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Solvency II newsflash

2021 UK Life Insurance Solvency II Disclosures

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The UK's review of Solvency II is well underway with an uncertain outcome as of yet for UK Life Insurers. However in this article, we take a look back at recent Solvency II disclosures made by the sector at the end of 2021. How have balance sheets emerged from the pandemic? How well placed are they to withstand future shocks? And how are insurers generating and planning to deploy any surplus capital?

Headline themes

Solvency ratios

Solvency ratios were resilient during 2020 as financial markets stabilised from initial volatility observed at the start of the COVID 19 pandemic. Ratios have risen during 2021 as markets have further recovered, with some UK life insurers sitting above target ranges at the end of the year.

Risk management

A number of insurers indicated they have continued to de-risk credit portfolios during 2021. Limited losses from downgrades or defaults were observed in our sample through the pandemic. This points to the success of the unprecedented government intervention in mitigating impacts on the wider economy along with the benefits of high-quality asset selection and diversification in credit portfolios. Insurers are continuing to diversify their illiquid asset origination geographically and by sector.

Longevity releases observed in 2021 were lower than previous years. As yet, insurers have not attempted to factor the effects of the pandemic into long term longevity assumptions.

Capital generation & deployment

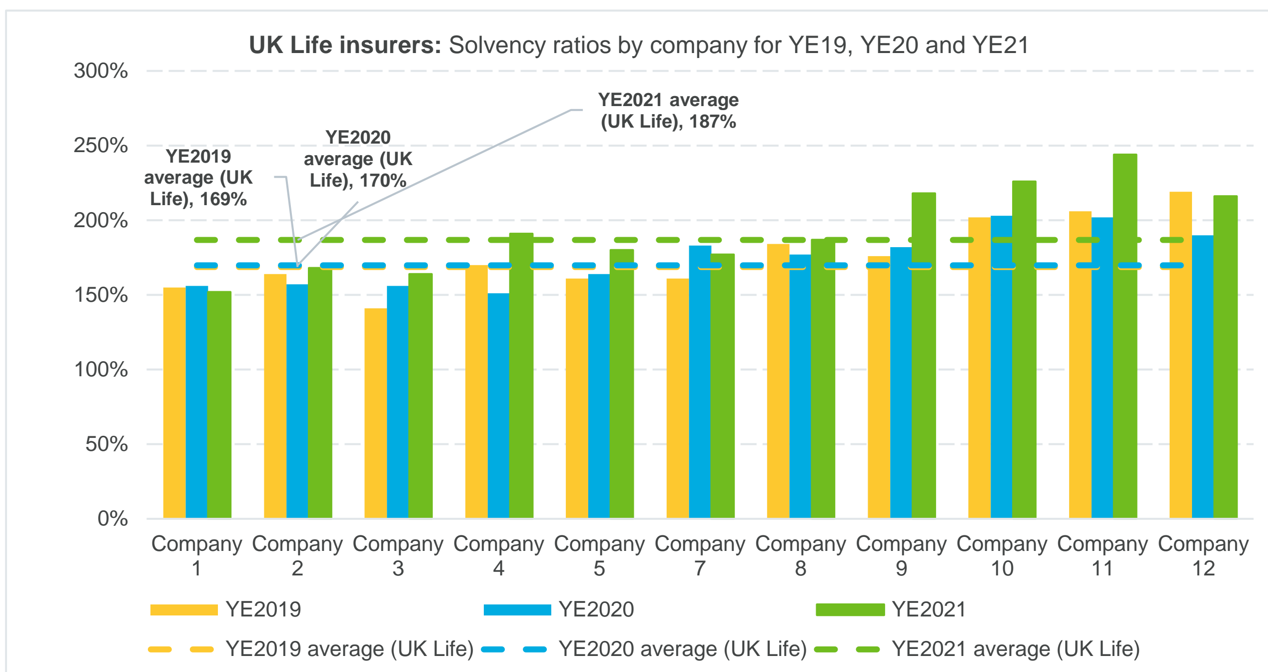
Favourable economic movements have contributed to increases in ratios in 2021, along with capital generated through management actions and restructuring for some.

Insurers are deploying spare capital in different ways, including return of capital to investors and completion of bolt on acquisitions across the value chain. In particular we observed a theme of further investment in wealth management and digital advice capability. A number of the large annuity writers are also well placed to invest capital in new business in 2022 with one insurer raising debt providing further capacity for growth.

