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Life Conference 2022

23-25 November, ACC Liverpool

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Mass Lapse Reinsurance: Making it Stick

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Agenda

- SJP Background
- Motivation/Problem Statement
- Options Explored
- Overview of Mass Lapse Reinsurance
- A Reinsurer's Perspective
- Operational Considerations
- Effectiveness of Risk Transfer
- Regulator Engagement
- Conclusions



SJP Background



St. James's Place Basics

FTSE 100 wealth manager

- £150bn of funds under management (FUM) at 31 December 2021 in own range of unique funds
- Distribution is via the Partnership (4,500 qualified advisers)
- Strategy of growing FUM through high quality service to clients and the Partnership.
- Very good client retention and strong inflows

Large Life Co.

- SJPUK, the key Life company within the Group, is most of the FUM at c£100bn
- Key cash generating entity
- Writes simple unit linked bonds and pensions (pre/post crystallised)
- Most of this is single premium investments

Regulatory treatment

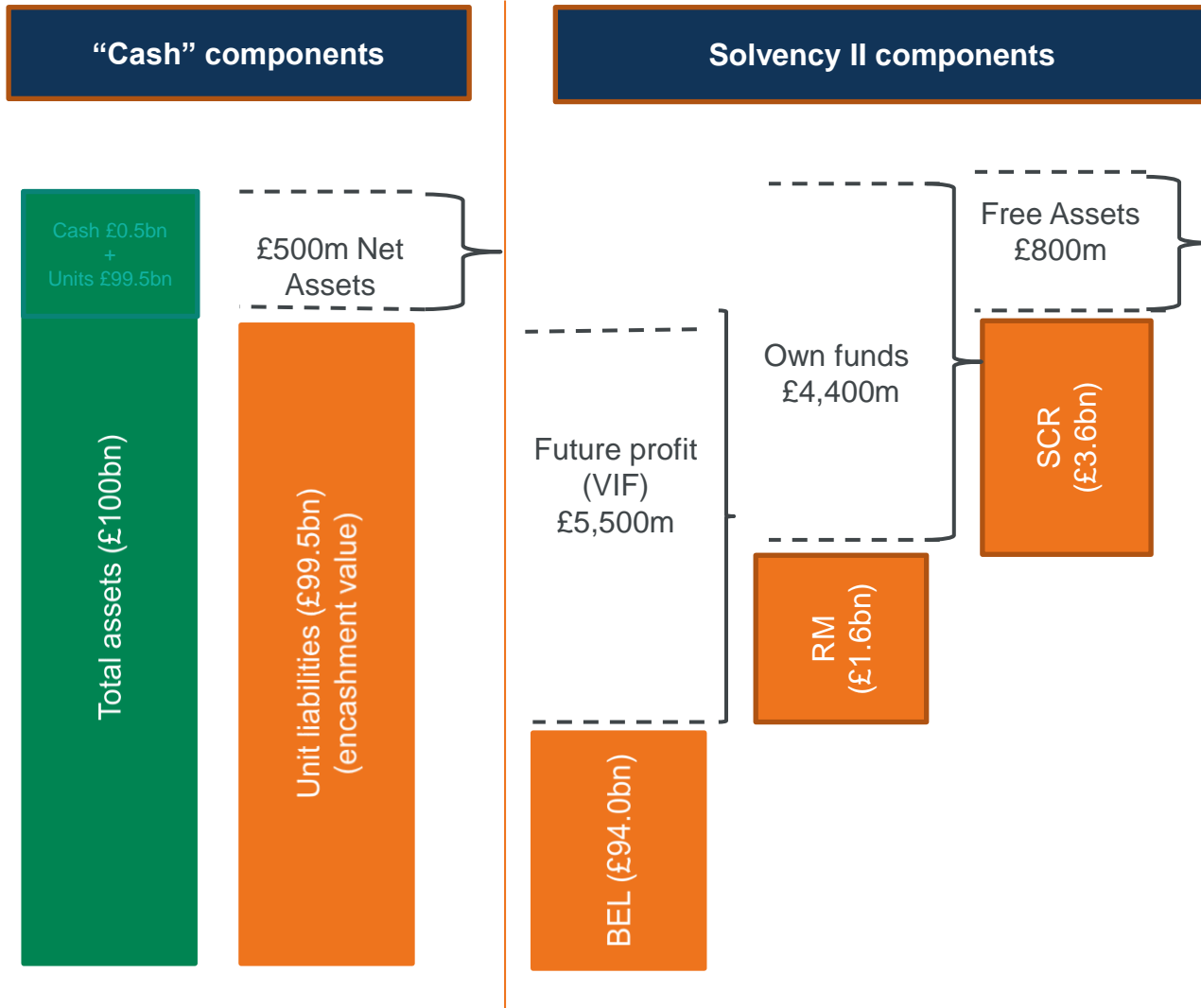
- SJPUK is a simple Solvency II standard formula firm
- Long contract boundaries means relatively large VIF asset
- Capital requirements largely comprise impact of stresses on that VIF



