Solvency II: Growing financial strength

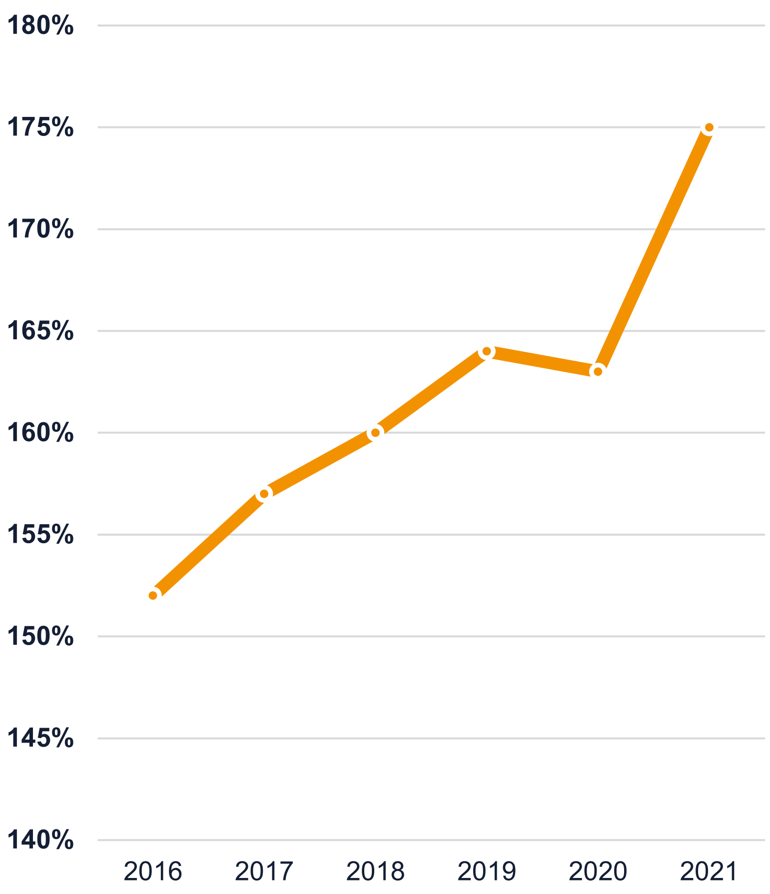
LCP's sixth annual review of SFCR reporting by 100 of the largest non-life insurers in the UK and Ireland

December 2022

Contents

Key highlights from our report

Aggregate eligible own funds ratio



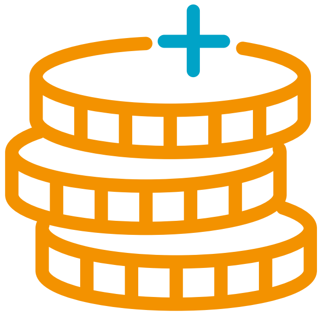
Total eligible own funds

increased from £85bn at the end of 2020 to £90bn at the end of 2021

£90bn

Inflation mentions

(77% of firms)



Russia mentions

(78% of firms)

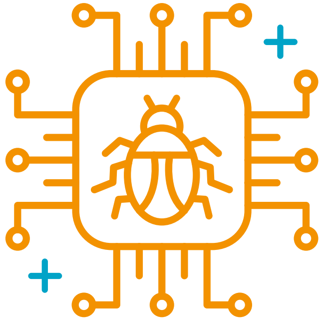
£199bn

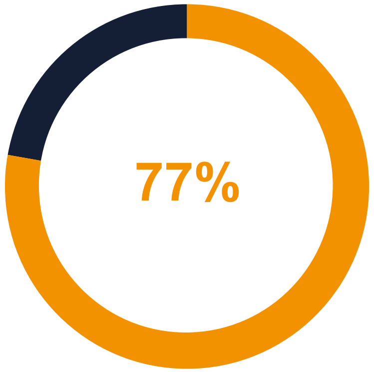
£8bn

Total aggregate investments and cash across our sample have increased by over **£8bn** over 2021 and now total **£199bn**

Cyber risk

(77% of firms referred to cyber risk in their SFCR)





Introduction

Our sixth annual review of insurers' SFCRs provides insights into the financial strength of the insurance industry, including the impact of inflation, the Russian invasion of Ukraine, and the ongoing effects of COVID-19.

While the global pandemic continues to be a key area of focus for firms, there is naturally less emphasis in this year's reporting as the world emerges into a "new normal". However, the emerging risks arising from inflation concerns and the Russian invasion of Ukraine are new features this year. Having said this, we were surprised at how many firms didn't cover these risks at all, or only gave them a cursory mention.

At the end of 2021, CPI inflation had already risen sharply to 5.4% p.a. in the UK and 5.5% p.a. in Ireland, and inflation in certain commodities such as energy and raw materials was far higher. With a very volatile outlook ahead for this key risk to claims costs, we were expecting insurers to cite this as one of their major emerging concerns in their SFCR reporting. In fact, fewer than half noted inflation as a key risk, and 15% of SFCRs did not even mention inflation. Very few firms provided any sensitivities showing the effect of inflation on their results.

Most firms referred to the Russian invasion of Ukraine even though it started after the 2021 year end. There were some good discussions of the effect on their business and the wider implications, but many firms only made a cursory mention without disclosing how it might affect their business.

We are pleased to see that more firms covered climate change this year, now up to 77% compared to 60% last year. But few reference the TCFD (Taskforce on Climate-related Financial Disclosures) recommendations in their SFCRs. This is despite the UK Government's plan to implement mandatory TCFD-aligned disclosures for UK insurers. There has been a similar increase in the number of firms mentioning ESG (environmental, social and governance) in their SFCRs.

The future of Pillar 3

Pillar 3 reporting is evolving slowly, and in the right direction regarding simplifying disclosures and helping users read the reports. EIOPA has made suggestions for the European Commission to streamline SFCRs and QRTs, including a refocussing of the SFCR into two distinct parts, one for the policyholder and one for other financial users. Plans also include standardising the sensitivity testing for groups or very large insurers, although this does not include scenarios on inflation – which is a key driver of financial results and capital coverage.

In the UK, it is now the PRA rather than EIOPA that sets Solvency II standards, soon to be renamed "Solvency UK". HM Treasury and the UK Government have a long-running consultation on changes to Solvency II aimed at freeing up capital for wider investment and to making the UK insurance market more competitive in the global insurance space.

Although the UK mini-budget in September threatened to scrap Solvency II entirely, it would appear that this proposal has also been dropped by the new administration. However, the PRA has just launched a consultation on slimming down some of the QRTs with the aim of making reporting easier, and with an estimated saving to the insurance industry of £23 million each year. There will be upfront costs with these changes, but we certainly agree that there is room for streamlining when there are, for example, three separate templates for reporting the SCR depending on whether you use the standard formula, or a partial, or full, internal model.

The financial strength of the market remains strong, with the average eligible own funds ratio across our sample being 206%, compared to 214% for the same firms last year.

Introduction (continued)

Ideally, we would also want to see these changes lead to some improvements to reporting, including:

- **Smarter sensitivity testing –** to include what really matters. Inflation is a hot topic right now and most firms will have thought hard about the potential impact of higher-than-expected inflation. They will similarly have looked at the effect of the current volatile interest rates. Too few SFCRs show sensitivities to these areas.
- **Firms should be clearer about the emerging risks for their own business -** how they are managing them, and how it affects them.
- **Firms should also give themselves more credit for what they are doing well.** This doesn't mean sharing commercially sensitive information with the market, but the SFCR is an opportunity for firms to demonstrate how well they are managing risks, and to show how well they understand their business.

We would like to thank those from LCP who have made this report possible:

- Sophia Davies
- Jordan Femi-Famakinwa
- Nikki Freegard
- April Harrison
- Amy Hodgson
- Louis March
- Jaun Merchant
- Deepika Misra
- Lara Palmer
- Will Sutcliffe
- Joanna Thornett
- Mehak Tyagi
- Richard York-Weaving

Reporting could include smarter sensitivity testing, more detail on how firms are managing emerging risks, and show more clearly how well they understand their business

Cat Drummond
Partner

Matthew Pearlman
Partner

Our findings

A high-level summary of our key conclusions

We have now completed our sixth review of the Solvency II public reporting for 100 of the top UK and Irish non-life insurers.

We have analysed the Solvency and Financial Condition Reports (SFCRs) and public Quantitative Reporting Templates (QRTs), where insurers and reinsurers are required to disclose key metrics relating to financial robustness and details of how they manage their businesses.

In line with our previous reviews, we considered:

- **The Solvency II balance sheets and regulatory capital positions of insurers.**
- **The key risks to which insurers are exposed**
- **Market-wide observations that may help with benchmarking insurers against their peers.**
- **Key changes over the last year and emerging trends.**

Financial strength

The financial strength of the market remains strong, with the average eligible own funds ratio across our sample being 206%.

The total SCR across our sample has reduced slightly from last year end to £51bn. However, total eligible own funds have continued to increase steadily over the last few years, to £90bn as at 2021 year end.

Total gross written premium (GWP) has increased nearly 10% since last year to £119bn at the 2021 year end. We expect that most of this is due to hardening rates across many lines of business, and the general effect of inflation.

Most major lines have seen strong growth in GWP although general liability has had particularly strong growth at over 20%.

Motor has also seen modest growth in GWP of just over 2% in the last year, after a reduction in our previous report as a result of COVID-19.

