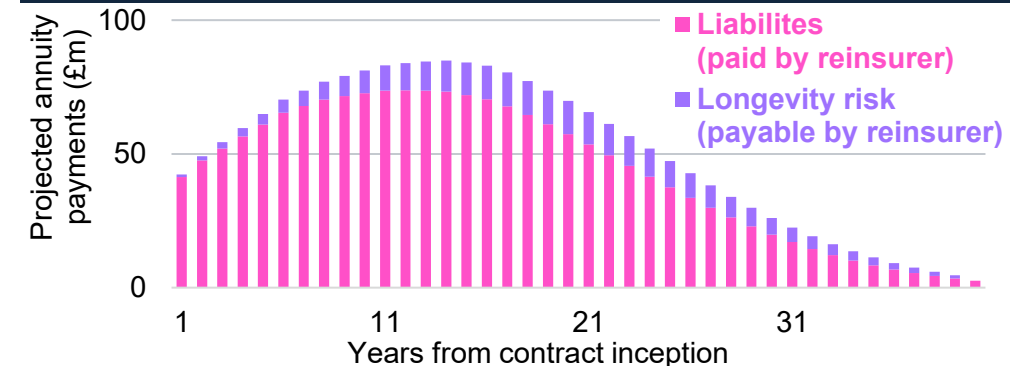
Summary of the problem statement explored in the first roundtable

- We explored whether the current treatment of the components of a FundedRe transaction accurately reflects the risks.
- We consider that any solution should ensure **consistent balance sheet treatment** for FundedRe when compared against economically similar structures.
 - Economic consistency: the valuation of the reinsurance asset should be consistent with its fair value.
 - Capital consistency: the capital treatment should only differ where this is justified by the difference in retained risks.

In a transfer of longevity risk, the reinsurer only pays when longevity risk crystallises...



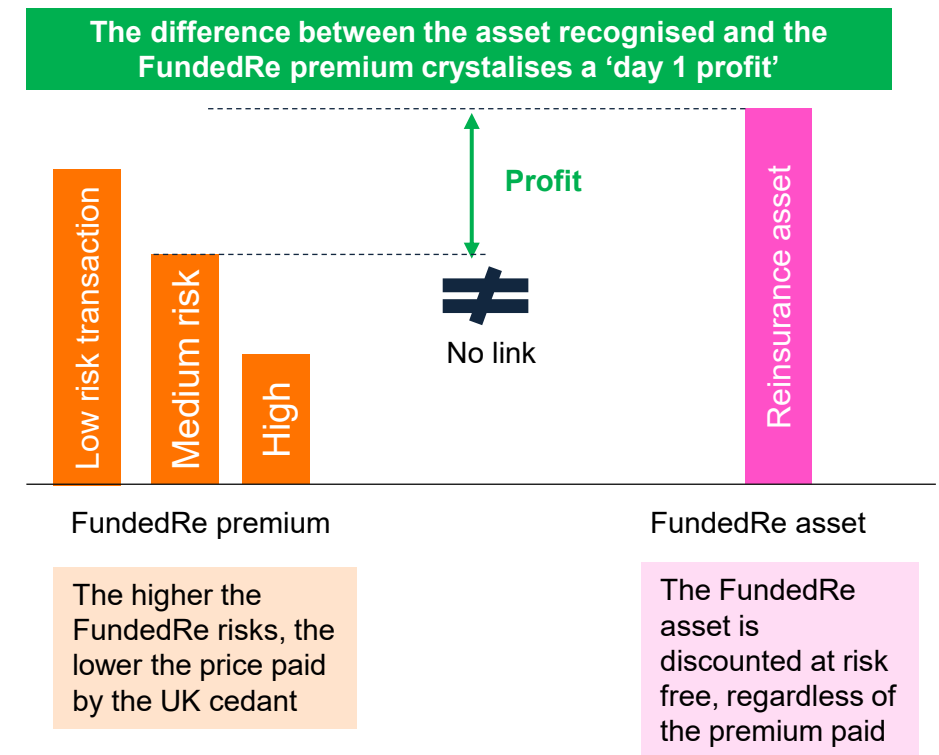
In FundedRe, the reinsurer also pays its share of the base annuity cashflows...