Solvency ratios

Solvency ratios were generally resilient through 2020. Falls in ratios as a result of the market volatility following the onset of the pandemic recovered in the second half of the year, with little change in average ratios. Favourable economic movements have contributed to increases in ratios during 2021 with average coverage of 187% at year-end 2021 compared with 170% at year-end 2020.

Most companies in our analysis saw increases in ratios during 2021 with only a couple of exceptions. Two insurers indicated they finished the year sitting above their target capital ranges. This was a result not only of the favourable economic movements, but also restructuring and disposals during the year. Both these firms announced planned return of capital to investors along with further strategic investments across the value chain covering asset management, wealth management and digital advice. These actions are expected to bring ratios back within target during 2022.



Source: Company year-end reports and accounts.

Note that some of the stated year-end 2019 ratios include the effect of a recalculation of the Transitional Measure on Technical Provisions (TMTP), of which some are "notional" and others are PRA-approved.

Note that caution should be exercised when comparing the Solvency Coverage ratios reported by different firms – the ratios are not intended to reflect or confirm the relative strengths of different firms. Where it is disclosed, we have shown the "investor view" of capital coverage which removes distortions from ring fenced funds and pension schemes.

Surplus generation

Analysis of surplus generation provided in year-end disclosures provides more granular insight into how insurers are generating and using free capital. The table below shows surplus generation during 2021 for a sample of companies. There is no standard or consistent way that companies disclose this information and, therefore, some judgement has been used to attribute the movements into the below categories.

	YE20	Operational surplus	Operating variances	Non-operating variances	Management actions	Dividends/ Buy back	Sub debt raise / payment	Other	YE21
Company 1	**5.3**	0.2	(0.2)	0.1	1.5	(0.8)	(0.2)	(0.6)	**5.3**
Company 2	**7.4**	1.3		0.7	0.1	(1.1)		(0.3)	**8.2**
Company 3	**4.8**	0.5	0.2	1.3		(0.4)		(0.2)	**6.1**
Company 4	**2.4**	0.4	(0.2)	(0.1)	0.2				**2.7**
Company 5	**1.1**	0.1		0.1					**1.2**
Company 6	**3.7**	0.3	(0.1)	0.2			0.6	(0.1)	**4.6**
Company 7	**13.0**	1.6		(0.2)	2.0	(1.9)	(1.5)		**13.1**
Company 8	**2.3**	0.2		0.5	0.4	(0.2)	(0.2)	(0.1)	**2.8**

Surplus generation may be used to return capital to investors or to provide capacity for organic or inorganic growth of the business. In general, companies will seek to be able to pay capital transfers (i.e. dividends, share buy-backs, debt repayments) from their operational surplus. However, some companies may also use capital generated from management actions, for example disposals or post acquisition integration, to return capital to investors. For two companies, capital returned to investors was in excess of operational surplus during 2021, supported by significant surplus generated by management actions in the year. One company completed an issue of Tier 1 subordinated debt during the year, providing further capacity for new business and growth in 2022.

Operational surplus (which includes the impact of writing new business where that is separately identified) varies across our sample and reflects differences in business model and the balance between surplus generated from the run-off of the in-force book and that utilised by writing new business during the year. The bulk purchase annuity market remained buoyant during 2021 with one participant noting that their annuity business is now self-sustaining with capital generated from the in-force book sufficient to cover capital required to write new business and contribute to dividend.

Non-operating variances include the impact of economic variances which were generally positive throughout the year, along with and capital generated from asset liability management. In general, lower capital releases as a result of changes to non-economic assumptions including longevity were observed relative to previous years. No firms have as yet attempted to reflect the potential long-term impacts of the pandemic in their longevity assumptions.

What of the Solvency II Reform?