Ukraine

The Russian invasion of Ukraine in February 2022 was a major world event and, as well as the humanitarian cost, also affected insurance companies.

There are two main sources of risk arising from the conflict:

- immediate impact on those insurers that have exposures in the area
- downstream effects as a result of the impact on the economy, heightened cyber threat, and changes to societal attitudes and behaviours.

Overall, 78% of firms mentioned the conflict and 60% described the effect on their own underwriting and investment exposures.

A few firms gave systematic detailed disclosures on the wider effects on their business.

Inflation

Inflation has become one of the biggest risks to economic stability: in the UK price inflation exceeded 10%, and in Ireland it exceeded 9% in 2022. This was exacerbated by the Russian invasion of Ukraine that drove up energy and commodity prices.

While 77% of firms mentioned inflation within their discussion of risk, fewer than half noted it as a key risk, and 15% of SFCRs did not even mention inflation throughout the whole report. Of those that did discuss inflation, fewer than a quarter provided any sensitivities showing the effect of inflation on their results.

Our findings (continued)

ESG and climate change

- We have continued to see an increase in the number of insurers mentioning climate change and the actions they are taking.
- Later in the report we include a number of examples of disclosures covering the positive steps that firms are taking on transition risk, sustainability, and scenario testing.

COVID-19 reporting

- COVID-19 remains an area of focus for insurers, but understandably the level of detail in this year's SFCRs was much lower than last year.
- As last year, some companies are still feeling the effect of the pandemic and have required further capital support.
- However, some companies, particularly medical insurers, have shared their additional profits with their policyholders.

Other key risks

- 16% of firms still consider Brexit as a key risk, around half of the figure last year.
- Increasing numbers of firms refer to cyber risk, and many cite this in particular in relation to the Russian invasion of Ukraine.
- Several personal lines insurers mention the UK FCA Pricing Review that outlaws price walking for existing customers.
- Still very few firms note the new insurance accounting standard IFRS 17 as a key risk.

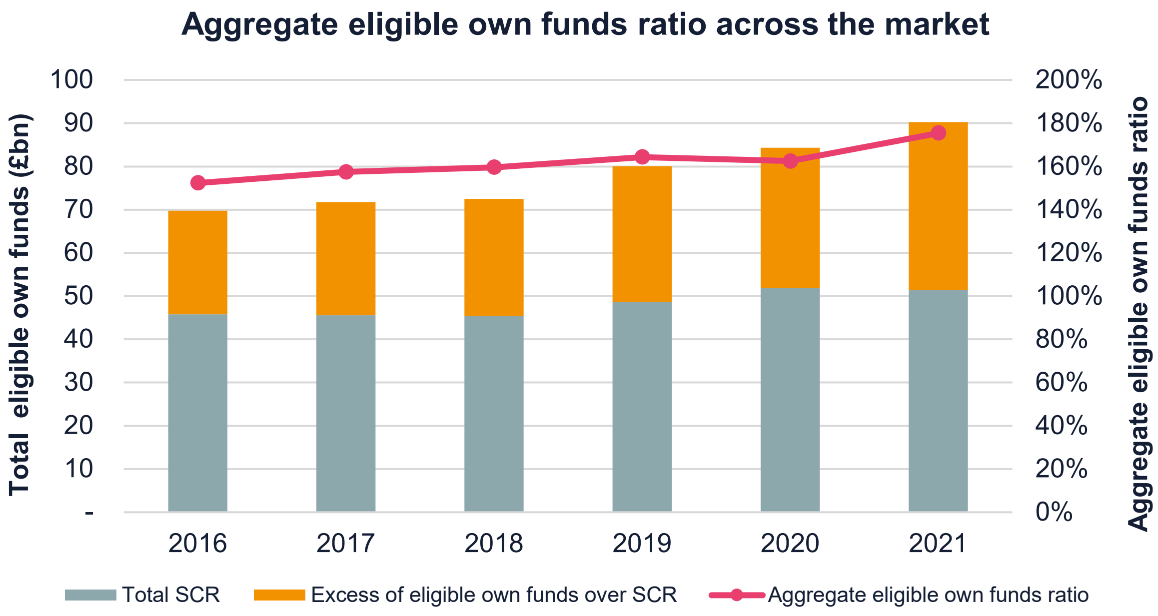
Financial overview

Financial strength of the market on 31 December 2021

Overall, the market has remained financially strong during 2021. The eligible own funds ratio - defined as eligible own funds divided by the Solvency Capital Requirement (SCR) - is an important measure for considering firms' solvency and financial strength. It represents the number of times an insurer can cover its regulatory capital with the net assets on the Solvency II balance sheet*.

We have considered the eligible own funds ratios for our sample of 100 insurers aggregated as a whole, as well as for each insurer individually.

* Subject to certain restrictions.



In aggregate

After a couple of years of increases, the total SCR aggregated across our sample has reduced slightly from last year end. However, total eligible own funds have continued to increase steadily over the last few years, from £72bn as at 2018 year end to £90bn as at 2021 year end, and so the 2021 aggregate eligible own funds ratio of 175% is at its highest level since Solvency II came into force. We comment on some of the major changes below.

For each insurer

The average (mean) eligible own funds ratio of our sample of 100 insurers was 206% as at 2021 year end compared to 214% as at the previous year end. This ratio has reduced from over 220% in earlier years but still remains very strong overall.

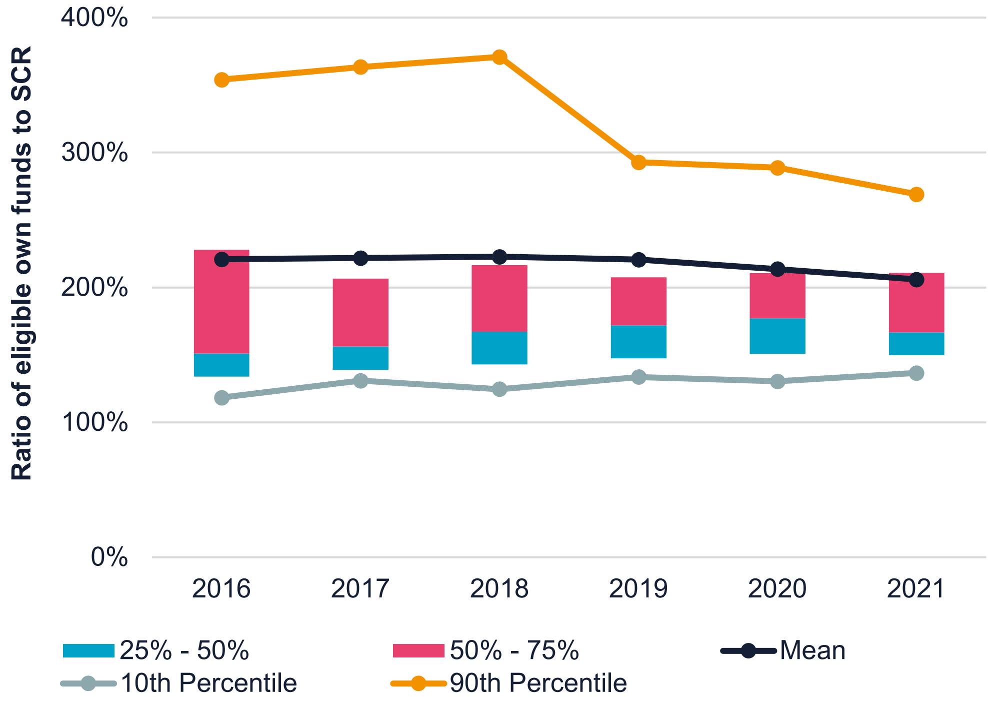
We note that the average ratio has reduced despite the increase in the overall aggregate ratio.

46% of insurers saw an increase in their eligible own funds ratio between the 2020 and 2021 year ends, whilst 54% saw a decrease.

Financial overview (continued)

The following chart shows the range of eligible own funds ratios for our sample at each year end since 2016.

Range of eligible own funds ratios at each year end



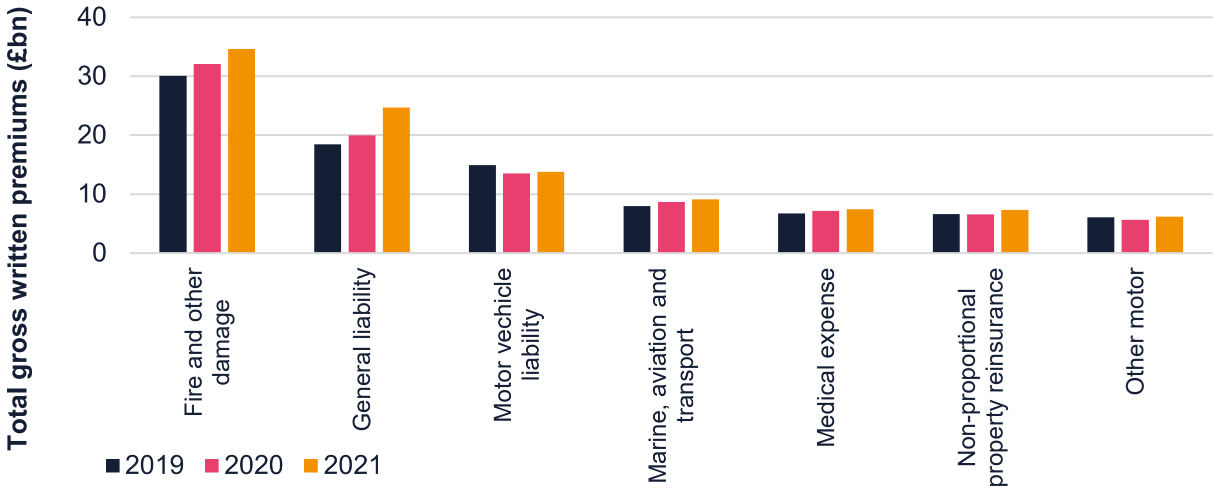
The median eligible own funds ratio, which is less influenced by extreme values than the mean, has also decreased this year to 167%, although this is higher than when Solvency II reporting began.

