Member of the Broadstone Group

Published 2022 SFCR analysis

A summary of key metrics using publicly available data contained in the SFCRs of AFM members and other firms of a similar nature and size

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Executive Summary

This report focuses on information contained in the publicly available Solvency and Financial Reports ("SFCRs") published in 2023 which refer to the year end 2022[1]. 27 insurers have been included, with total assets of £9.8bn, the majority being members of the Association of Financial Mutuals ("AFM").

Asset values have fallen by just under 10% over the period reported. This reflects the stockmarket downturn and higher bond yields. The impact of this is to reduce insurers' own funds but also to reduce their exposure to market risk.

Risk margins have reduced significantly this year owing to the large increase in risk free rates. This is ahead of the material reductions to the risk margin proposed under the Solvency UK reforms which are now expected to come into effect before the 2023 year end.

With the fall in own funds more than offset by a fall in technical provisions, solvency ratios have improved over 2022. They will improve significantly further assuming the proposed changes to the risk margin are implemented.

There is an expectation that the increased capital resources brought about by the proposed reforms will allow more investment in "productive assets" such as social infrastructure and green energy.

Introduction

OAC has produced a summary of various metrics using the publicly available data contained in the SFCRs of AFM members and other firms of a similar nature and size (collectively referred to as "insurers" in this summary).

The data analysed covers 27 insurers. Each insurer's name is shown alongside the relevant data for that organisation. This is intended to aid comparison between insurers with their peers, as the various metrics can differ significantly depending on the nature of the insurance and business profile of the insurer.

For a very small number of insurers, where there is published data for either 2021 or 2022 but not both, the same data has been used for the missing year.

Last year's figures (those reported as 2021) are typically shown in brackets after this year's values and a comparison is reasonable as the population is unchanged.

Note: Some AFM insurers have not been included due to size being significantly larger than the majority of the membership.

[1] The reporting date for the majority of insurers included in this report is 31 December 2022. Two insurers (Cornish Mutual and Westfield Health) have reporting dates earlier in 2022.

Assets

Chart 1 shows the total asset values in £m for the insurers analysed that have assets less than £500m.

The average 2022 asset value is £96m (£105m) and the median value is £68m (£80m). On average, the asset values have decreased by almost 10% compared to 2021. There are 2 insurers where asset values have marginally increased.