Motivation/Problem



Solvency II Balance Sheet*



Solvency ratio = 122% (£800m/£3,600m)

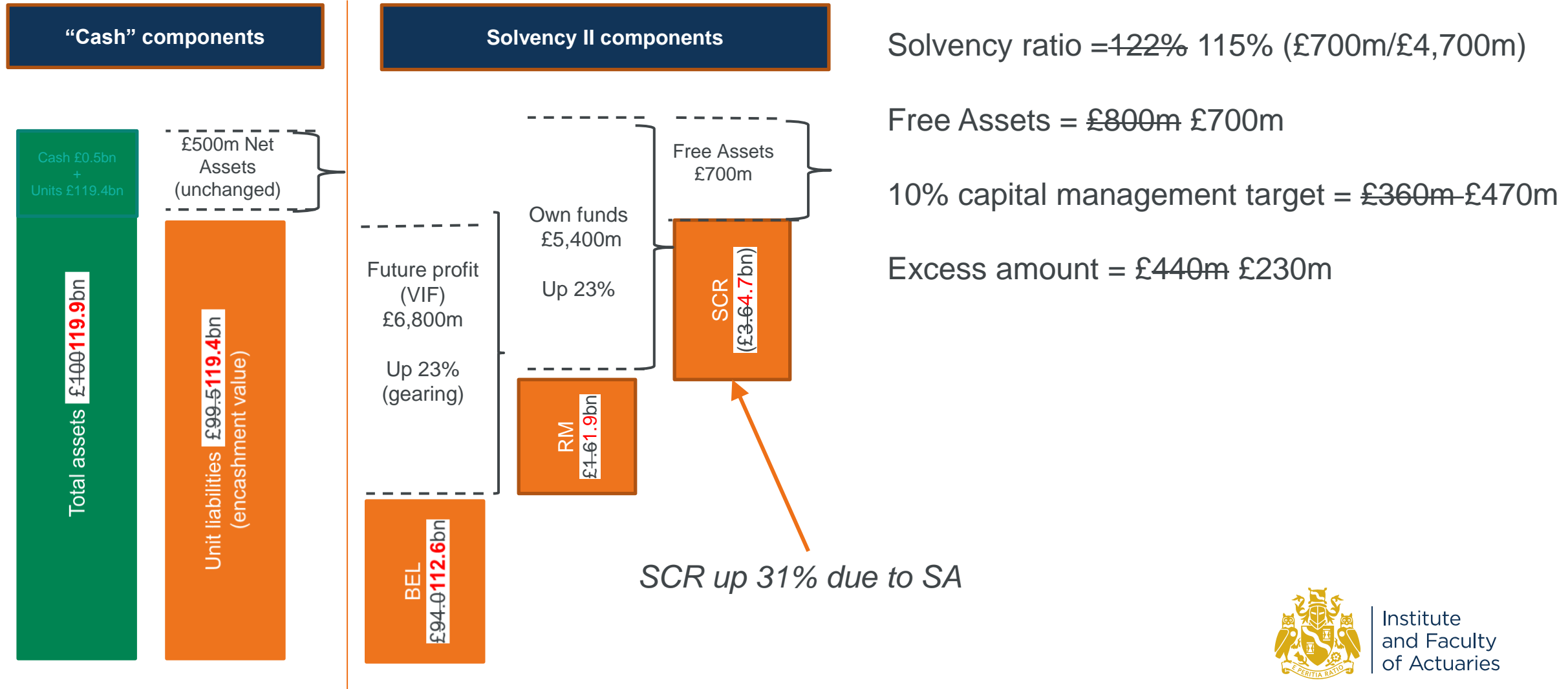
Free Assets = £800m

10% capital management target = £360m

Excess amount = £440m BUT...



Solvency II Balance Sheet* after 20% equity up-shock



Summary so far...

- An equity up shock would ultimately be a very good thing!
- And it is long term, but it can also negatively affect short term reported solvency.
- We have a desire to maintain our minimum target capital (110% SCR) in all reasonably foreseeable circumstances.
- Volatility means uncertainty when making capital management plans
- A desire to transfer risk or otherwise provide an offset to such impacts



Some ideas



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Partial Internal Model

- Similar to standard formula but eliminate the symmetric adjustment





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Too slow, long governance/approval process & SF not inappropriate for our risk profile





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Review methodology and judgements

- Sense check modelling and other judgements – are we being fully efficient?
- E.g. dynamic policyholder behaviour, management actions





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Contingent loan

- Contingency linked to solvency and surplus emergence
- Aim is to increase the assets of the life co. but without increasing liabilities





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Done internally doesn't give benefit at Group level. Externally not cost effective v options below





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Contract boundary reinsurance

- Expect 60% of vesting pensions to remain with SJP as new drawdown contracts, but this value is outside the SII contract boundary
- Transfer risk of lower vesting rate and monetise some of this value using reinsurance.





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- Expect 60% of vesting pensions to remain with SJP as new drawdown contracts, but this value is outside the SII contract boundary
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- **Might work, but some complexities and next option has more certainty for similar cost**