The range of eligible own funds ratios between the 10th and 90th percentiles for our sample has narrowed considerably since 2016.

Breakdown of gross written premium by SII line of business

The following chart shows the breakdown of the total gross written premium (GWP) for our sample of 100 insurers for the largest Solvency II line of business at the last three year ends.

Gross written premium (GWP) by SII LoB



Total GWP has increased nearly 10% since last year to £119bn at the 2021 year end. We expect that most of this is due to hardening rates across many lines of business, and the general effect of inflation.

Most major lines have seen strong growth although general liability has had particularly strong growth at over 20%. This was driven by **Lloyd's** which wrote nearly 30% more in this class in 2021 than 2020.

Of particular note is that motor, after a reduction in our previous report as a result of COVID-19, has seen modest growth of just over 2% in the last year. However, this is a combination of certain writers substantially increasing their portfolios: **Hannover Re's** motor premiums increased by nearly 60% and **Allianz Re** by nearly 80%, while **XL Insurance** reduced their motor premiums to a third of their 2020 levels, and **Soteria** reduced to almost zero as they went into run-off.

The only lines of business seeing a reduction last year were the smaller assistance and income protection lines (not shown on the above graph).

Russian invasion of Ukraine

In February 2022, Russia invaded Ukraine and commenced a military operation that is still ongoing 9 months later. This has created a humanitarian crisis and seen millions of refugees displaced inside Ukraine, and in neighbouring countries. The US, UK and EU have imposed sanctions on Russia, and exports from Ukraine and Russia have been severely reduced.

Insurance companies, like most other businesses, have been affected by this conflict, and while it started after the 2021 year end on which most of the SFCRs reviewed were based, most firms have considered the implications in their published reports.

There are two main sources of risk arising from the conflict:

- immediate impact on those insurers that have exposures in the area
- downstream effects as a result of the impact on the economy, heightened cyber threat, and changes to societal attitudes and behaviours.

78% **of firms mention the invasion**

60% **of firms describe the impact on underwriting and investment**

Overall, 78% of firms mentioned the conflict and 60% described the effect on their own underwriting and investment exposures.

Some firms took a more thorough approach and systematically discussed the potential effect on each risk area. A particularly good example is **IGI** (see box) who published its risk assessment for each area including not only market effects (eg asset price volatility, credit risk downgrades) but also supply chain disruption and the possibility of cyber attacks, as well as societal attitudes to insuring fossil fuel providers. These disclosures give comfort to the statement that IGI "*is confident that it will not have a material effect*" on its business.

Risk Category Impacted	Risk	Potential Impact / Risks to the Company
Insurance Risk	Increase in Oil Prices	Potential direct impact for some classes particularly Upstream Energy.
	Claims Inflation	In addition to changes in oil prices, issues may arise relating to supply chain disruption, which could result in increased claims inflation for various classes.
Strategic Risk	ESG Issues	The focus on Environmental issues will continue, although may lead to an increase in tolerance for providing insurance to areas to assist with any short-term energy provision gaps whilst there is a transition to more carbon neutral energy production.
Market Risk	Market Volatility	Anticipated short term volatility both in respect of asset prices and exchange rates, which to some extent will be managed through existing asset liability matching arrangements.
Credit Risk	Downgrades	No downgrades or defaults anticipated in the market and will continue to monitor the situation.
Operational Risk	Operational Resilience	Although there has been no uptick in respect of cyberattacks on the IGI Group, we continue to monitor this situation closely through the IT team. Given IGI's experiences with coping effectively with COVID-19, the Company expects to be relatively resilient to these issues.

Source: IGI SFCR as at 31 December 2021

Russian invasion of Ukraine (continued)

Another example is **Motors**, which included a list of the key risks it is monitoring as a result of the conflict.

Key risks being monitored are:

- Inflationary pressures
- Supply chain issues
- Interest rate pressures
- Decreased volume of new car sales
- Increased average prices of used cars and decreased volumes
- Increased credit risk on business conducted in Russia and to key clients
- Increased fears over cyber-attacks

Source: Motors SFCR as at 31 December 2021

The SFCR notes that the business is affected because of the worldwide implications, and critically the severity of the impact depends on "*the group's ability to spot, monitor and mitigate potential risks*" leading on to a list of areas for consideration including increased horizon scanning to understand potential threats, increased stress and scenario testing, as well as exploitation of new product potential.

However, nearly a quarter of firms made no comment at all on what is one of the current biggest risks to the economy, and 40% either did not disclose how this might affect the firm, or gave very limited coverage. Many firms simply noted that they had limited, or no, direct underwriting or investment exposure in Ukraine and Russia, without talking about the knock-on effect of supply chain disruption on their business, inflationary pressures, or possible contagion to a wider region.

Inflation

Inflation has become one of the biggest risks to economic stability: in the UK the standard CPI measure of price inflation has recently topped 10% and the Bank of England has raised interest rates 7 times so far in 2022 to try to control inflation; in Ireland the CPI reached over 9% in mid-2022, and the European Central Bank has also raised interest rates.

By the end of 2021, concerns were already surfacing around inflation expectations as a result of supply chain issues and wider financial implications arising due to the global COVID-19 pandemic. This was exacerbated by the Russian invasion of Ukraine that drove up energy and commodity prices increasing inflation further.

Inflation has a profound effect on insurance companies who have to consider not just headline price inflation but also the specific impact on claims in their industry. For example, property insurers need to consider raw materials inflation, motor insurers need to consider second hand car inflation, medical insurers need to consider costs of medical equipment and legal services, and all of these need to consider relevant wage inflation in respect of their claims costs.

The uncertainties are amplified for long tail insurance classes such as liability insurance as projections of costs have to be made further into the future. Discussing these uncertainties gives insurers the opportunity to demonstrate their understanding of the specific features of their own businesses, and their resilience to relevant changes in the economy.

We would therefore expect most insurers to place inflation high on their list of key risks in the current environment. This is especially the case in highly competitive industries like motor insurance, where a few percentage points on the inflation rate can mean the difference between a profit or loss for the year.

However, while 77% of firms mentioned inflation within their discussion of risk, fewer than half noted it as a key risk. More surprisingly, 15% of SFCRs did not even mention inflation. Of those that did discuss inflation, fewer than a quarter provided any sensitivities showing the effect of inflation on their results.

77%

mention inflation in discussion of risk

43%

disclose inflation as key risk

15%

don't mention inflation at all

One possible reason for this absence is the method of classification of risks under Solvency II that all firms are required to follow. Risk must be divided into named categories: underwriting risk, market risk, counterparty default risk and operational risk. Then market risk is divided further into interest rate, equity, property, spread, concentration and currency risks. But there is no specified bucket for inflation risk, and so it can be easily overlooked when doing sensitivity testing.

Inflation (continued)

Allianz and Scottish Widows Group (where **Lloyds Bank GI** and **St. Andrew's** are subsidiaries) were some of the few firms to disclose sensitivities to inflation. Other firms disclosed partial sensitivity information, for example, **Admiral**, and **UKI** (which includes Direct Line Group and Churchill), but this was confined to their exposures to PPOs (periodical payment orders – long term annuity payments to claimants injured generally in road accidents). While this is important, it ignores the very real effect of inflation on the rest of their portfolio.

Similarly, **AIG UK** published an inflation sensitivity test, although this was part of wider Brexit scenarios, and **Soteria** included inflation within their recession scenario test. **RSA** listed inflation as a material risk, but only in the context of their pension schemes.

AXA XL provides a good definition of inflation risk, noting that it is a key driver of market risk. **PartnerRe's** SFCR also identifies inflation risk as material and has a useful section outlining the main sources of inflation risk on its portfolio and how it is mitigated. Both firms also note that they carry out inflation scenario testing in their ORSA, but neither quantifies the sensitivity within the SFCR.

This touches on a wider point around how insurers can improve the usefulness of sensitivity testing. In a previous report, we flagged that many firms were not complying with the Solvency II requirements as they were not reporting anything on sensitivity testing. This has improved in that more firms now include the results of sensitivity testing in their SFCRs, but these are typically limited to generic tests (eg the impact of a 10% fall in equities), rather than focussing on the risks that are most important for each firm, and therefore what is most useful and insightful to the reader.