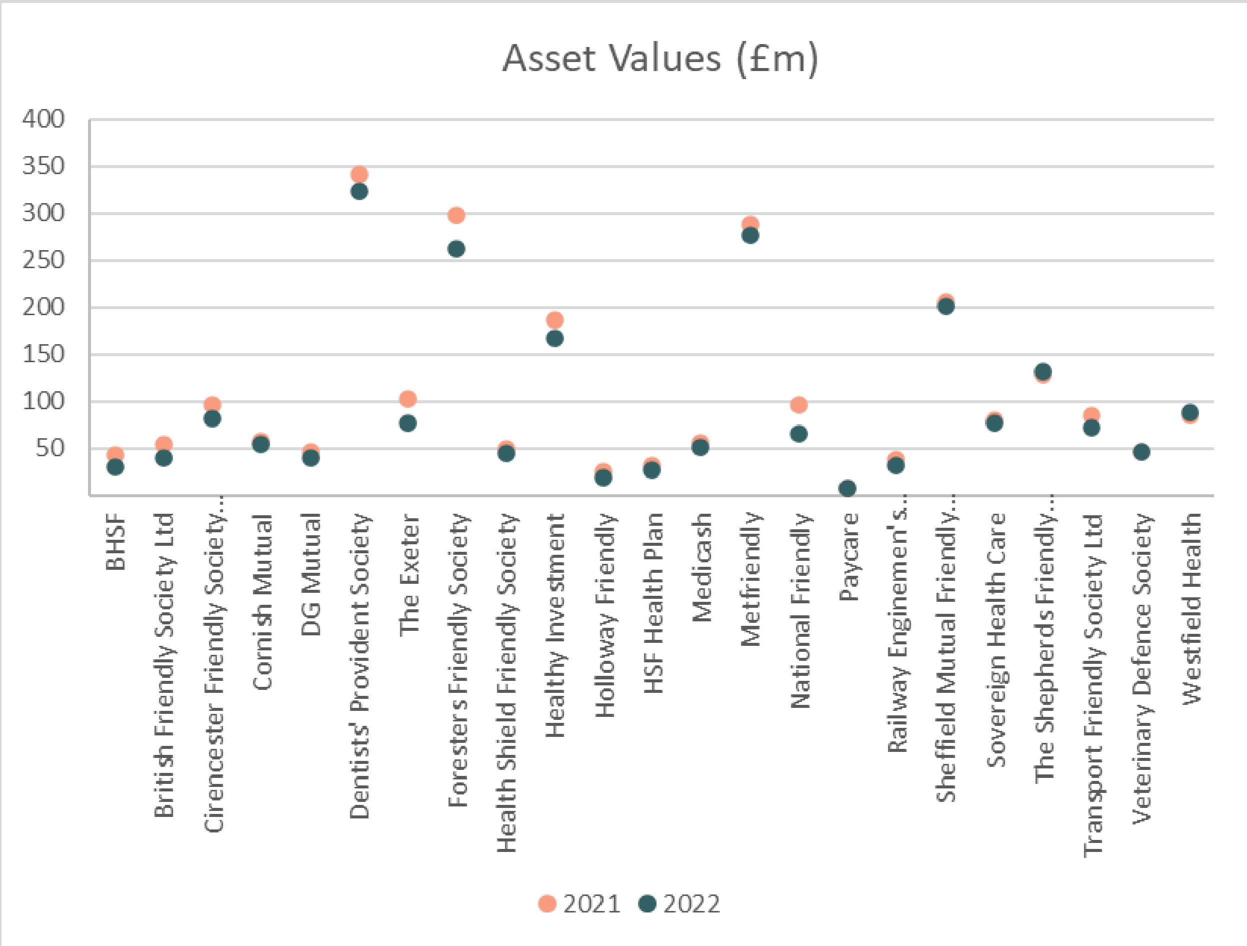

Chart 1: Asset Values

Note: Scottish Friendly Assurance Society Ltd, with assets in excess of £5bn, and OneFamily, IPB Insurance and The Oddfellows, all with assets above £500m, have been excluded from Chart 1 to allow a more proportionate comparison for the majority of the group analysed.

Chart 2 below shows the minimum and maximum percentage of assets by the main asset categories for 2022 along with the average percentage for 2022 and 2021.

There is relatively little movement year on year in the average asset mix. There are small decreases in cash and other assets, and, contrary to last year, a small increase in corporate bond holdings.

