

PRA publishes 2022 stress test feedback for insurers

AT A GLANCE

January 2023

What's new?

- The PRA published its feedback on the [Insurance Stress Test 2022](#) (IST 2022) exercise on 23 January 2023. The results show that the UK insurance sector is resilient to the PRA-specified stress scenarios, subject to mitigating measures. For life insurers these scenarios were market stresses and an increase in longevity. For general insurers, which includes Lloyd's syndicates, the stress scenarios were natural catastrophe (NatCat) and cyber losses.

What does this mean?

IST 2022 – Life insurance results

- 16 UK regulated life insurance entities participated in the IST 2022 exercise. In aggregate, the life insurance sector's solvency capital requirement (SCR) coverage falls from 162% (pre-stress) to 123% (post-stress).
- Firms were most vulnerable to credit downgrades, property shocks and longevity improvements. However, the aggregate across the sector SCR coverage remained above 100%, although several firms breached their internal capital risk appetite limits. Management actions, existing longevity reinsurance, and transitional measure on technical provisions (TMTP) acted as key mitigants for firms.
- The PRA questions the effectiveness of some management actions noted by firms. For example, the ability to sell sub-investment grade assets quickly, especially where other investors would be taking similar actions.

IST 2022 – General insurance results

- Approximately 75% of the UK general insurance sector, which includes 17 general insurers, 21 large syndicates and the Society of Lloyd's, participated in IST 2022. In aggregate, the general insurance sector's post stress SCR coverage remained above 120% in

all scenarios. Further, IST 2022 highlights UK firms' continued dependency on the global reinsurance market.

- NatCat – The three NatCat scenarios are US hurricanes, California earthquake, and UK wind storm and flood. The PRA finds that in aggregate, firms were able to withstand the scenarios, but between one and five firms saw their SCR fall below 100%, with US hurricanes being most likely to cause a breach of the SCR. While the PRA observes that overall firms' approach to modelling NatCat risks has become more sophisticated over time, it notes that certain aspects of modelling could be further improved, such as the quantification and assumptions of factors such as claims inflation, post loss amplification, and secondary uncertainty.
- Cyber losses – The three cyber scenarios are cloud outage, mass data exfiltration, and systemic ransomware. The PRA finds that all firms were resilient to the scenarios, but between one and two firms saw their SCR fall below 100%. There was significant variance in firms' assessment of the likelihood of this risk. Also, several firms were unable to assess the potential impact of unusable key exclusions

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in contracts. Further, non-affirmative loss reduced significantly in comparison to the IST 2019 results.

What do firms need to do?

- The PRA encourages boards to assess whether the risk management findings and gaps highlighted in its feedback apply to their firm and, if so, to commission an action plan to address them.
- The PRA expects all firms to generally increase engagement of stress testing at board level. It also expects the results of this exercise to be scrutinised by firm boards.

Life insurers

- Credit downgrade risk - The PRA expects firms to have adequate risk management in place, with the board setting appropriate risk appetites, ensuring that these appetites are put into practice throughout the business and assessing the position against a range of scenarios.
- Trading management actions - The PRA states it is important to allow for market liquidity and potential stress amplifications arising from actions that would be expected to be taken by other investors. Boards should also increase their focus on the feasibility of management actions and the impacts beyond the immediate effect on their firm's solvency position.
- TMTP – The PRA states it is important for firms to ensure that they have adequate plans to cover the SCR with eligible own funds when TMTP expires in 2032.

General insurers

- Reinsurance – The PRA states that UK insurers continue to be materially dependent on the global reinsurance

market to mitigate the financial impact of gross losses. Therefore the PRA plans to undertake targeted investigations with selected firms to assess potential reinsurance risks to their financial and business model stability. In addition, as highlighted in its recent [Dear CEO letter](#), the PRA expects firms to comply with the Prudent Person Principle in relation to their reinsurance activities.

- Assumptions – The PRA encourages risk teams and boards to challenge whether their assumptions in the different modelled components remain appropriate. Further, firms should reflect on the limitations of their models and address any modelling gaps.
- On NatCat, the PRA encourages firms to continue including comparisons to real-world events in their catastrophe model validation and to take steps to remediate any material gaps.
- On cyber, the PRA states the market should develop greater consensus on the likelihood of risks to ensure capital comparability across the sector. With regards to contract uncertainty, the PRA encourages boards to be aware of the implications of uncertain policy language, and to ensure exposures continue to be managed within their firm's risk appetite. Further, the PRA encourages firms to continue to robustly assess and manage non-affirmative loss reduction exposure. Firms should focus on building their expertise to assess and manage cyber exposures by investing in the data, models and parametrisation.

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Next steps

The PRA will engage with life insurers and general insurers in Q2 and Q3 2023 respectively about the timing and design of the next stress testing exercise. The PRA plans to host industry forums in due course to discuss the results of IST 2022.

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