COVID-19

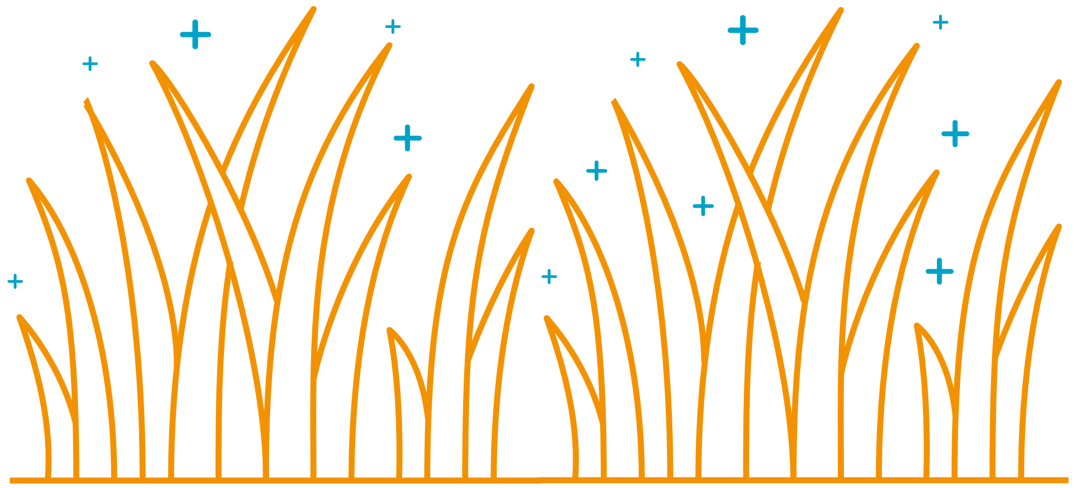
Last year, COVID-19 was a major area of focus for insurers. It was the second year that the impact of COVID-19 had been reflected in insurers' financial disclosures although widespread uncertainty was still a central theme.

This year, we have seen firms take a much more "business as usual" approach. For example, **CNP** showed that its operational risk arising from the pandemic had reduced since last year, and for **RSA** the main continuing concern is around uncertainty in the cost of business interruption claims. **Lloyd's** reported that COVID-19 loss estimates had remained stable and had no impact in 2021. **BHSF** included discussion of the impact of COVID 19 on its future strategy and competition risks.

All but two firms mentioned COVID-19 (**Ironshore** and **TT Club** being the exceptions) but the level of detail was generally much lower than last year. We are comfortable with this general approach – it is important for firms to describe what their main business issues are, and not to use up valuable space in their report just because they did so last year. It is good that firms generally continued to cover all aspects of the pandemic, both how it affected their policyholders, and also how it affected their own staff and working practices.

The industry is still feeling the impact of the pandemic and **Arch** revealed that it had received £10m capital support from its parent in 2021 partly due to the reserve implications of the pandemic.

There were also some positive results from the pandemic, particularly among the medical insurers. **Exeter Friendly Society** has agreed a return of £5.3 million to its health insurance members and **Irish Life** returned a significant proportion of premiums to its policyholders – up to 60% for those with private hospital cover. **Aviva** has provided a fair value pledge to policyholders to recognise the ongoing uncertainty around the ability to access treatment.



Climate Change

How prepared are firms for impending climate change regulation?

From our sample of 100 insurers, 77% mentioned climate change, with the majority considering it as a key risk. We are pleased to see this proportion continuing to increase – it is up from 60% last year. We would still expect a higher proportion to disclose their climate change considerations in their SFCRs given the increasing public interest in climate responses.

Further, the PRA made it clear in its July 2020 'Dear CEO' letter that UK firms should have fully embedded their approaches to managing climate-related financial risks by the end of 2021, covering governance, risk management, scenario analysis and disclosure requirements. The CBI set out its expectations for Irish insurers in its August 2022 consultation CP151.

The UK government has also set out its plan to implement mandatory TCFD-aligned disclosures for UK insurers in its Interim Report of the UK's Joint Government Regulatory TCFD Taskforce. The Irish government has also been very supportive of the TCFD framework.

That said, only 7% of firms mentioned the TCFD in their SFCRs. As we noted last year, EIOPA is proposing to include three climate change disclosures in insurers' QRTs: the proportion of investments identified as environmentally sustainable in the EU taxonomy; the proportion of investments exposed to transition risk; and the proportion of investments exposed to physical risk. While this would apply directly to Irish insurers, it remains to be seen whether the PRA will echo any requirements for UK firms.

Governance and risk management

Several firms have disclosed their strategic responses and other efforts taken to improve oversight and handling of climate-related financial risks, as well as their responses to the three identified stages of climate risk – transition risk, physical risk and liability risk.

- **Ageas** notes that transition risk represents the largest of the climate threats in the short-term, but that its strategic approach, including the ability and speed in which it can adapt to support the transition to a low-carbon economy will ultimately impact on the longer-term success of the business. It is currently developing climate-related stress and scenario testing and establishing climate-related metrics and targets and has confirmed that it intends to integrate TCFD recommendations.
- **AmTrust** has developed a Climate Change Financial Risk Framework to identify, measure, manage, monitor and report on the financial impact to the company resulting from climate change.
- **Arch** has made an assessment of the specific risk of climate change to the company and identified potential risks relating to underwriting and investment risks, which it sets out in detail in its SFCR. It has embedded management of climate change risks into its standard approach for risk management and underwriters are working to continually assess the impact of various climate change scenarios on the existing and future portfolio
- **AXA UK** has stated its ambition to play an active role within the UK and Ireland insurance industries in tackling climate change, taking a clear, methodical and collaborative approach that will produce long-term results. It has set up a working group to draw together activity from across the business and recommend a high-level climate change strategy for Board approval in 2022. Climate change will explicitly be considered within the annual strategy process.
- **AXIS Re** has also set up a working group to ensure that the potential risks and opportunities from climate change are identified and then managed in line with its standard risk management framework. It has developed a plan to ensure that any exposures are systematically assessed and well monitored as appropriate, and its policy limiting thermal coal and oil sands underwriting and investment went into effect on 1 January 2020.
- **Cornish Mutual** has focused on understanding the financial risks of climate change and implementing the TCFD recommendations, and provides a detailed update on its implementation of each of these recommendations.
- **Covea** stated its desire to align itself with the ABI's Climate Change Roadmap and associated targets. These include a 50% reduction in total emissions by 2030 with the aim of being net carbon neutral by 2050.
- RSA Group (where **Marine**, **RSA** and **RSA Reinsurance** are subsidiaries) notes that it participated in the Climate Biennial Exploratory Scenario ("CBES") in 2021, considering the long-term implications of Climate Change on catastrophe losses, insurance liabilities and the value of assets. It also introduced a new Special High Risk category to exit specific high carbon emission risks in the energy sector.
- **XL Insurance** noted that its aerospace underwriters are heavily involved in conversations with the airline industry as to how a transition to Sustainable Aviation Fuels could unfold.

Sustainability

Some companies also emphasise their commitment to sustainability, for example:

- **Hannover Re** has a separate section on sustainability risk noting that sustainability is an essential part of its strategy, expressed in its purpose and values. It has put in place a Sustainability Strategy and Management Framework which describes its sustainable actions and contribution to a transformation into a sustainable future.
- **Irish Public Bodies** says that sustainability is a clear priority and will remain so for the foreseeable future. It has committed to implement and embed a 'Climate First' sustainability strategy that meets its business and member needs whilst delivering on its wider responsibilities. Irish Public Bodies achieved an ESG Evaluation Score of 73/100 with S&P Global, the first such report by S&P for an insurance company in Ireland and EMEA Region.

Scenario and sensitivity testing

Several companies include climate risk within their scenario and sensitivity testing which is mainly reported through their ORSA.

- **Bupa** has a scenario test that considered 'worst ever' flooding events occurring in consecutive years. The flooding scenario envisages an extreme flash flood occurring in two consecutive years, causing disruption to the provision of medical services and/or operational and customer servicing disruptions.
- **Fidelis** runs climate change related scenario testing over short, medium and long-term horizons on both the underwriting and investment portfolios as a part of the ORSA process.
- **Hiscox** carries out climate stress testing on its bond portfolio in line with CBES methodologies, and will extend this to other asset classes in 2022.
- **NFU Mutual** states that it has undertaken scenario testing on terms of climate-related risk.

Other key risks

Firms' SFCRs provide useful insights into the key risks facing non-life insurers in the UK and Ireland.

Brexit

The proportion of firms that considered Brexit as a key risk has continued to decrease. Out of the 100 insurers considered, only 57% now even mentioned Brexit, and only 16% considered Brexit as a key risk compared to 30% last year.

Cyber risk

77% of firms referred to cyber risk in their SFCR. While most of these relate to cyber as a key ongoing operational risk, many also made a particular mention of cyber risk in relation to the Russian invasion of Ukraine.

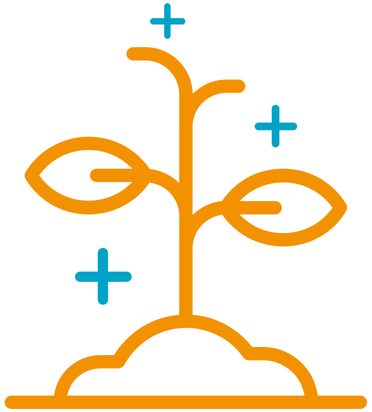
- **BHSF** reports "an ever present and continually increasing cyber threat".
- **HCC International** includes follow-on cyber attacks as part of its suite of reverse stress testing.
- **Mitsui Sumitomo Europe** is one of the few companies that acknowledges that its cyber risk exposure includes silent exposures which are harder to identify and quantify.
- **RSA** took action to identify policy language that is 'silent' on cyber risks and has updated policy language where appropriate.
- **Western Provident** has sought independent assurance over the robustness of the operational practices including the risk of cyber attack.