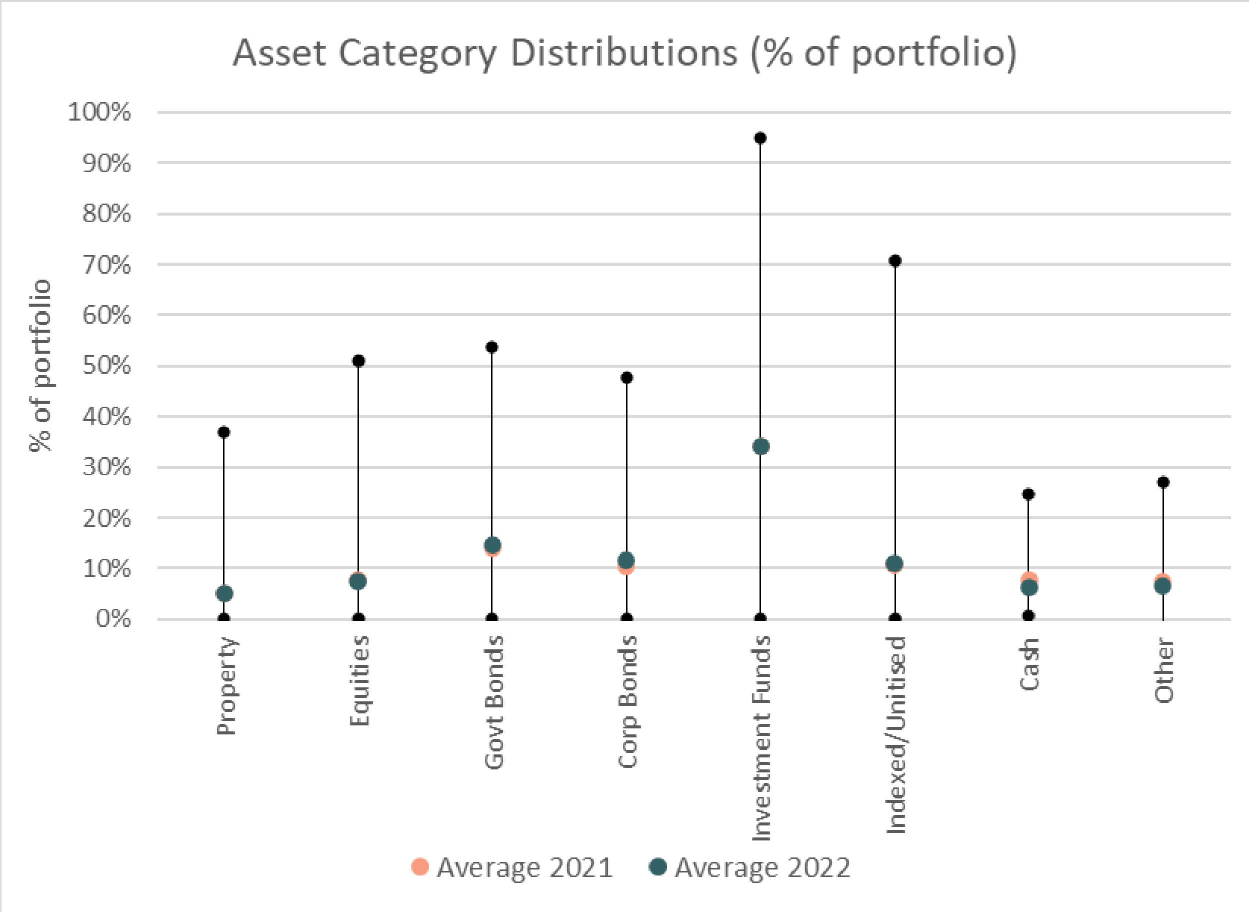

Chart 2: Asset Category Distributions

Note: Some insurers have negative "other" values and this typically relates to insurers with negative reinsurance recoverables.

Chart 3 shows the asset mix by insurer for 2022. This chart, along with the chart above, show the considerable investment in collective investments undertakings overall. This is consistent with their use to achieve diversification with smaller total assets as is typical for this sector.