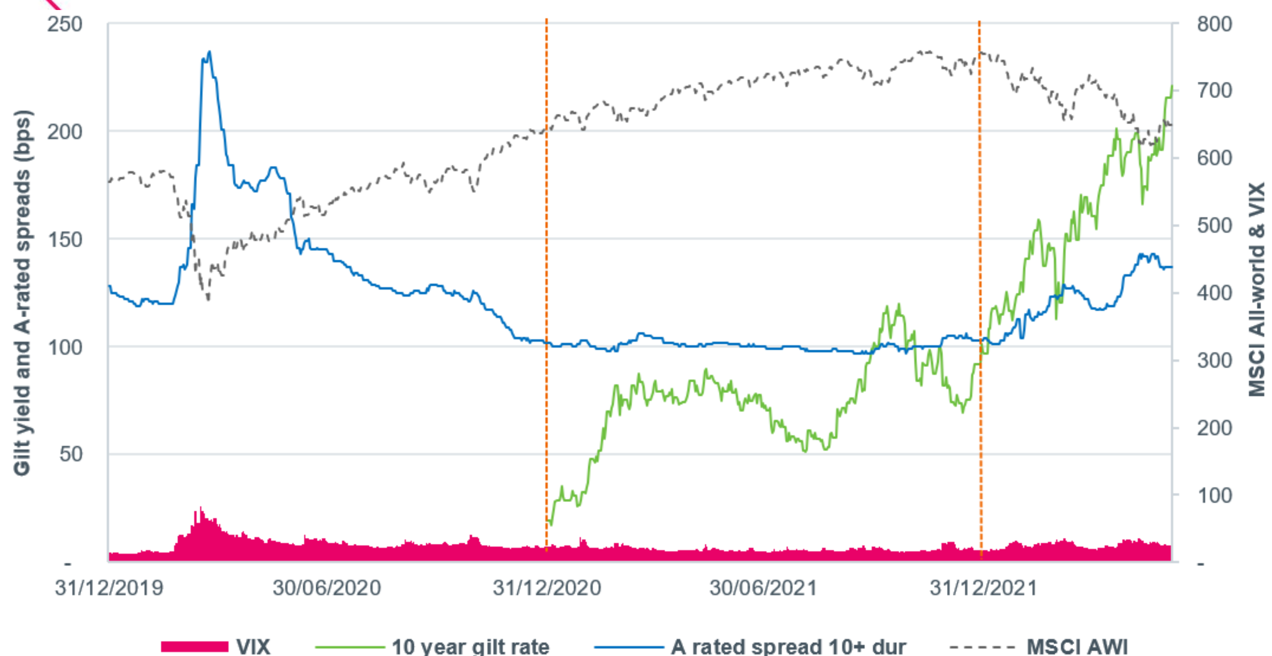
In general, insurers struck a supportive tone on Solvency II reform within their year-end disclosures – and in particular the potential opportunity to invest in a wider universe of illiquid assets. However, most were unwilling to speculate on the potential capital impacts in advance of seeing detailed legislation despite some analyst interest.

Following the year-end reporting season, the UK Treasury launched a further consultation setting out more details on the proposed reform. Uncertainty in capital impacts remains, with a degree of scepticism that the capital releases suggested by the Treasury will be seen in practice. Some insurers may not be quite so supportive now.

Outlook

The look back at disclosures made by the UK Life insurance sector over the past two years evidences the benefits of strong balance sheets and robust risk management frameworks with the sector emerging from the pandemic with healthy capital coverage ratios.

Market volatility in the equity and credit markets observed at the start of the global pandemic in March 2020, along with the subsequent recovery can be observed in the chart on the following page. Throughout 2021 inflation has been on the rise due to supply chain disruption resulting from the pandemic and subsequent increases in commodity and energy prices.



In the UK, inflation has risen to levels not seen since 1990 driving a sell-off in government bond markets and sharp rises in yields. To date, the impact in the credit and equity markets can be seen to be much less than the volatility that accompanied the start of the pandemic. Sensitivities disclosed at the end of 2021 suggest coverage ratios will have further improved in response to rises in risk free yields although in some cases this will be partially offset by the falls in equity values.

Nonetheless, the impact of the high inflation environment on asset portfolios and business models is likely to be a hot topic for the sector. Within year-end disclosures there was already some evidence that insurers were starting to review their credit portfolio to assess the ability of counterparties to withstand higher inflation. And whilst bulk purchase annuity and retirement markets might be expected to remain strong the cost-of-living squeeze could see weaker flows in the retail wealth market leading to a drag on operational surplus generation.

With the final landing of Solvency II reform still to play out and the long-term impacts of the pandemic yet to be reflected in bases, insurance industry participants, analysts and investors will be keen to stay close to these issues and the development of solvency ratios in half year and year end disclosures.

Hymans Robertson has a wealth of experience across risk and capital management and optimisation, investment and ALM, and longevity. We also have a market leading team who are on the pulse with respect to Solvency II reforms and, more importantly, their potential impacts. We would be delighted to support you in any aspect of your strategic and capital management needs. If you would like more information, please get in touch.

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