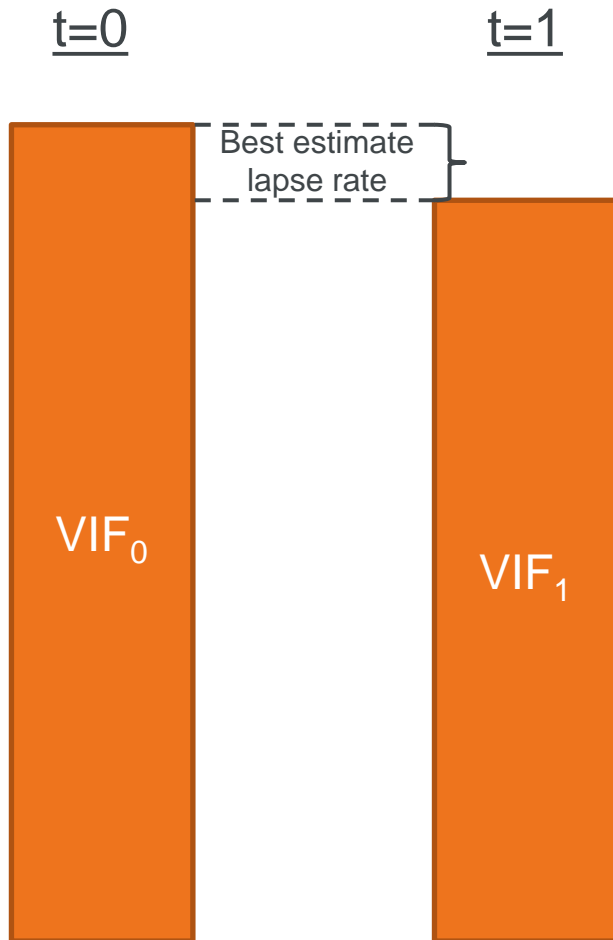
Overview of Mass Lapse Reinsurance



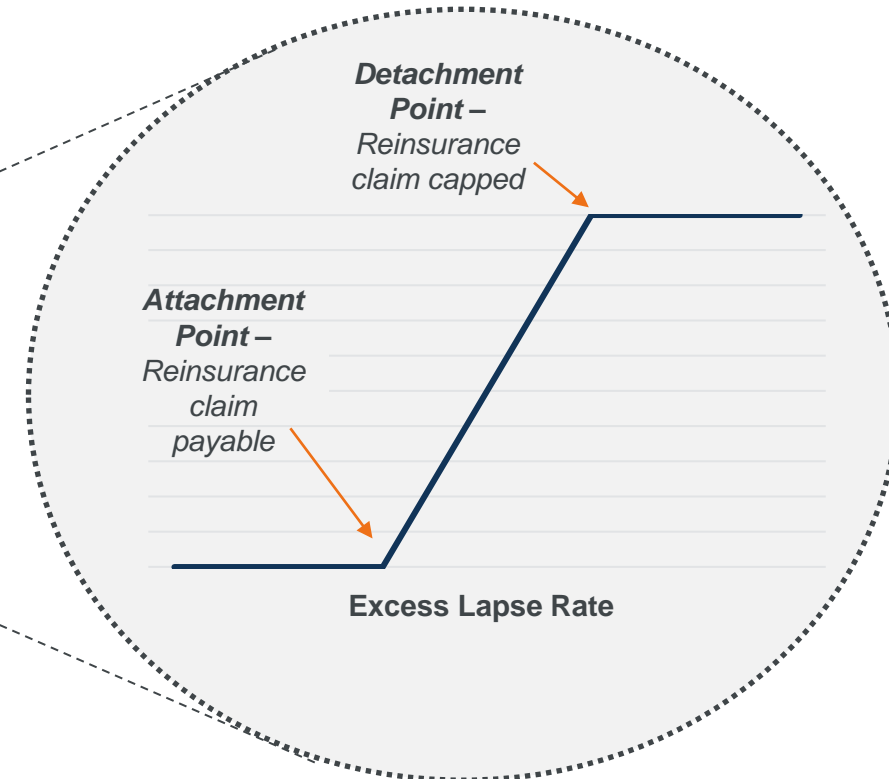