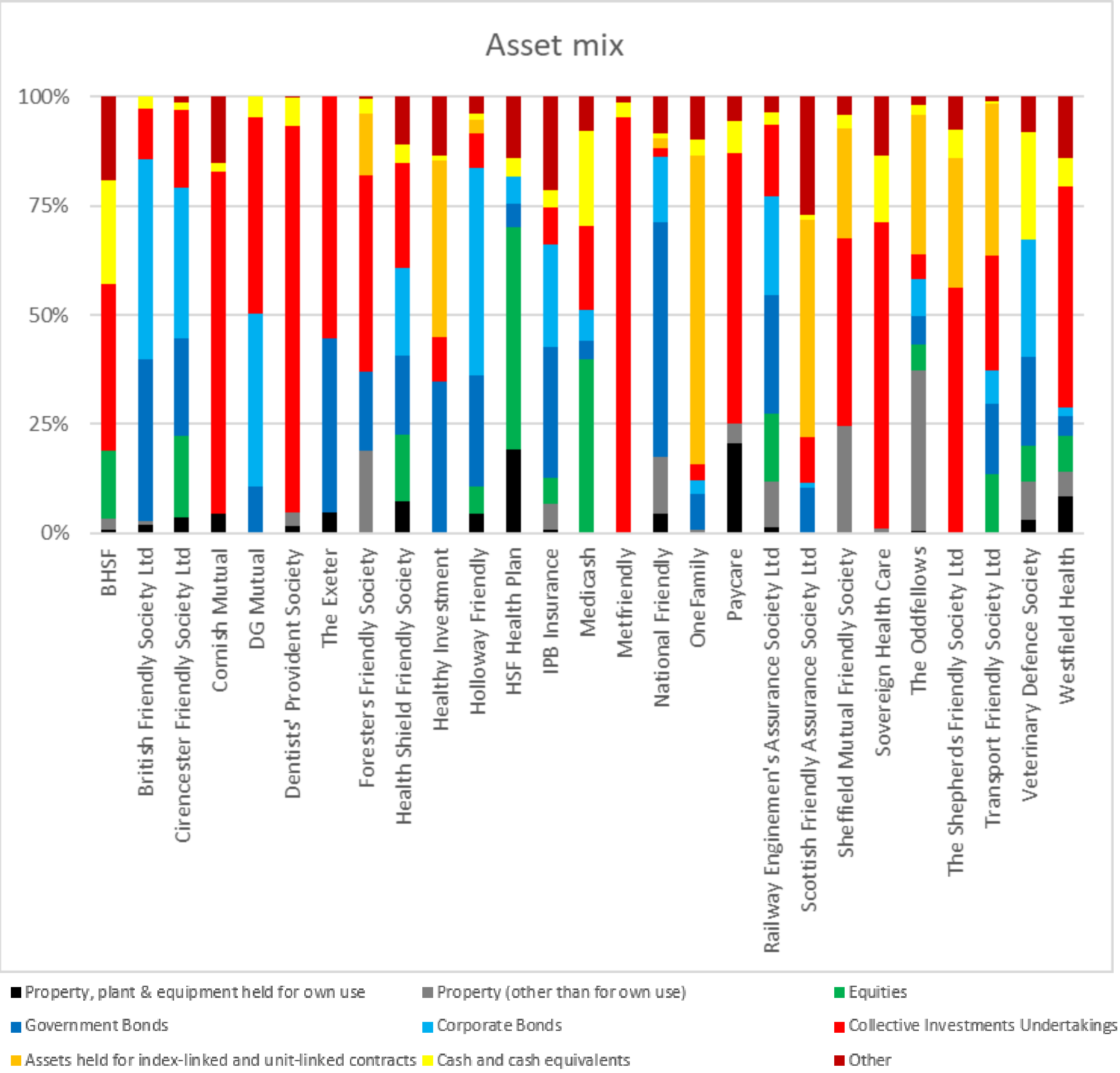

Chart 3: Asset mix

Note: A significantly larger range than shown is required for The Exeter due to negative reinsurance recoverables and a larger percentage of collectives (86%) and cash (9%).

Premiums written

Chart 4 shows the gross premiums written for 2021 and 2022 by insurer. The average gross premium written is £37m (£35m) and the median value is £26m (£22m).

As reported last year, the higher mean reflects the large spread owing to large values for both Scottish Friendly and IPB Insurance. (This comment holds true for later statistics too.)

On average, insurers increased gross premiums written by 3% compared to 2021, with the largest increases from non-life insurers (5%) although composite insurers suffered a 3% decrease. However, overall, this increase has been ceded to reinsurers of life and composite business with the average premiums net of reinsurer's share unchanged.

With the cost of living crisis, this may be regarded as a good result for this group of insurers as a whole and perhaps indicates that policyholders regard their insurance cover as a suitably high priority.