Other risks

Several of the personal lines writers including **Ageas**, **Aviva**, **Covea**, **esure** and **Lloyds Bank GI**, mentioned the UK FCA Pricing Review that outlaws price walking for existing customers. There seemed to be consensus that it is too early to tell what the effect will be in this competitive area.

The new insurance accounting standard IFRS 17 is due to be implemented from 2023. Despite the enormous IT and logistical risks of developing appropriate systems and having them tested and ready in time, still very few firms mention delivering IFRS 17 as a key risk. However some firms have carried out a formal assessment, for example **British Gas** notes that it has carried out an impact assessment and does not expect IFRS 17 to have a significant financial or operational impact.

77% of firms referred to cyber risk, with many making particular mention of cyber risk in relation to the Russian invasion of Ukraine



Detailed analysis of solvency and financial strength

Financial strength by insurer type

The average eligible own funds ratio across our sample at the 2021 year end was 206%.

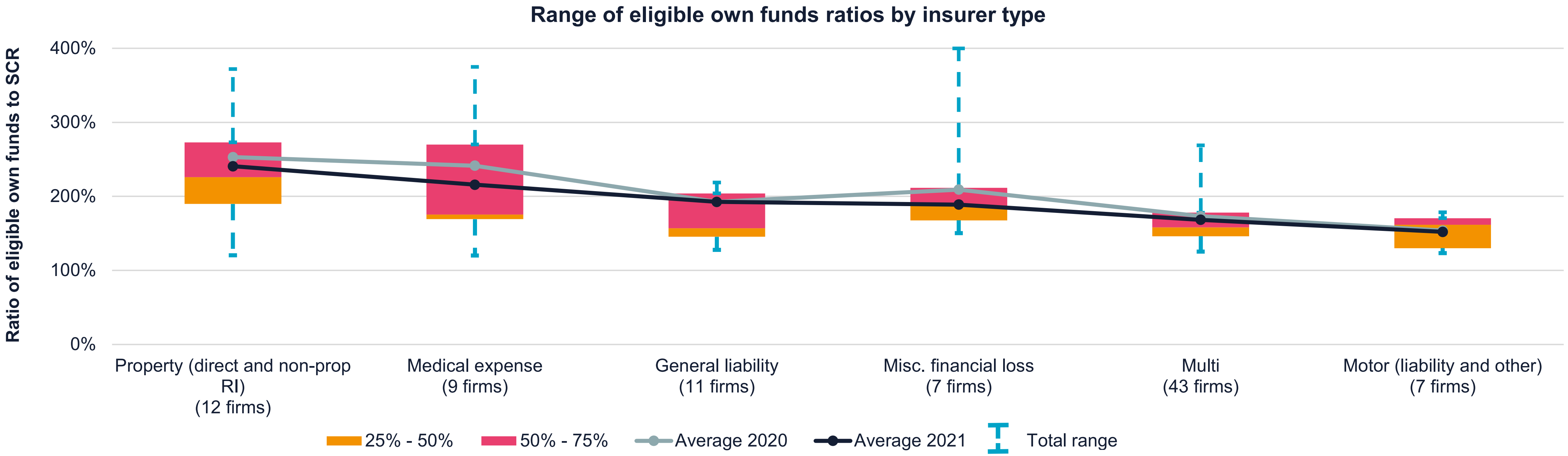
We have considered how eligible own funds ratios vary between different insurer types.

We have classified our sample of insurers by insurer type according to gross written premiums. Insurers are allocated to a Solvency II line of business if more than 50% of their 2021 gross written premium was in that line of business, otherwise they are classified as "multi-line".

For the following graph, we have excluded insurer types with only a small number of firms in the group as these results can be heavily skewed by individual insurers.

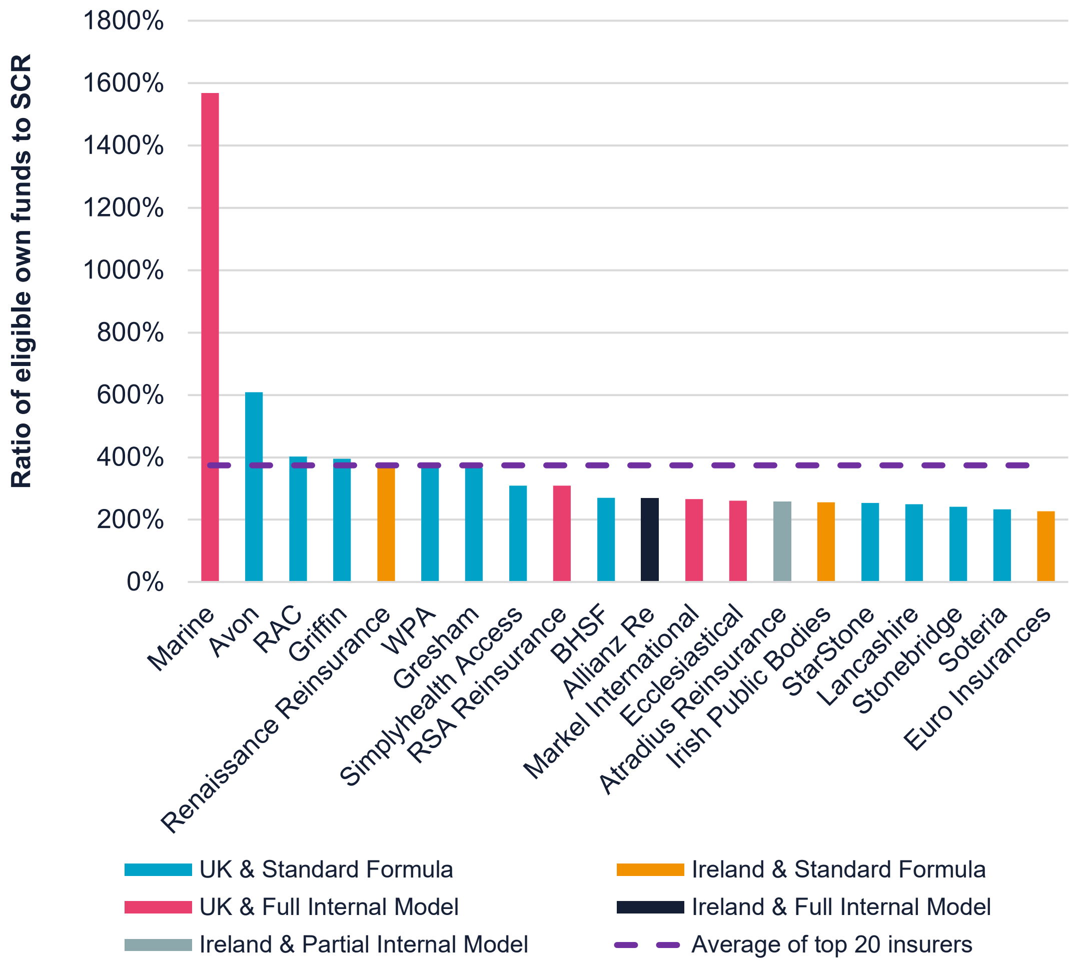
Motor (liability and other) insurers typically have the lowest eligible own funds ratios. They also have a smaller range of eligible own funds ratios between firms relative to most other insurer types. Miscellaneous financial loss insurers have the smallest range of eligible own funds ratios, and medical expense, property and general liability insurers have the largest range of eligible own funds ratios between firms.

Since the 2020 year end, medical insurers have on average seen a reduction in eligible own funds ratios of 26%. This is largely driven by **Simplyhealth Access** and **WPA** who saw reductions of 160% and 78% respectively (see further detail below), although they both still have very strong eligible own funds ratio of over 300% at 2021 year end.



Top twenty insurers by eligible own funds ratio

The following chart shows the top twenty firms by eligible own funds ratio as at their 2021 year ends.



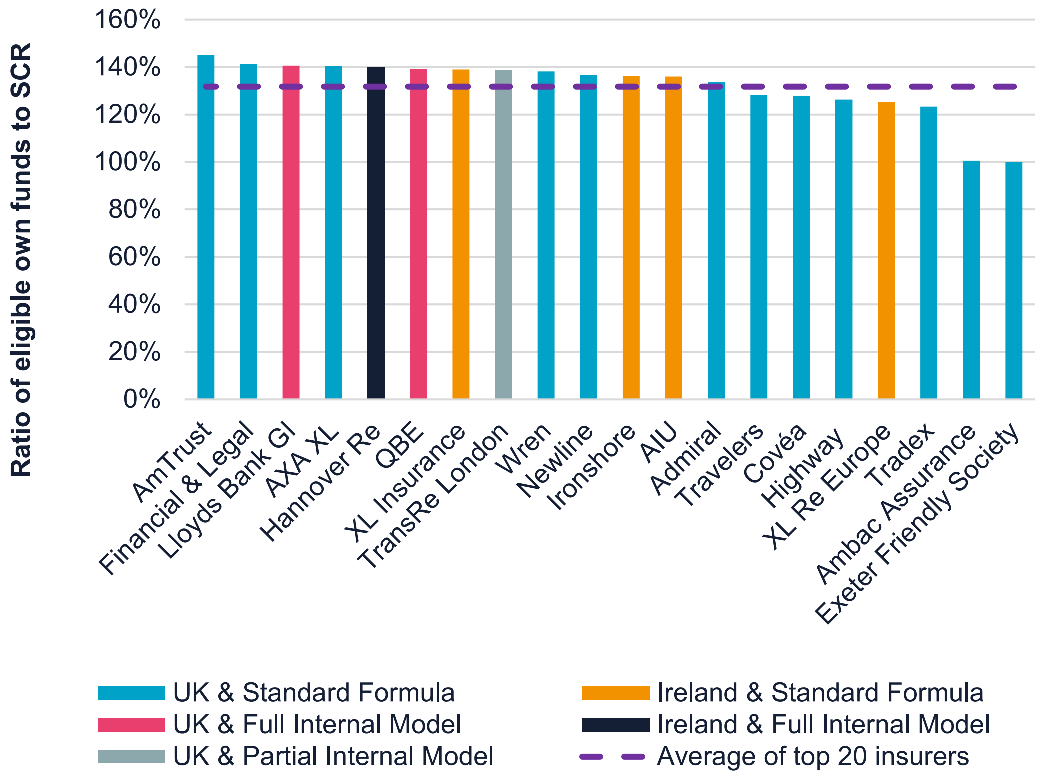
13 of these firms were also in the top twenty as at 2020 year end.