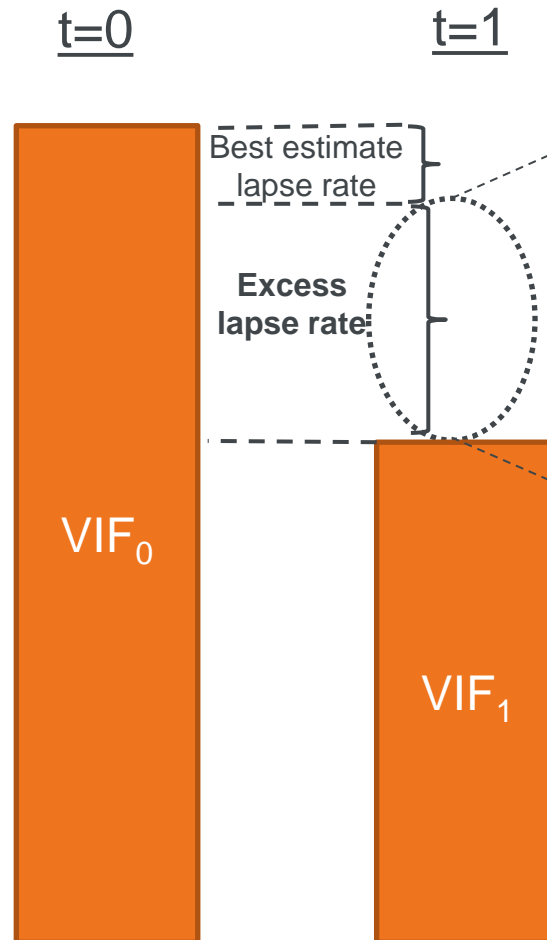
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Concept Overview