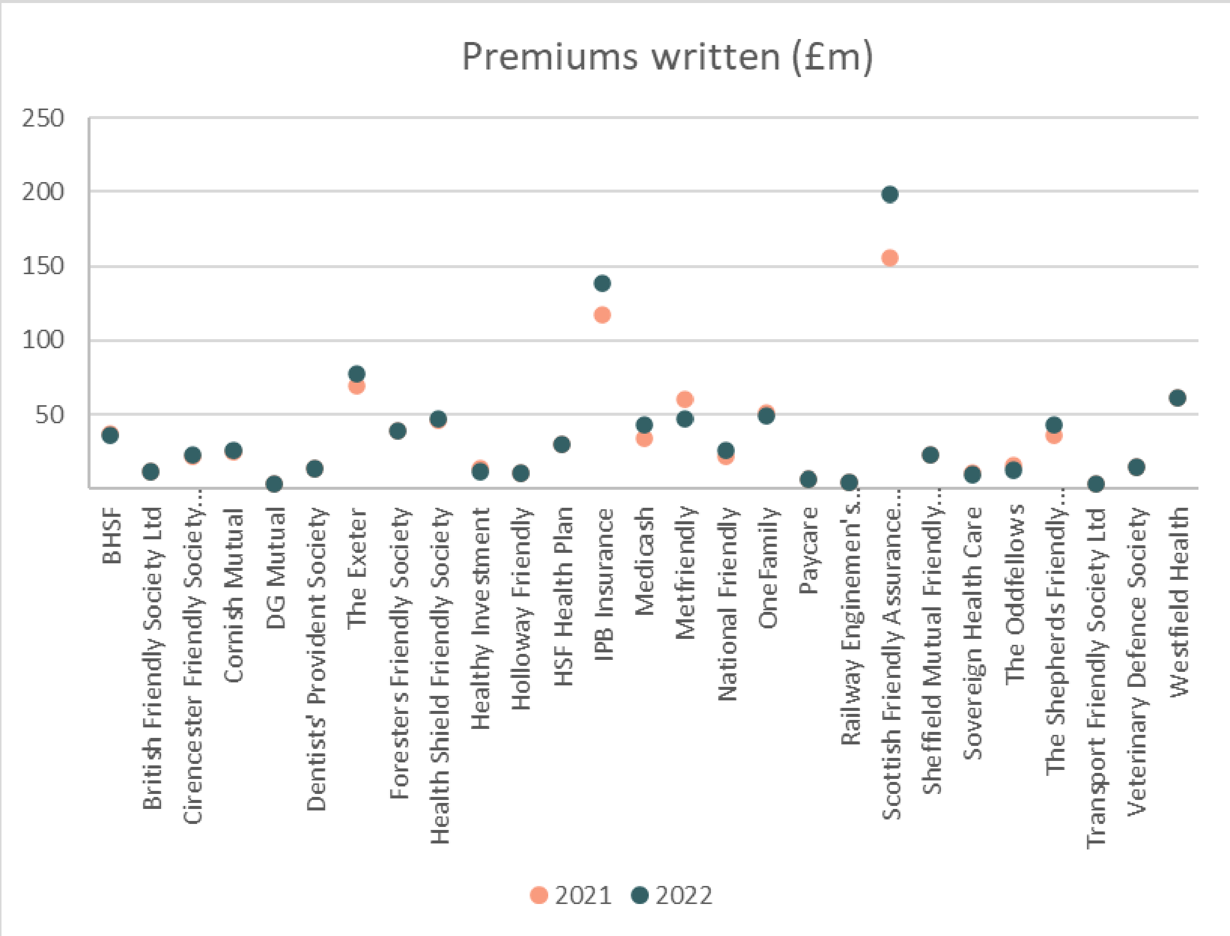

Chart 4: Premiums written

Claims incurred

Chart 5 shows the gross claims incurred for 2021 and 2022 by insurer. The average gross claims incurred is £32m (£28m) and the median value is £18m (£16m).

On average, the gross claims incurred have increased by 13% compared to 2021 with large increases for non-life insurers (reversing falls seen last year) and composites. The increases are similar after allowing for reinsurer's share of claims.

