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Matching Adjustment: Update from IFoA MA working party

Ross Evans
Michael Henderson

09 October 2017

Matching Adjustment working party

- ✓ **Chair:** Ross Evans, Hymans Robertson
- ✓ **Deputy Chair:** Stephan Erasmus, Legal & General
- ✓ Michael Henderson, Legal & General
- ✓ Peter Maddern, Canada Life
- ✓ Keith Neil, Lloyds Banking Group
- ✓ Andrew Kenyon, NatWest Markets
- ✓ Ravi Dubey, Reliance Mutual Insurance Society



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Agenda

- The Matching Adjustment – why is it such a big deal?
- What is the Matching Adjustment?
- Why are we still talking about it 18 months into Solvency II?
 - Industry feedback
 - Case studies
- What's next ...



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The Matching Adjustment – why is it such a big deal?

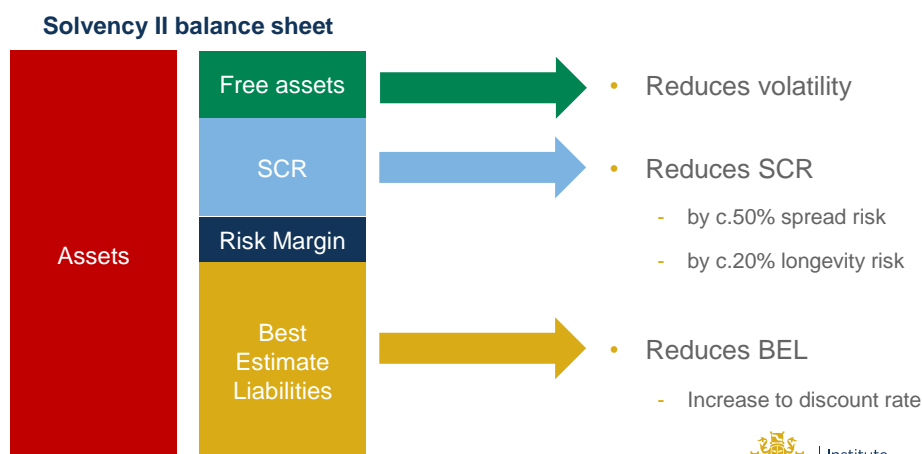
Significant impact on insurance companies and pension scheme de-risking

- Matching Adjustment (“MA”) = increase to discount rate for annuity business
- The MA is worth **£59bn** to the UK insurance industry
Source: Sam Woods, PRA
- There is around **£2trn** of pension scheme liabilities outstanding, so the MA could become worth significantly more over the coming years
Source: Working party estimate
- The MA is crucial for insurers to deliver competitive/acceptable de-risking solutions to UK pension schemes



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Crucial for the insurer balance sheet

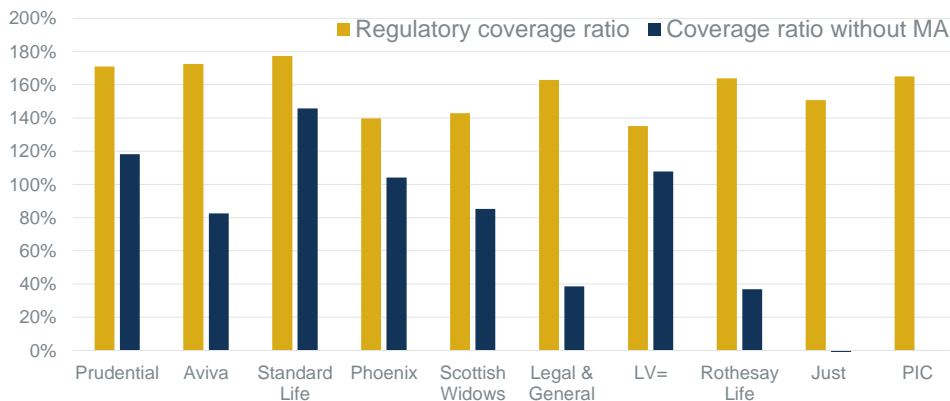


Schematic diagram; not to scale



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Effect of stripping out the MA



Source: Hymans Robertson analysis of 2016 Solvency and Financial Condition Reports
 Regulatory coverage ratio = Eligible own funds + SCR
 Figures refer to the Solvency II groups
 For some firms the reported coverage ratio drops below 0% when the MA is removed



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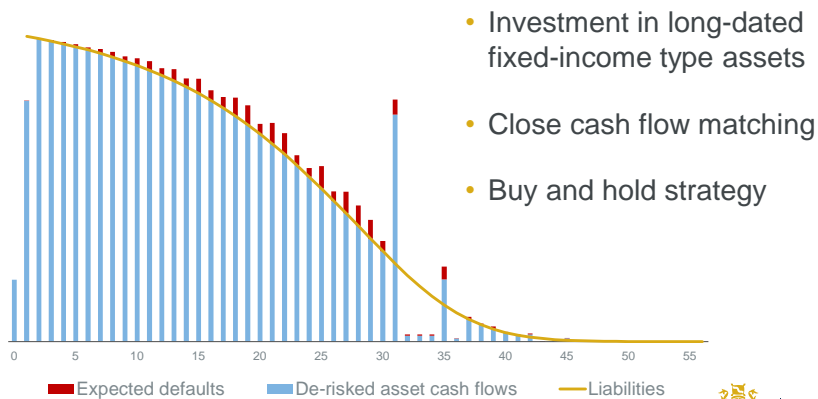
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What is the Matching Adjustment?