(Recap) Economic consistency: re-building the disconnect between price and reinsurance asset

- “The additional value that the reinsurer provides in this transaction, beyond its role as a capital provider, is a collateral wrapper, transforming unstructured and risky collateral into the funding required under the FundedRe contract.”
 - In Sol UK rules, the reinsurance recoverable asset is valued almost entirely at the risk-free rate, bar an often negligible CDA.
- “By extending the label of ‘reinsurance’ to the funding component within FundedRe, Solvency UK treats it as close to a risk-free construct.”
 - This means that, what a UK insurer pays for the FundedRe is not linked to the reinsurance asset recognised on its balance sheet.
 - Generates an opportunity to create value from transferring risks.
 - Strong risk management discipline needed to avoid accepting a higher risk transaction to obtain a better price.

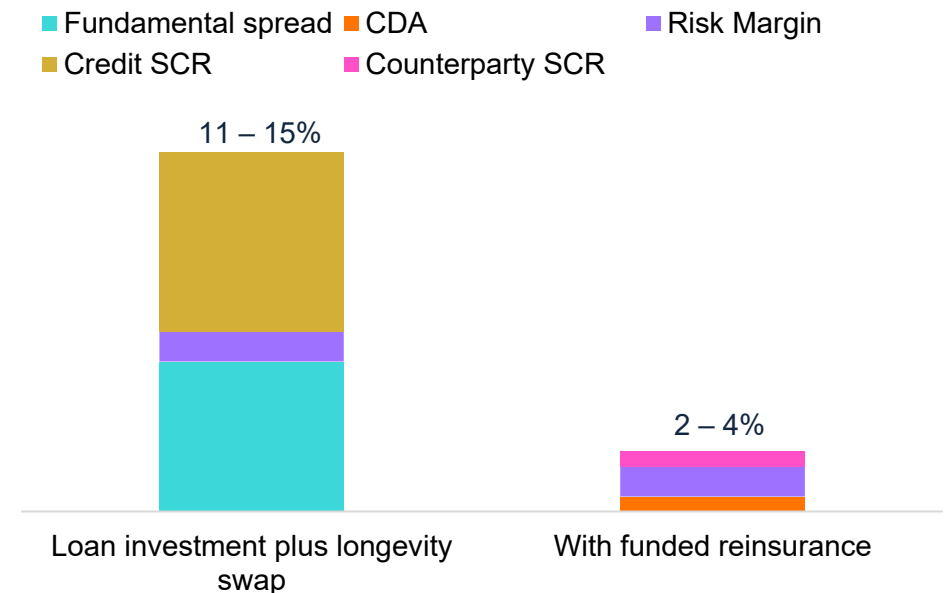
Currently, the often inverse relationship between the premium and the risks results in a ‘day 1 profit’



(Recap) Capital consistency: bridging the gap between current treatment of FundedRe, and loan plus longevity swap

- There are arguments on both sides...
 - The 'additional protections' in FundedRe mean that the treatment for loans plus longevity reinsurance is too penal.
 - The 'additional risks' in FundedRe mean the current treatment isn't capturing the retained risks.
- The next slide has a summary of some of the arguments we've heard.
- Consistent treatment means at least partially closing this gap.
- And getting to a level that is reflective of the retained risks.

Illustrating the current difference between FundedRe, and loan plus longevity reinsurance/swap
(% of best estimate liabilities)



This is for illustration only, to show the relative importance. The actual numbers will depend on the nature of the liabilities and current market conditions.

CDA = Counterparty Default Adjustment
SCR = Solvency Capital Requirement

Some of the arguments for ‘bridging the gap’ we’ve heard

Additional protections	Additional risks
Direct risk is to a (potentially stronger) reinsurer than asset pool ratings	Exposure to ‘issuer’ credit risk should be captured to be consistent with Technical provisions (TPs)
Multiple layers of additional security, including reinsurer’s own capital cushion	Wrong-way risk, correlated default and collateral values with some counterparties
Fundamental spread (FS) tables assume a lower recovery rate than collateral in recapture scenario	FS tables assume a diversified portfolio rather than a large, concentrated exposure
Reinsurers typically operate in well regulated, strongly supervised regimes	Same kinds of collateral may be shared across multiple transactions, exacerbating stress valuation/liquidity risks
The reinsurer monitors and regularly tops up the collateral pool	Basis risks in collateral versus liability (duration, currency, inflation, and during default period), influenced by margining frequency and controls
Early solvency termination triggers should protect the level of collateral on recapture	Collateral may not be compliant with firms’ MA permissions, look through might be difficult