Experience in line with assumptions



Mass lapse scenario



Key Features

- Attachment/Detachment Point
- Notional amount
- Term
- Reinsurance premium payable (% of notional)
- Reinsurance claim definition



Impact on Capital Position (Standard Formula)

- The Standard Formula requires mass lapse risk capital to be held against:
 - 40% discontinuance (retail business)
 - 70% discontinuance (institutional business)
- Insurers can assume mass lapse reinsurance would pay out in the Standard Formula stress scenario, provided the reinsurance meets the requirements of the Solvency II Delegated Regulation on risk-mitigation techniques (Article 208 onwards)
- Risk Margin relief is also available during the period of cover



A Reinsurer's Perspective



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Who are Munich Re

- Global Reinsurance Company who take a wide range of risks
- Can this risk diversify with other risks within Munich Re?
- Pride ourselves on having a high degree of client focussed flexibility



How to assess the risk?

Contract Design

- Need to ensure contract can actually achieve what we are aiming for

Past Experience

- Low, stable and credible lapse experience with appropriate assumptions

Products

- All sales fully (and holistically) advised
- Tax implications and restrictions on withdrawals (pensions business)
- No lapses by default (e.g. accidental cancellation of direct debit)
- Low proportion of institutional business – less volatile



How did we arrive at an appropriate price?

Pricing Process

- Relatively small cost for a relatively low risk – how to build up the price?
- Can compare the price to other instruments with similar capital benefit?
- More appropriate to look to existing market in Continental Europe – how does it compare to them given the bespoke features?
- Does the proposed price meet internal pricing hurdles?



Operational Considerations



Operational considerations

- Claim definition
 - Measurement period
 - Reassigned claims
- Format / frequency of reinsurance accounts
- Definition of 'policy'
- Definition of 'lapse'
- Ongoing operation of the treaty



Effectiveness of Risk Transfer



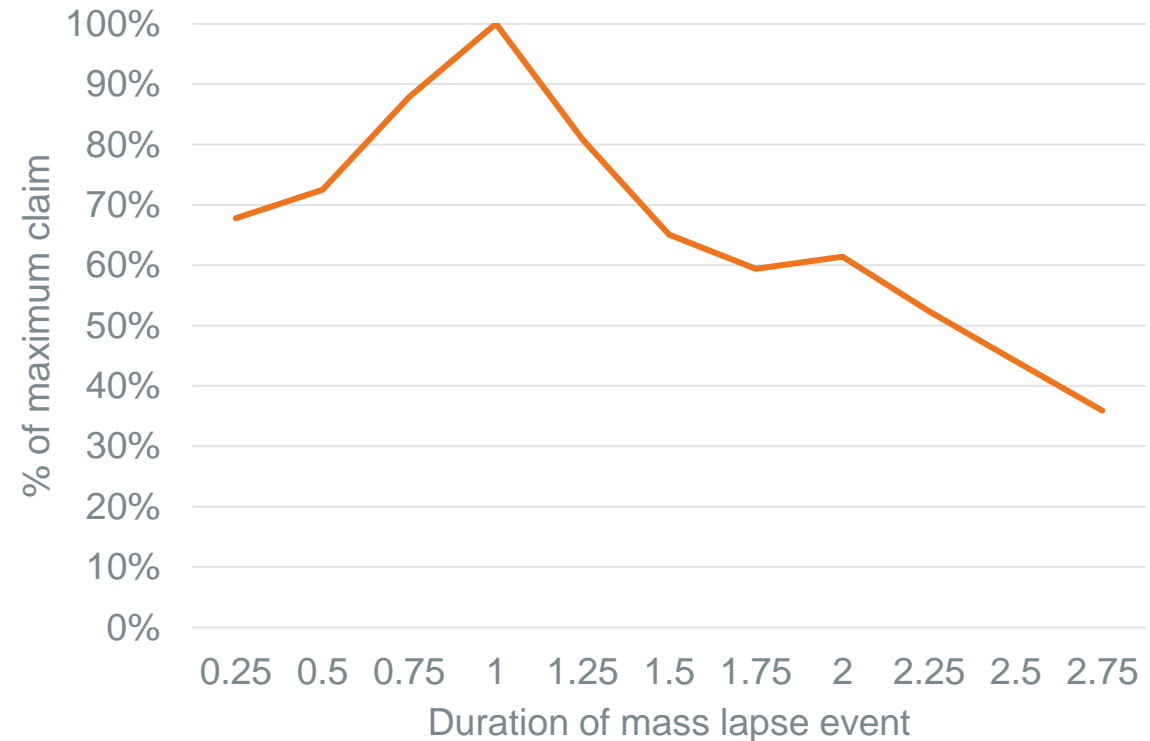
Key Challenge – Effective Transfer of Risk