The average eligible own funds ratio for the top twenty firms is 375%, materially higher than the average of 206% across the whole sample, but a little lower than the average for the top twenty last year end of 386%. Some of the more notable changes were:

- **Arch** has fallen out of the top twenty, with a reduction in its eligible own funds ratio from 280% to 201%, still well capitalised. During 2021 Arch received a further £10 million capital contribution from its parent company to support the business following the reserve deterioration arising from the pandemic and to support planned growth.
- **Marine** (a subsidiary of RSA Insurance Group) has the highest eligible own funds ratio of all insurers in our sample at 1569%, well over twice that of the second highest firm **Avon**. It also had the highest eligible own funds ratio at 2020 year end of 1581%.
- **Simplyhealth Access**'s eligible own funds ratio reduced from 469% to 310%, which it explains was a conscious decision to support customers and community with extra help during the pandemic. This help included spending an additional £4.2m on antigen testing and returning £9m of premium rebates to eligible customers. They still remain one of the best capitalised insurers.
- An interesting new entry into the top 20 is **Soteria**, which was ranked in the bottom 20 last year. During the year, Soteria was placed into run-off and its last insurance policies will expire in March 2022. As a result, the premium risk part of its SCR benefits reduced substantially, boosting the overall eligible own funds ratio.
- **Stonebridge**'s ratio reduced from 405% to 241% over the year, which is another significant reduction from 708% at the 2019 year end. These movements are driven by dividends paid to its parent company of £35m in 2020 and £19m in 2021.
- **WPA** also reduced its ratio significantly from 447% to 369%. Although they are also in the health insurance industry, the reasons for the reduction are very different. For WPA, the change was driven by a large increase in the SCR caused by higher market risk due to greater exposure to equities, and higher health risk arising from its planned growth in premium income in 2022.

Bottom twenty insurers by eligible own funds ratio

The following chart shows the bottom twenty firms by eligible own funds ratio as at their 2021 year ends.



- 9 of these insurers are new entrants to the bottom twenty firms this year although some of these are due to relatively small movements in the eligible own funds ratio.
- One of the biggest movements is **Ambac Assurance** which last year had the lowest eligible own funds ratio at 72% which therefore gave a capital shortfall. This year its ratio has crept just above 100%. It states that the surplus has been created due to the run-off of the portfolio and the increase in risk-free interest rates, rather than any capital reorganisation. It remains in ongoing dialogue with the regulators with respect to options for strengthening the capital position further.
- **Exeter**'s eligible own funds ratio is effectively fixed at 100% because its business falls into ring-fenced funds within which own funds are restricted to the total SCR.
- **Zurich**'s eligible own funds ratio increased from 137% to 163% taking them out of the bottom twenty. They removed "post-aggregation steps" from their SCR calculation which had increased the SCR last year by over a quarter, which therefore results in a higher eligible own funds ratio. It does not provide any further details on this change.
- As noted above, **Soteria** has moved from the bottom twenty to the top twenty.

Ancillary own funds and Tier 2 Funds

Tier 2 funds are assets of lower quality and there are restrictions on how much of this type of capital can be counted as eligible own funds. They are typically cumulative preference shares, and subordinated liabilities.

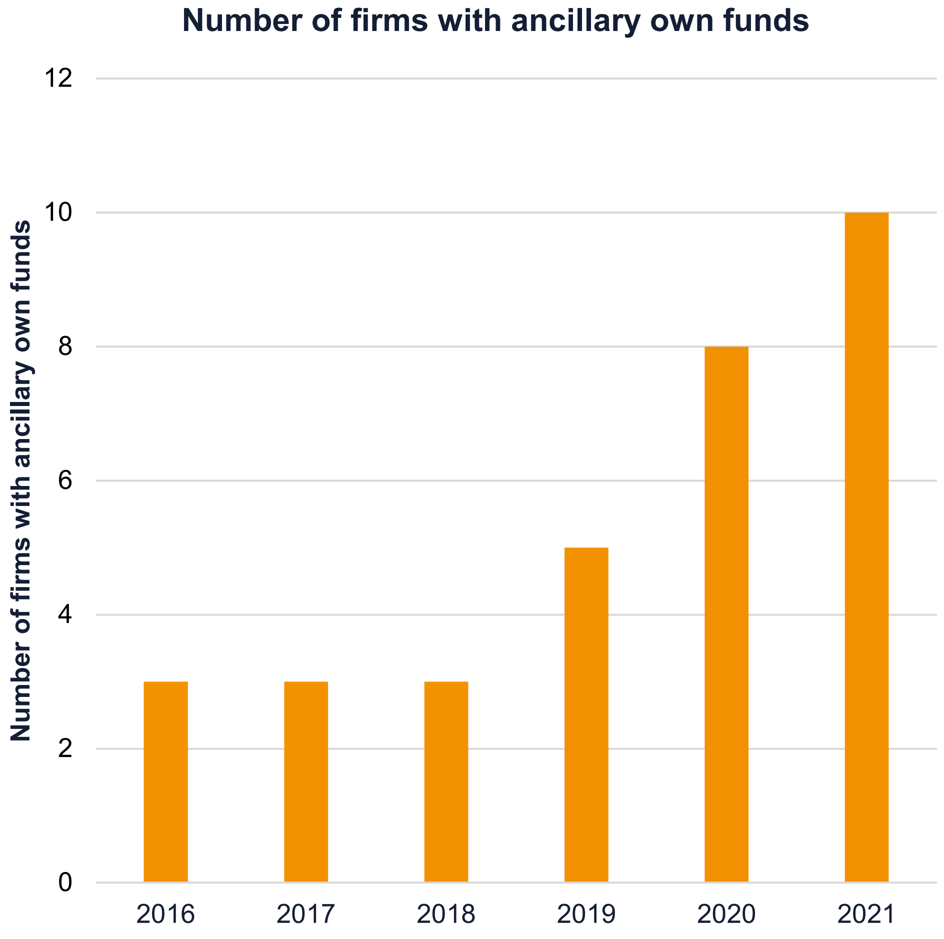
Ancillary own funds (AOF) are a form of Tier 2 capital under Solvency II regulations. They are effectively unconditional capital commitments, but that are not paid up or called up when issued. These funds must be callable on demand, and create Tier 1 basic own funds (BOF) capital when paid-up or called-up at a future point in time. They also must be approved by the relevant supervisory authority to be classified as Tier 2 capital on the Solvency II balance sheet.

The number of firms with ancillary own funds has increased in recent years. For the 2016, 2017 and 2018 year ends, only 3 firms of our sample of 100 disclosed having ancillary own funds. This has now increased to 10 firms, with **Fidelis** and **RSA** newly disclosing ancillary own funds over the year.

RSA introduced £250m of AOF in 2021, although it also redeemed £275m of otherTier 2 funds and confirmed that a further £160m of Tier 2 funds is not available to meet the SCR. This means it has overall reduced its reliance on non-Tier 1 funds. **Fidelis** was granted approval for $50m of AOF to support business growth.

The total amount of Tier 2 capital for the firms in our report has remained stable over the year, increasing marginally to £10.5m in total. This includes some ups and downs, for example:

- **Atradius Re** no longer has the €78m of Tier 2 funds that it had last year.
- **Ecclesiastical** issued €30m of subordinated debt to support future profitable growth opportunities. This is one of the reasons that its eligible own funds ratio increased significantly over the year from 197% to 261%.
- **Vitality**'s Tier 2 funds reduced from £19.3m to £6.8m because some of its subordinated loans matured.



Approaches to calculating capital

Analysis of firms by their approach to calculating Solvency II capital

Under Solvency II, firms calculate their SCRs using either the standard formula or, subject to regulatory approval, a partial or full internal model to better reflect their risk profile.

2020 Average eligible own funds ratios	Change	2021 Average eligible own funds ratios
Standard formula firms 205%	-11%	Standard formula firms 194%
Partial Internal Model firms 177%	+14%	Partial Internal Model firms 191%
Full internal model firms 263%	-1%	Full internal model firms 262%

The average eligible own funds ratio for standard formula for the 2021 year end is lower than the previous year, while for partial internal model firms it is a little higher. The average eligible own funds ratio for full internal model firms is very similar to last year.

Diversification as a proportion of diversified SCR

We also analysed the level of diversification benefit that insurers allow for within their capital calculations.

The average diversification benefit as a proportion of diversified SCR for firms using the standard formula, partial internal model or full internal model approach to calculate regulatory capital is shown below.