Three key criteria to help assess any potential solutions

- We've heard a number of criteria that could be used when assessing possible solutions.
- We have discussed one 'unbundling' approach that could meet the PRA's problem statement and criteria for a potential solution.
- Participants have also provided constructive challenge and suggestions of alternative solutions.

Problem statement

Balance sheet consistency: Economic and capital treatment should only differ where justified by the economics and retained risks

Criteria for a potential solution

1. Risk responsiveness

A solution that is sensitive to the risks within individual transactions

2. Implementation simplicity

A solution that is simple to apply by firms

3. Application consistency

A solution that does not lead to a wide divergence of outcomes between firms making similar transactions

What does risk responsiveness mean in the context of FundedRe?

- One way the reinsurer provides value is by transforming the unstructured and risky collateral cashflows into those that meet the reinsured liabilities.
 - So, the direct exposure is to the counterparty's balance sheet and its financial strength.
- FundedRe provides additional protections for enhanced loss absorption following recapture.
 - These layers are similar to those in secured assets.
- Its important any potential solution allows for the retained risks within each contract.

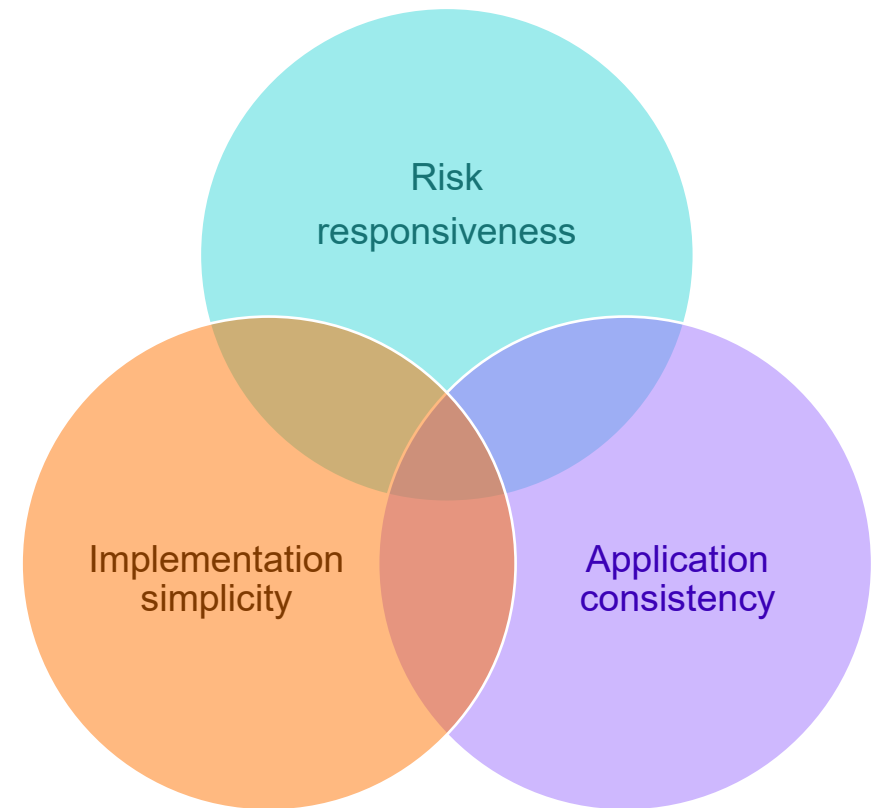
Example of similar layers of protection between FundedRe and a collateralised loan

	FundedRe	Collateralised loan
Layer 1: Direct exposure	Counterparty balance sheet	Loan issuer balance sheet
Layer 2: Contingent security	Collateral assets held in trust	Security held
Layer 3: Pre-default protection	Early recapture triggers	Loan covenants (interest cover, LTV)

There are different approaches that may meet the criteria

- There are many potential approaches to solutions we have heard from participants.
- We have grouped some of the different approaches into variations on two themes:
 - counterparty default adjustment (CDA) reform; and
 - unbundling.
- These different approaches may meet some of our criteria but will also come with challenges.
- Where there are limitations, these could be addressed through complementary restrictions on the amount of FundedRe.