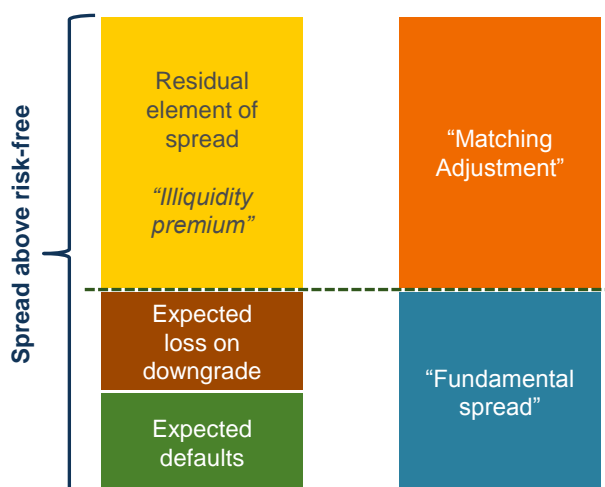
Matching Adjustment 101



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Matching Adjustment 101 (continued)



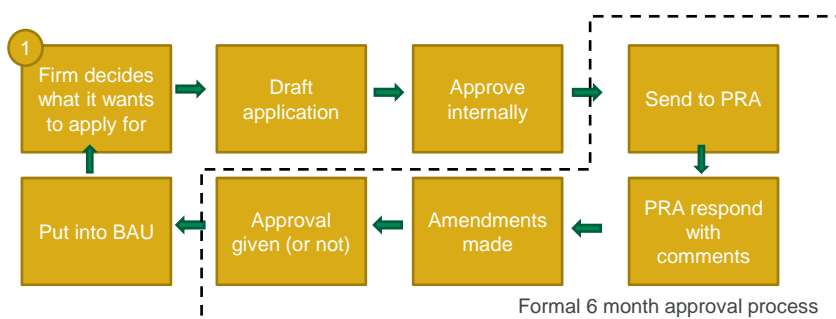
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Assets and liabilities subject to eligibility assessments

MA rules (summary)	
Asset eligibility	Bond-like, fixed cash flows
	No issuer optionality, unless sufficient compensation provided to replace lost cash flows

Stringent approval process



- Long and involved process but prize is high
- Some firms very conservative initially



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Why are we still talking about it 18 months into Solvency II?

What you've been telling us – Assets

- Everyone chasing the same MA eligible assets
→ Yields down → Annuity rates down
- Rules can lead to significant additional complexity
e.g. SPV repacks
- The all or nothing nature of the rules is very unhelpful
- Macro effect of the rules → Stifling lending to the economy
- How to deal with the risk of prepayment



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What you've been telling us – Approvals process

- Insurers missing opportunities → Bad for consumers
- Some firms deciding to just walk away from opportunities
- Increasing the lead time on large BPA deals
- Impacting the price of BPA deals
- Need for more reliance on firms' internal governance



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Case study 1 – Infrastructure

The Telegraph

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British insurers commit £25bn to UK infrastructure

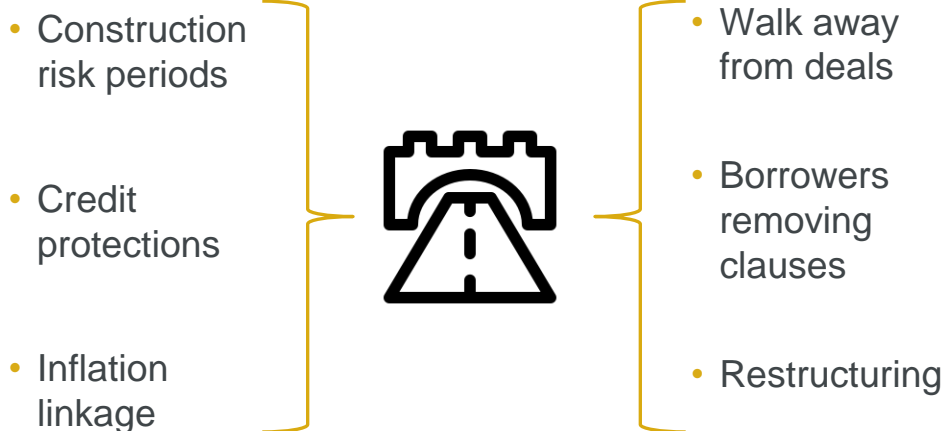
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UK life insurers can help boost infrastructure
 More government encouragement is needed for private sector investment



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Infrastructure (continued)



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Case study 2 – Benefit restructures

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Sir Philip Green

Philip Green agrees to pay £363m into BHS pension fund

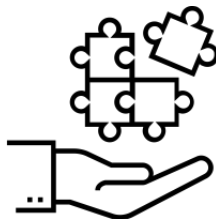
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 Tata Steel agrees deal to offload British Steel pension fund



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Benefit restructures (continued)

- Surrender options
- Flexible buy-in terms
- Future premium



- Fewer insurers quoting
- Higher cost
- Scheme enters PPF

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What's next?



Work underway and what's to come

ABI/PRA working party

- Looking at how to ease practical burdens and hurdles **under existing rules**
- More clarity on “features”
- Extending callable bond treatment to other assets
- Ease application burden

IFoA MA working party

- Looking at potential changes to ease practical burdens and hurdles **post Brexit**
- More principles based
- Applying a level of judgement based on materiality
- The use of capital buffers for certain types of risks

More scrutiny from PRA on illiquid asset classes (SS3/17)

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Questions

Comments

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