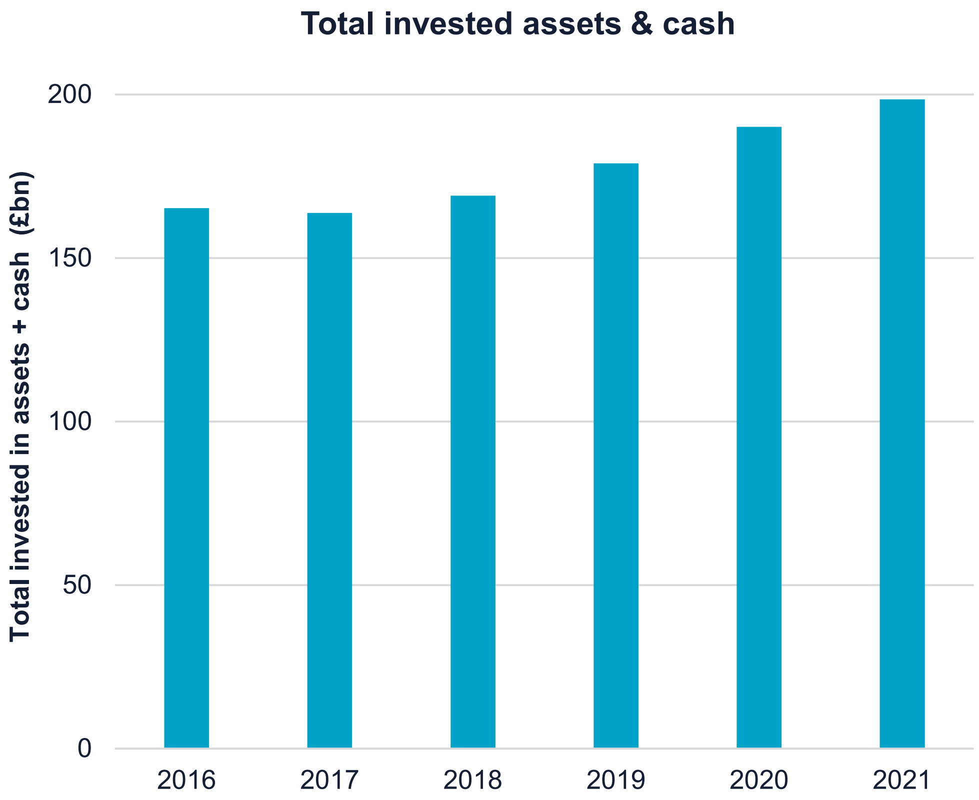
Firms using a full or partial internal model typically get the benefit of a greater level of diversification, since the Standard Formula takes a prudent view on dependencies between high-level risks, in particular by assuming that operational risk is 100% correlated with all other risks..

Standard formula	Partial Internal Model	Full Internal Model
21%	52%	52%

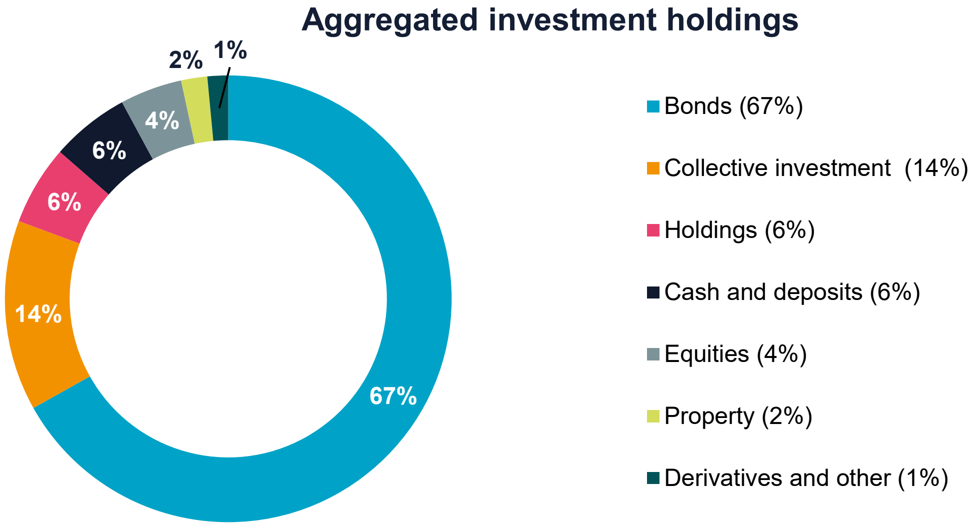
Investment disclosures

Aggregate investment holdings across the market and trends over time

The following charts show the total invested assets and cash, and the aggregated allocation of each asset as a proportion of total investments and cash at 2021 year end.



Across the 100 insurers in our review, the combined total amount in investments and cash has steadily increased over time, increasing to around £199bn at 2021 year end.



In aggregate, 67% of invested assets were held in either corporate, government or other bonds as at 2021 year end, and 14% in collective investment undertakings. Collective investment undertakings are pooled funds that allow investors to access a wide range of investments in an efficient way. These funds can cover a variety of asset types and the QRTs are not sufficiently granular to allow more detailed analysis into the investment types being invested in. Note that 86% of firms invest in bonds, and the vast majority of the remainder have investments in collective investment undertakings, which could include bond-like holdings.

Only 4% of invested assets were held in equities at 2021 year end, and this percentage has been decreasing over time from 7% at 2016 year end. Again many of these could be investing indirectly in equities via their collective investment undertakings.

Investment disclosures (continued)

> *We have seen a steady increase in the number of firms discussing ESG (environmental, social and governance) issues in their SFCRs, with 42% of firms now including this, compared to 33% last year.*

ESG investment considerations

There is a particular emphasis on sustainable investment, and the transition risks involved as part of climate change and reducing reliance on fossil fuels. For some firms, these issues then feed into investment strategy and risk appetites.

Examples of firms that have mentioned integrating ESG criteria and standards in their investment strategies and practices include:

- **Ageas** says that its investment strategy is a key mitigant for transition risk, and that it will have a continuing strategic response to climate change as customers' demands and expectations develop and as its core market transitions from fossil fuel vehicles to more sustainable energy sources.
- **AXA UK** monitors the ESG score and the carbon footprint of its invested assets and the implementation of its Green Investment Plan.
- **BHSF** moved its investments onto a platform that is more conscious of ESG matters in 2021. This included requiring its investment manager to utilise an ESG focused investment strategy.
- **DAS Legal Expenses** uses the MSCI ESG rating system to balance its investment portfolio and has agreed targets for ESG investments. It also disclosed that its investment portfolio was tested against the PRA climate change stress tests, and showed excellent resilience to all such tests. It also included within its 2021 investment mandate a target that at least 95% of the entire portfolio by value should be invested in assets with an MSCI 'A' rating or better by 31 December 2021, and managed to achieve this target.
- **Hannover Re** notes that it has no direct equity investments or physical assets within the energy and fossil commodity industry. It is also a signatory to the UN Principles for Responsible Investment and the UNEP FI Principles for Sustainable Insurance. It has become a member of the United Nations Environment Programme Finance Initiative and joined the Net-Zero Insurance Alliance – committing to a net zero target by 2050 in reinsurance business. In addition it actively excludes issuers from its investment portfolio that derive more than 25% of annual revenues from thermal coal extraction and power generation.
- **Hiscox** increased its focus on mitigating the climate change risk of its investment portfolio during 2021. This includes signing up to the UN Principles of Responsible Investment and having investment managers commit to ESG exclusions. It goes on to detail several initiatives including working with investment managers to embed the approved Hiscox Group Greenhouse Gas targets and align HIC's investment portfolio with a net zero objective by 2050; development of an ESG dashboard to assess compliance with climate targets; and climate stress testing.

Survey constituents and other notes

To improve the readability throughout this report, we have shortened the names of some insurers when referring to them. The following table sets out the full entity names of the insurers we reviewed, together with the name used in this report, if applicable.

UK-based insurers

Insurance company name	Report name
Admiral Insurance Company Ltd	Admiral
Ageas Insurance Ltd	Ageas
AIG UK Ltd	AIG UK
Allianz Insurance PLC	Allianz
Ambac Assurance UK Ltd	Ambac Assurance
AmTrust Europe Ltd	AmTrust
Arch Insurance (UK) Limited	Arch
Assurant General Insurance Ltd	Assurant GI
Assured Guaranty UK Ltd	Assured Guaranty
Aviva Insurance Ltd	Aviva
Aviva International Insurance Ltd	Aviva International
Avon Insurance PLC	Avon
AXA Insurance UK PLC	AXA UK
AXA XL Insurance Company UK Ltd	AXA XL
BHSF Ltd	BHSF

Insurance company name	Report name
British Gas Insurance Ltd	British Gas
Bupa Insurance Ltd	Bupa
CNA Insurance Company Ltd	CNA
Convex Insurance UK Ltd	Convex
Cornish Mutual Assurance Company Ltd	Cornish Mutual
Covea Insurance PLC	Covea
DAS Legal Expenses Insurance Company Ltd	DAS Legal Expenses
Ecclesiastical Insurance Office PLC	Ecclesiastical
Endurance Worldwide Insurance Ltd	Endurance Worldwide
esure Insurance Ltd	esure
Exeter Friendly Society	Exeter Friendly Society
Fidelis Underwriting Ltd	Fidelis
Financial & Legal Insurance Company Ltd	Financial & Legal
First Title Insurance PLC	First Title
FM Insurance Company Ltd	FM Insurance
Gresham Insurance Company Ltd	Gresham
HCC International Insurance Company PLC	HCC International
Highway Insurance Company Ltd	Highway
Hiscox Insurance Company Ltd	Hiscox