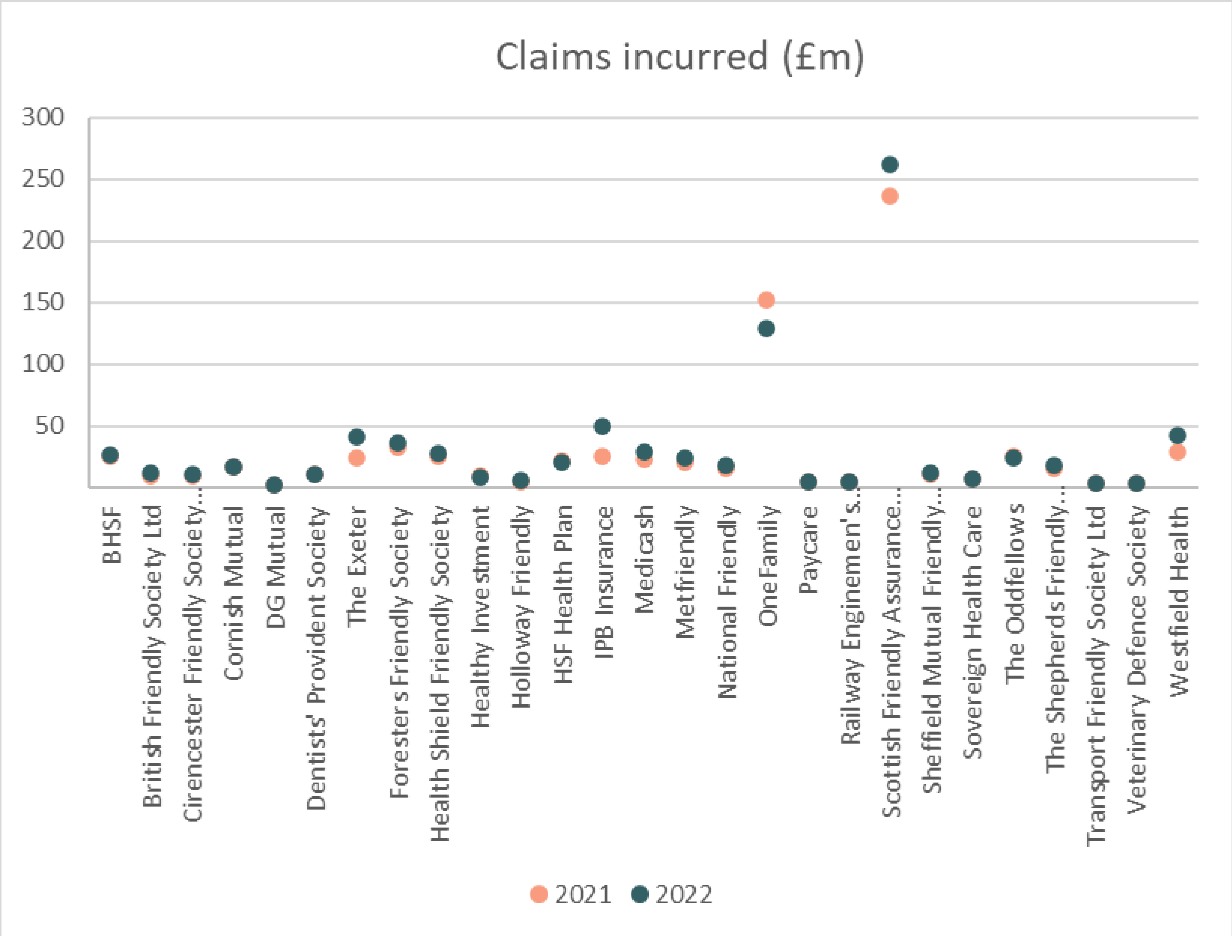

Chart 5: Claims incurred

Solvency

Chart 6 shows the spread of solvency ratios within the sample for 2022 and 2021 by insurer.

There is a wide range in this metric with solvency ratios lying between 142% (118%) and 382% (334%). On average, solvency ratios were 11%-12% higher for all types of business.

The solvency ratio is calculated as the ratio of the own funds (see later) and the solvency capital requirement (SCR).