- Does the treaty provide genuine protection against a foreseeable risk, or is it narrowly targeting the Standard Formula mass lapse scenario? In what range of scenarios would the reinsurance pay (or not pay) a claim?
- EIOPA opinion on use of risk mitigating techniques:
 - *“Where there is a calculated capital relief, a commensurate risk transfer is also expected”*
 - *“..to recognise a risk mitigation technique in the SCR calculation there should be a proper balance between the effective risk transfer and the SCR relief”*
 - *“Standard Formula formulas and scenarios are a means to an end: quantify a risk; but they should not be considered comprehensive in terms of the risk covered, which can adopt many shapes (e.g. mass-lapse risk)”*
 - *“Where there is a significant deviation of the SCR due to a reduction in the SCR that is not commensurate with the extent of the risk transferred.....insurance and reinsurance undertakings should consider that the risk-mitigating technique does not provide an effective transfer of risk”*
 - *“it is expected that the most complex [risk transfer transactions] and those that present specific interactions with the Standard Formula (e.g.mass-lapse risk transfer...) need more attention from supervisory authorities”*



Effectiveness of Risk Transfer

- Over what period of time might a mass lapse event manifest itself?
- What “shape” might a mass lapse event have?
- How effective would the treaty be in such scenarios?



Regulator engagement



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Key points and areas of interest

Communication

- Early engagement and ongoing communication helpful
- Written questions and feedback received and prompt responses provided

Term

- Key area of interest and a risk mitigating effect point
- 6 years positively received

Attachment/detachment

- Also a key area of interest from a risk mitigating effect point of view
- The chosen attachment point (20%) much lower than the 40% SF stress.

SF Appropriateness

- Standard formula appropriateness a consideration
- “Vanilla” nature of contract, doesn’t change biting stress etc.

Definition of “Lapse”