These approaches should be appraised these three criteria





1: A counterparty default adjustment (CDA) reform approach

One suggested approach could be reforming the CDA framework

- Current CDA outcomes seem inconsistent with economically similar structures.
- We received suggestions on potential CDA reforms:
 - new guidance (or rules) making CDA more prescriptive, and
 - floor the outcome to the equivalent fundamental spread on the whole 'FundedRe asset'.
- We've heard that CDA reforms would:
 - ensure consistency with other reinsurance contracts,
 - be responsive the risks within each transaction, and
 - be simple to implement.

Risk responsiveness: ensuring that a solution is sensitive to the risks within individual transactions

- Reinsurance recoverables must be valued separately from ceded liabilities, and consistently with Technical Provisions.^[1]
- Which means probability of default (PD) should be based on market consistent data.^[2]
 - Firms have taken different approaches, with some arguing CDS implied PDs are unreliable.
- Loss given default (LGD) modelling should take into account the expected losses on each contract.^[3]
 - Including the loss absorbance of the collateral in SCR calculations.

The PRA added expectations on setting PDs for internal models in SS5/24

Probability of default

3.6 For probability of default (PD) the PRA's expectations for firms in relation to their funded reinsurance arrangements include the following:

- **Forward looking** – firms should consider whether their historical data captures all risks including forward looking risks of deterioration of the counterparty conditions.²⁸ The PRA expects firms to consider how the PD used can be informed by market surveillance activities or information implied from market traded instruments such as credit default swaps.

SS5/24 – Funded reinsurance

Some firms argued in CP5/24 that CDS implied PDs are unreliable

Three respondents noted that the forward-looking information is unlikely to be sufficiently comprehensive and that the credit default swap (CDS) data is limited given the illiquid nature of the market. Three respondents however noted that this form of information should be allowed where appropriate to reduce the PD.

Paragraph 3.28 of PS 13/24 – Funded reinsurance

[1] Technical Provisions 11.1

[2] Technical Provisions 2.3

[3] Technical Provisions – Further Requirements 24.2

Discussion on a CDA reform approach

Balance sheet consistency

- How could CDA reform re-build the economic link between the reinsurance asset value and price?

Risk responsiveness

- How could we resolve market consistent PD calibration?
- How could this approach capture changes in risk as longevity transfer reduces?

Application consistency

- How could we ensure consistent outcomes within PD and LGD modelling?
- How prescriptive would any approach need to be to ensure consistent outcomes?

Implementation simplicity

- If ultimately the CDA outcome has to recognise the risks retained in the transaction, wouldn't it be simpler and more consistent with the valuation of annuity TPs to use a fundamental spread (FS)?
- If this approach isn't sufficient in meeting the solution criteria, could this be accompanied with a volume limit to recognise limitations and uncertain calibration?