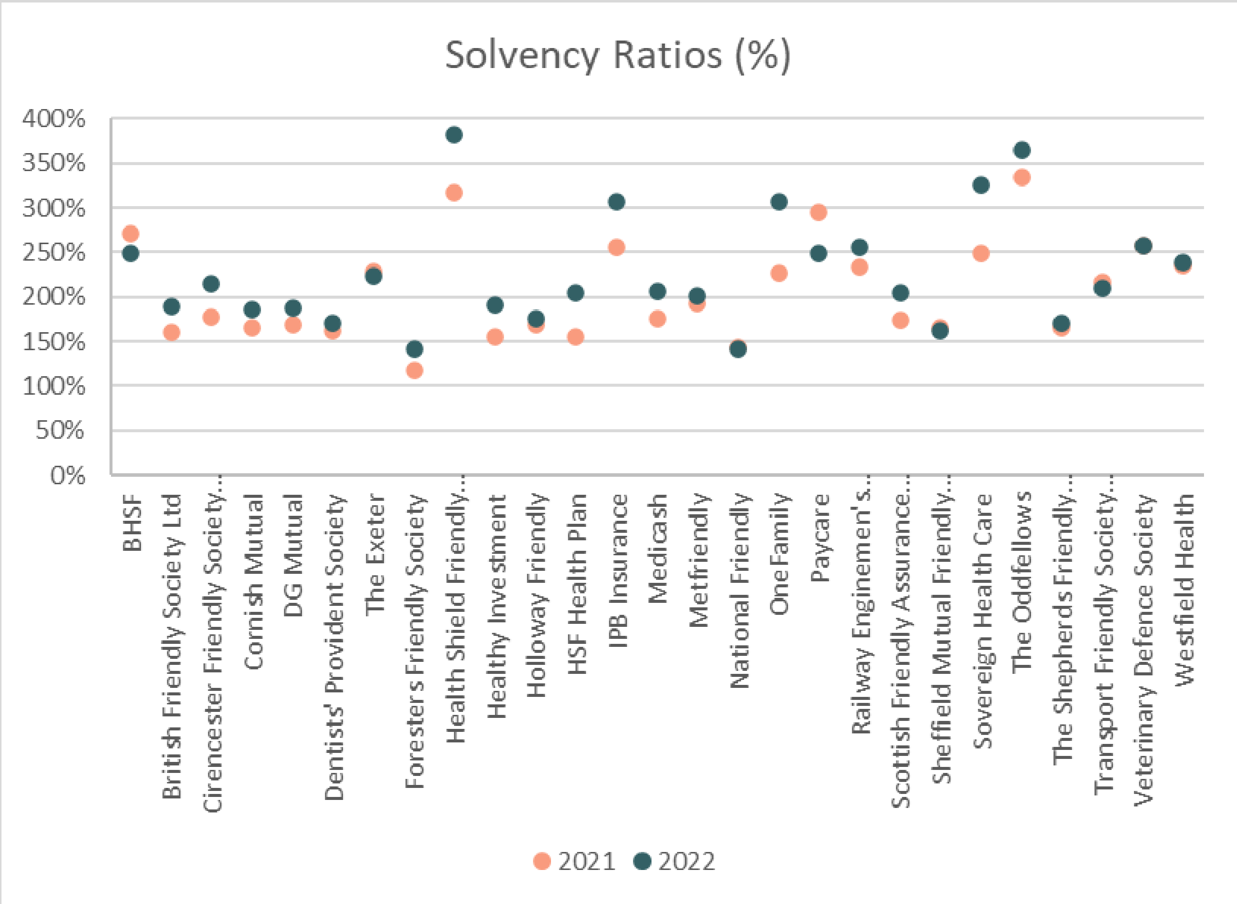

Chart 6: Solvency Ratios

Note: The Exeter's solvency ratio is shown for the Group prior to any Ring Fenced Fund restrictions. Healthy Investment, Paycare and Railway Enginemen's have reported MCRs that are higher than their SCRs and so the ratios shown are based on the reported MCRs.

Solvency Capital Requirement

The Solvency Capital Requirement (SCR) is an amount of financial resources set to allow insurers to cover material losses[2] such that policy holders can be reasonably confident that their insured benefits will be received when due. Insurers' financial resources should not fall below the lower Minimum Capital Requirement (MCR).

Charts 7, 8 and 9 show the percentage contributions of the various market and insurance risks to the SCR before diversification. The vertical lines represent the spread from the lowest percentage in the sample to the highest.

To enable meaningful comparisons to be made, the data has been subdivided into life, non-life and composite insurers. This splits the total sample of 27 into 14 life, 9 non-life and 4 composite insurers.

Across all insurance types, market risk is, on average, the major component of the SCR. The next highest component is health risk at around 40%-50% of the market risk.

There is considerable variation for all risks other than default risk.