Survey constituents and other notes (continued)

Insurance company name	Report name
International General Insurance Company (UK) Ltd	IGI
Lancashire Insurance Company (UK) Ltd	Lancashire
Liverpool Victoria Insurance Company Ltd	LV=
Lloyds Bank General Insurance Ltd	Lloyds Bank GI
Markel International Insurance Company Ltd	Markel International
Medicash Health Benefits Ltd	Medicash Health Benefits
Mitsui Sumitomo Insurance Company (Europe) Ltd	Mitsui Sumitomo Europe
Motors Insurance Company Ltd	Motors
Newline Insurance Company Ltd	Newline
Pinnacle Insurance PLC	Pinnacle
QBE UK Ltd	QBE UK
RAC Insurance Ltd	RAC
Renaissance Reinsurance of Europe	Renaissance Re
RiverStone Insurance (UK) Ltd	RiverStone
Royal & Sun Alliance Insurance PLC	RSA
Royal & Sun Alliance Reinsurance Ltd	RSA Reinsurance
Sabre Insurance Company Ltd	Sabre
Samsung Fire & Marine Insurance Company of Europe	Samsung Fire & Marine
SCOR UK Company Ltd	SCOR UK

Insurance company name	Report name
Simplyhealth Access	Simplyhealth Access
Soteria Insurance Ltd	Soteria
St. Andrew's Insurance PLC	St. Andrew's
Starr International (Europe) Ltd	Starr
StarStone Insurance SE	StarStone
Stewart Title Ltd	Stewart Title
Stonebridge International Insurance Ltd	Stonebridge
The Association of Underwriters known as Lloyd's	Lloyd's
The Equine and Livestock Insurance Company Ltd	Equine and Livestock
The Griffin Insurance Association Ltd	Griffin
The Marine Insurance Company Ltd	Marine
The National Farmers Union Mutual Insurance Society Ltd	NFU Mutual
The Wren Insurance Association Ltd	Wren
Tradex Insurance Company Ltd	Tradex
TransRe London Ltd	TransRe London
Travelers Insurance Company Ltd	Travelers
TT Club Mutual Insurance Ltd	TT Club
U K Insurance Ltd	UKI
Vitality Health Ltd	Vitality Health
Western Provident Association Ltd	WPA

Survey constituents and other notes (continued)

Irish insurers

Insurance company name	Report name
Allianz PLC	Allianz Ireland
Allianz Re Dublin Designated Activity Company	Allianz Re
Amtrust International Underwriters DAC	AIU
Arch Reinsurance Europe Underwriting DAC	Arch Reinsurance
Atradius Reinsurance DAC	Atradius Re
AXA Insurance DAC	AXA Ireland
AXIS Re SE	AXIS Re
AXIS Specialty Europe SE	AXIS Specialty
CACI Non-Life Ltd	CACI Non-Life
CNP Santander Insurance Europe DAC	CNP
Euro Insurances DAC	Euro Insurances
Everest Reinsurance Company (Ireland) DAC	Everest
FBD Insurance PLC	FBD
Greenlight Reinsurance Ireland DAC	Greenlight Reinsurance
Greenval Insurance Company Ltd	Greenval
Hannover Re (Ireland) DAC	Hannover Re
IPB Insurance CLG	Irish Public Bodies

Insurance company name	Report name
Irish Life Health DAC	Irish Life Health
Ironshore Europe DAC	Ironshore
Partner Reinsurance Europe SE	Partner Reinsurance
PartnerRe Ireland Insurance DAC	PartnerRe
RSA Insurance Ireland DAC	RSA Ireland
Travelers Insurance DAC	Travelers DAC
VHI Insurance DAC	VHI
XL Insurance Company SE	XL Insurance
XL Re Europe SE	XL Re Europe
Zurich Insurance PLC	Zurich

Survey constituents and other notes (continued)

Summary of insurers analysed

The firms we analysed wrote £119bn of non-life gross premiums during 2021 and held £173bn of gross best estimate technical provisions on their Solvency II balance sheets at their 2021 year end. 75% of the firms we analysed use the standard formula, 7% use partial internal models and the remaining 18% use full internal models to calculate their SCRs.

Groups vs solo entities

Some of the entities listed above are part of a larger group. When analysing the QRTs, we have considered only the QRTs of the solo entities listed. Where a firm has produced an SFCR at a group level for multiple solo entities, we have applied their comments to all entities within the group unless they explicitly disclosed otherwise.

Year ends and aggregating figures

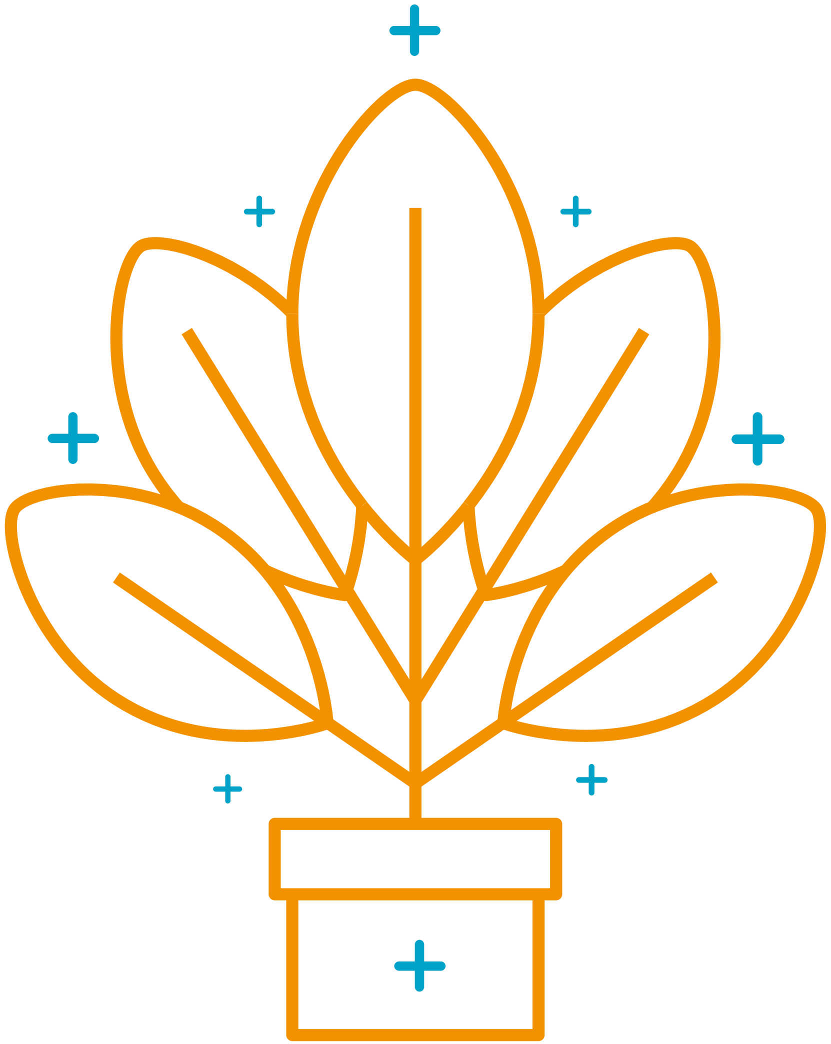
A small proportion of firms analysed had a financial year end that was not 31 December 2021. When we have aggregated figures within this report, we have done so for all companies, including those with other year end dates during 2021.

Exchange rates

For those firms that do not report in Sterling, we have taken all of their reported figures and converted them to Sterling using the prevailing exchange rate as at 31 December 2021.

Data

The data analysed in this report was sourced from Solvency II Wire Data and the company disclosures. Solvency II Wire Data provides detailed information about the Solvency II figures, enabling users to build reports and view changes over time to better understand the impact of Solvency II. The data is available via subscription here.



More from LCP's Insurance Consulting Team

LCP InsurSight

Our award-winning analytics and automated trend identification platform for general insurers.

Click here to find out more and request a demo

Our Roundtables

Did you know we host regular roundtable meetings for NEDs, chief actuaries and CROs as well as for reserving and capital specialists?

If you would like to attend our roundtables, please get in touch with Jinita Shah

Our Viewpoint

For our insurance consulting blogs check out: Our Viewpoint

Risk & Capital Webinar

In this on-demand webinar, LCP will equip you with practical tools to take a fresh approach to risk management and assessment of capital needs. Topics include inflation, people risk and key themes from insurers' public disclosures.

WATCH NOW

Insurance Uncut

Have you heard our podcast about all things insurance? Join show hosts Charl Cronje, Jessica Clark and guests to hear key issues impacting the general insurance market.

LISTEN NOW

Contact us

Contact one of our experts below to discuss the key findings from our report and what this means for your company, or to discuss options for how we can benchmark you against your peers.

Matthew Pearlman
Partner
+44 (0)20 7432 6770
matthew.pearlman@lcp.uk.com

Cat Drummond
Partner
+44 (0)20 7432 0637
catherine.drummond@lcp.uk.com

Declan Lavelle
Partner
+353 (0)1 588 2455
declan.lavelle@lcpireland.com

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in insurance, pensions, investment, energy, financial wellbeing and business analytics.

Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060

Lane Clark & Peacock Ireland Limited
Dublin, Ireland
Tel: +353 (0)1 614 43 93