- Noted the need for this to be very clear for the contract to be effective

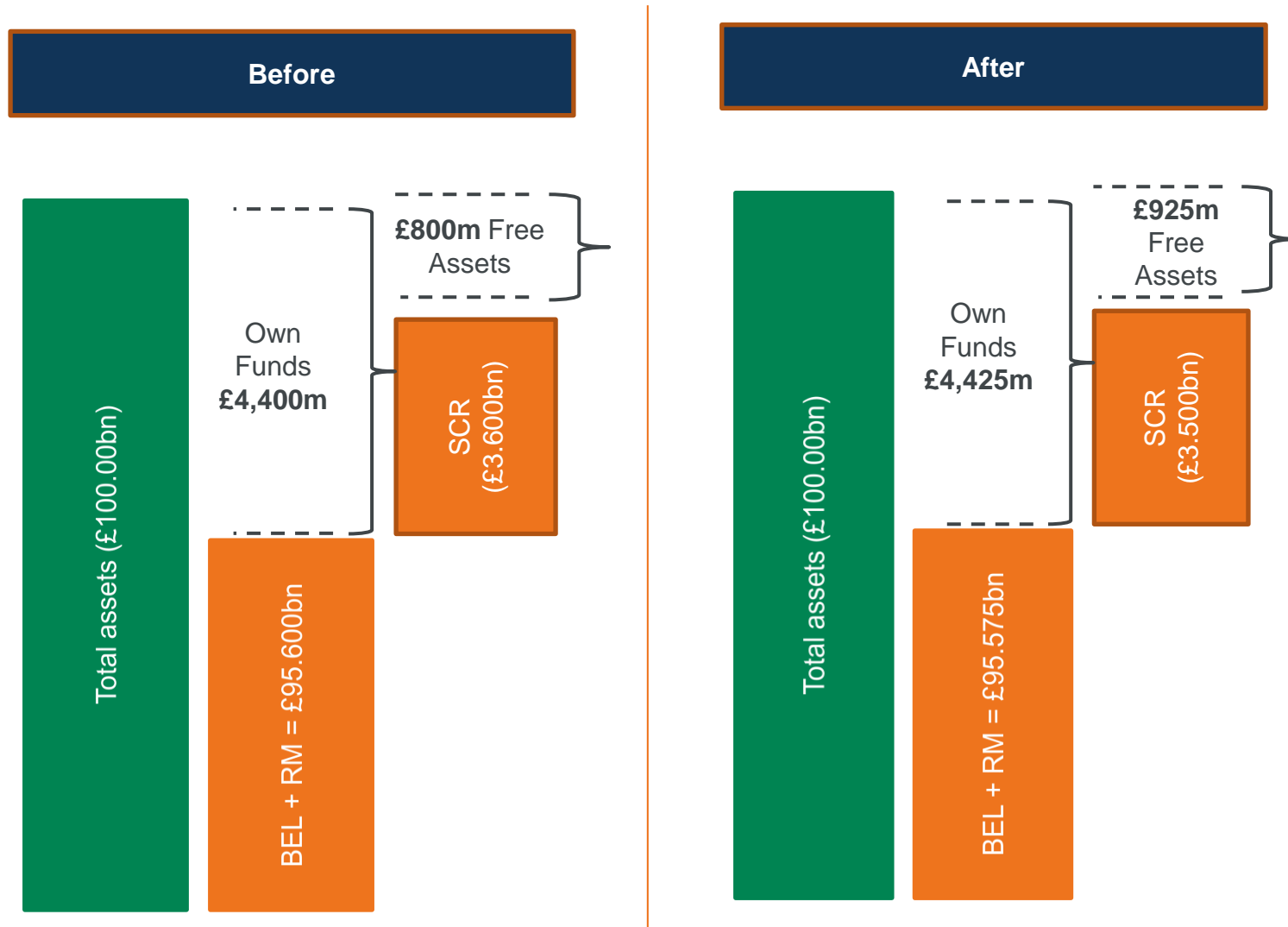


Summary



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Before and After (£175m notional cover)



- Own funds improve as the risk margin reduces with lapse risk capital. The cost of reinsurance premiums offsets some of this.
- Solvency capital requirement improves with notional cover per treaty reduced by diversification effects
- Free assets improve overall by **£125m**, reflecting the reduction in risk and sufficient to offset a large part of any temporary solvency shock



Key points

- **Outcome**

- Sufficient risk transfer and capital benefit achieved to offset solvency effect from short-term equity volatility
- Provided certainty around associated capital plans and decisions

- **Lessons learned**

- Communication is key. Keep all stakeholders informed and engaged throughout.
- Seek external opinion and peer review.
- Demonstrate real risk transfer. Our solution provides material protection in a much broader range of mass lapse scenarios than that specified by the standard formula.
- Don't forget operational considerations. Regular reinsurance accounts should be simple to produce.





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Thank you

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenters.



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