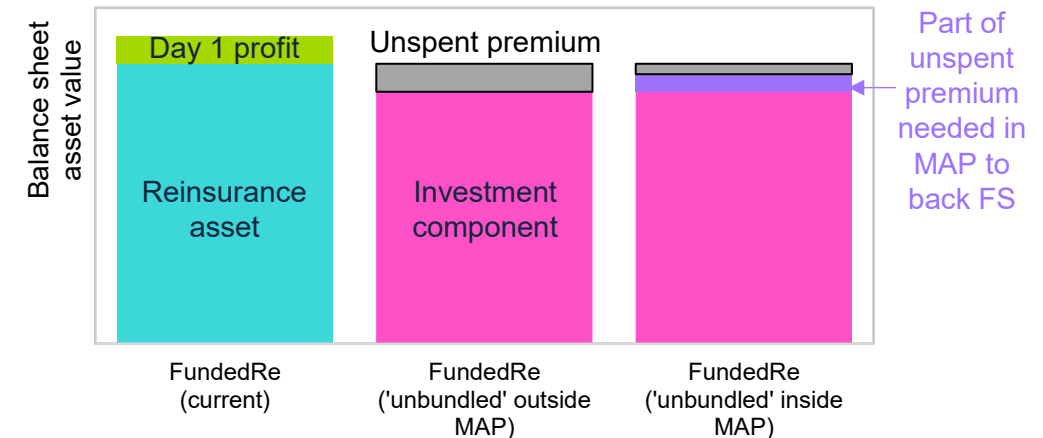


2: An unbundling approach

Reminder of an unbundling approach

- Cedents would separate the FundedRe asset into two components.
 - The **investment component** would capture the funding element and be treated like an asset.
 - The **risk transfer component** would capture the deviations in longevity experience and be treated like reinsurance.
- This rebuilds the economic link between the valuation of the total FundedRe asset, and the premium paid for that asset.
- Therefore, ensuring consistent treatment with strategies with similar economics.

Summarised illustration of an unbundling approach



FundedRe (current): All risks transferred for a premium which is often less than value of annuity liabilities realising a 'day 1 profit'

FundedRe (unbundled outside MAP): FundedRe asset is unbundled, the investment component is discounted at asset spread so is closer to the FundedRe payment.

FundedRe (unbundled inside MAP): The liabilities discounted at spread subject to an FS. Assets would need to be injected into the MAP to meet this FS.

Risk responsiveness: how layers of protection could be allowed for in an unbundling approach

- Credit rating agencies (CRAs) have methodologies to rate private assets with similar economics.
 - IFS ratings assess the ability of a regulated (re)insurer to meet its policyholder obligations.
 - Covered bond and collateralised loan rating criteria allow for notching of similar structures, reflecting enhanced payment continuity and recovery under stress from additional layers of security, depending on details of individual transactions.
- Loss-absorption provided by collateral in stress should continue to be allowed for within the SCR, further incentivising good collateral practices.

Examples from CRA rating methodologies that ensure risk responsiveness in their final rating

Key Rating Drivers

IFS Rating as Anchor: IFS ratings cover the ability of the insurer to pay claim obligations in a full and timely manner, and serve as the initial "anchor" against which most other insurance ratings are derived.

FitchRatings – [Insurance Rating Criteria](#)

An Insurer Financial Strength Rating is our forward-looking opinion about an insurance organization's ability to pay its policies and contracts.

S&P Global – [Insurer Financial Strength Rating](#)

Insurance Financial Strength Ratings

Opinions of the ability of insurance companies to repay punctually senior policyholder claims and obligations.

Moody's – [Rating Scale and Definitions](#)

Notching And Analysis Of Specific Instruments

34. The analysis of specific instruments includes consideration of priorities within an obligor's capital structure and the potential effects of collateral and recovery estimates in the event of the obligor's default. The analysis may apply notching to instruments that rank above or below their obligor's senior, unsecured debt. For example, subordinated debt would generally receive a rating below the senior debt rating. Conversely, secured debt may receive a rating above the unsecured debt rating.

S&P Global – [Insurer Financial Strength Rating](#)

Application simplicity: leveraging existing infrastructure and variations

- The unbundling approach leverages existing methodologies to maximise implementation simplicity.
 - We've heard from some that this could require unfamiliar application of existing methodologies, others have suggested practical solutions.
- We've heard variations that could further increase simplicity, for example:
 - without separation step, apply the FS to the whole reinsurance asset (only the impact of unbundling); and
 - PRA guidance on the rating approach for the investment component.

The unbundling approach looks to achieve simplicity through leveraging existing infrastructure

1. Valuation methodologies used for private assets.
2. CRA's credit rating methodology and the PRA's framework on illiquid unrated assets.
3. The PRA's published Fundamental Spread tables.
4. Existing framework for recognising collateral as risk-mitigating techniques for SCR calculations.

Discussion on an unbundling approach

Risk responsiveness

- How could using rating methodologies be used ensure sufficient risk responsiveness?
- How much should transaction-specific factors influence the rating outcome?

Application consistency

- How could PRA guidance on a rating approach for FundedRe help to ensure a consistent approach?

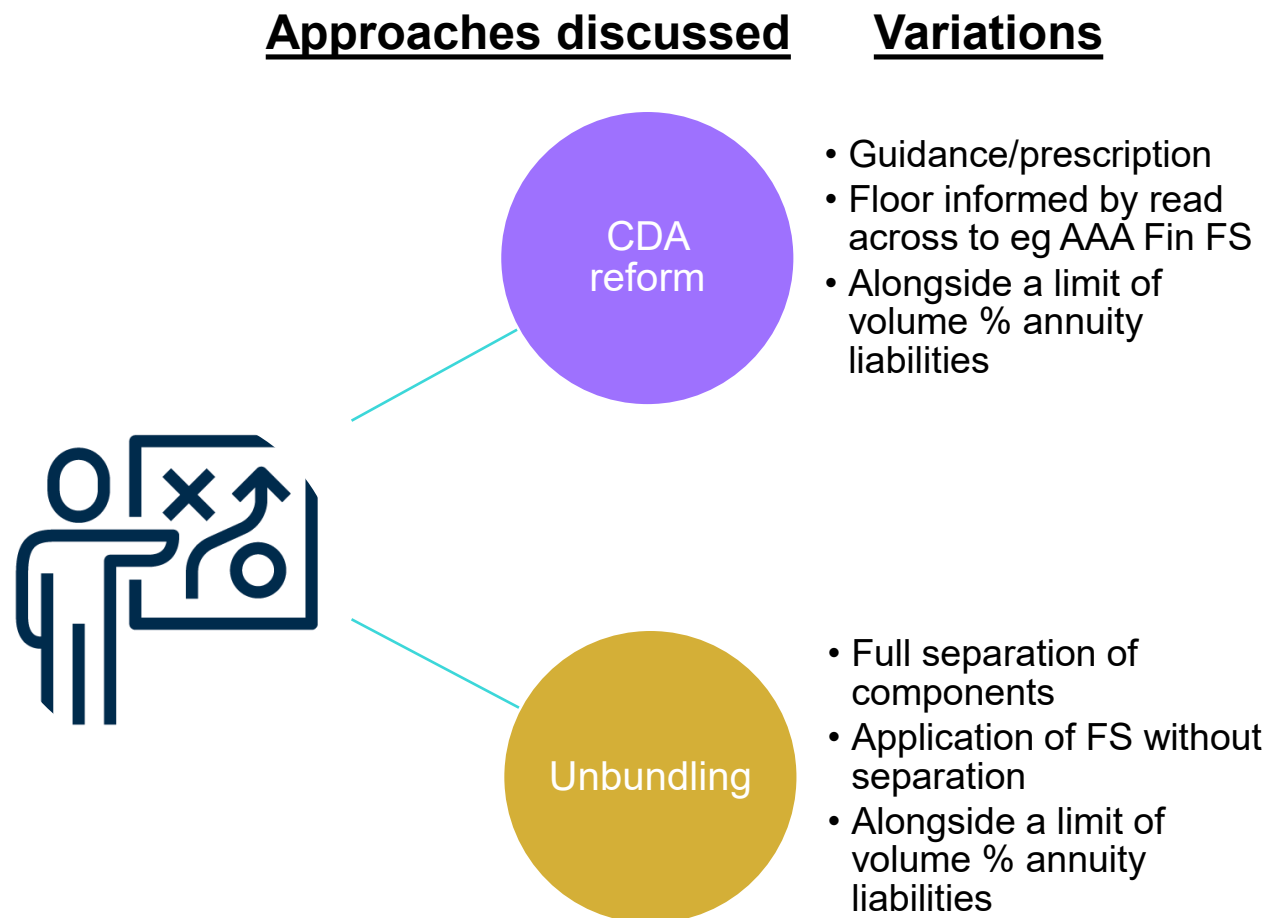
Implementation simplicity

- How could the reinsurance cashflows be separated between a fixed investment component and a variable risk-transfer?
- How could existing methodologies for private assets be used to value the investment component?
- How could a volume limit enable more flexibility and less prescriptiveness in the implementation of this approach?



Next steps

Summary and next steps



- We have discussed different ways we could assess potential solutions (the criteria).
- We are keen to hear more about the challenges with the unbundling approach, and suggestions on alternatives.
- Please share completed questionnaire replies by 14 November 2025.