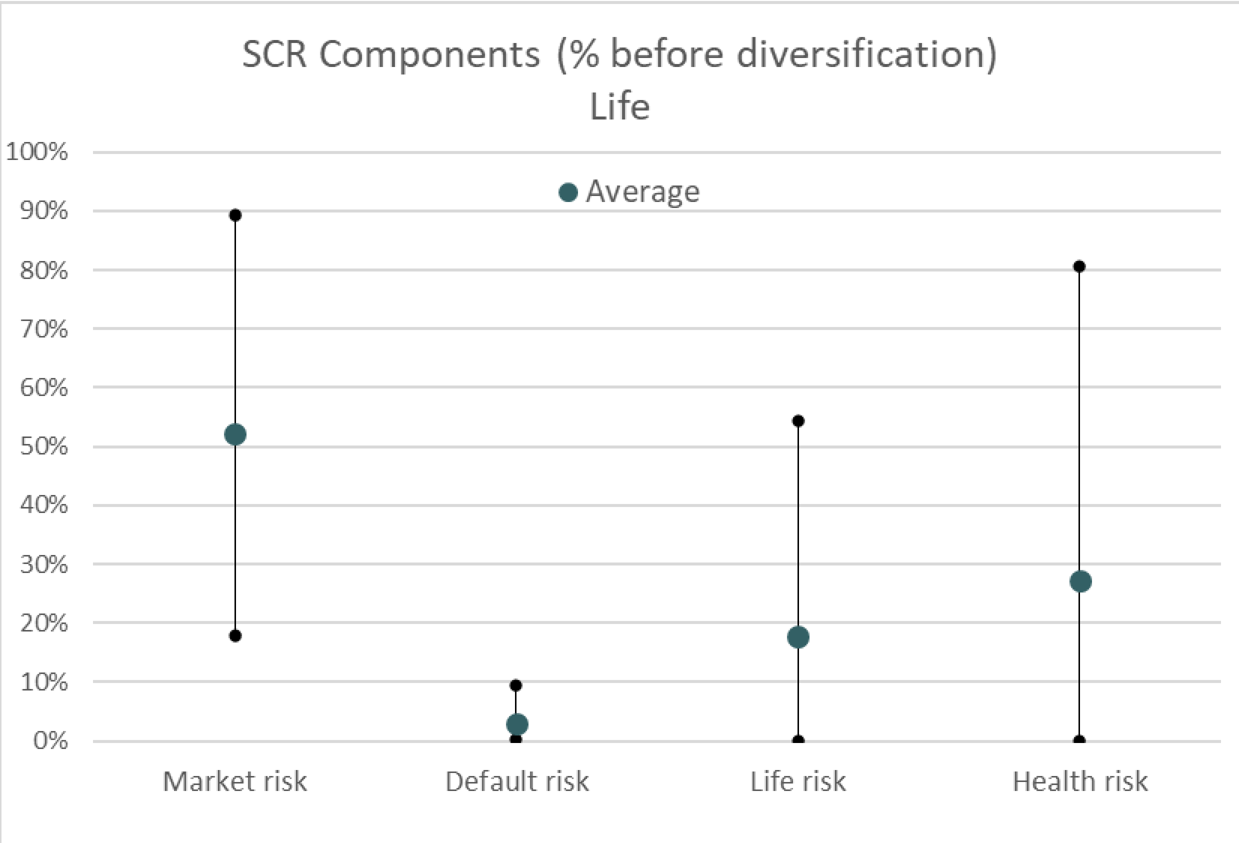

Chart 7: SCR Components – Life insurers

[2] Technically, it is the variation in own funds due to a 1 in 200 year event (under certain assumptions)

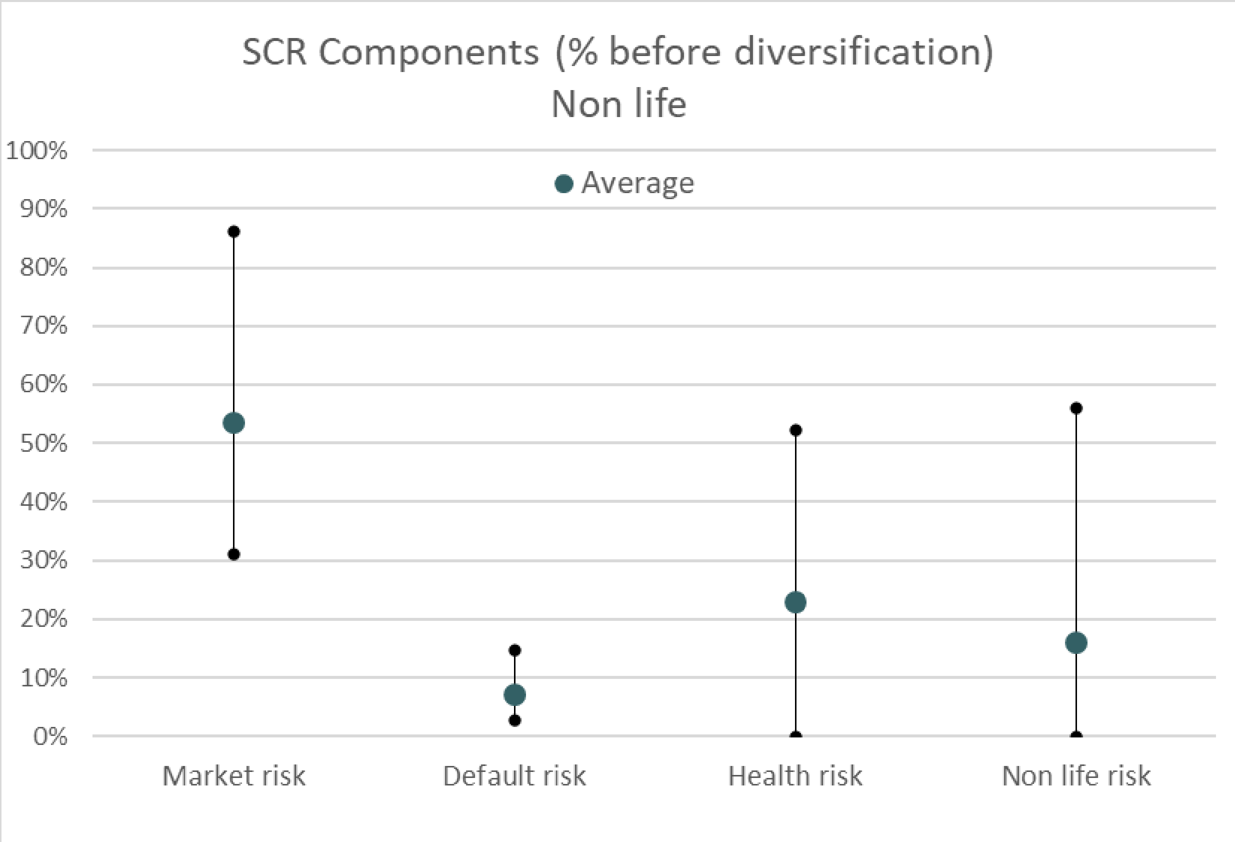

Chart 8: SCR Components – Non Life insurers

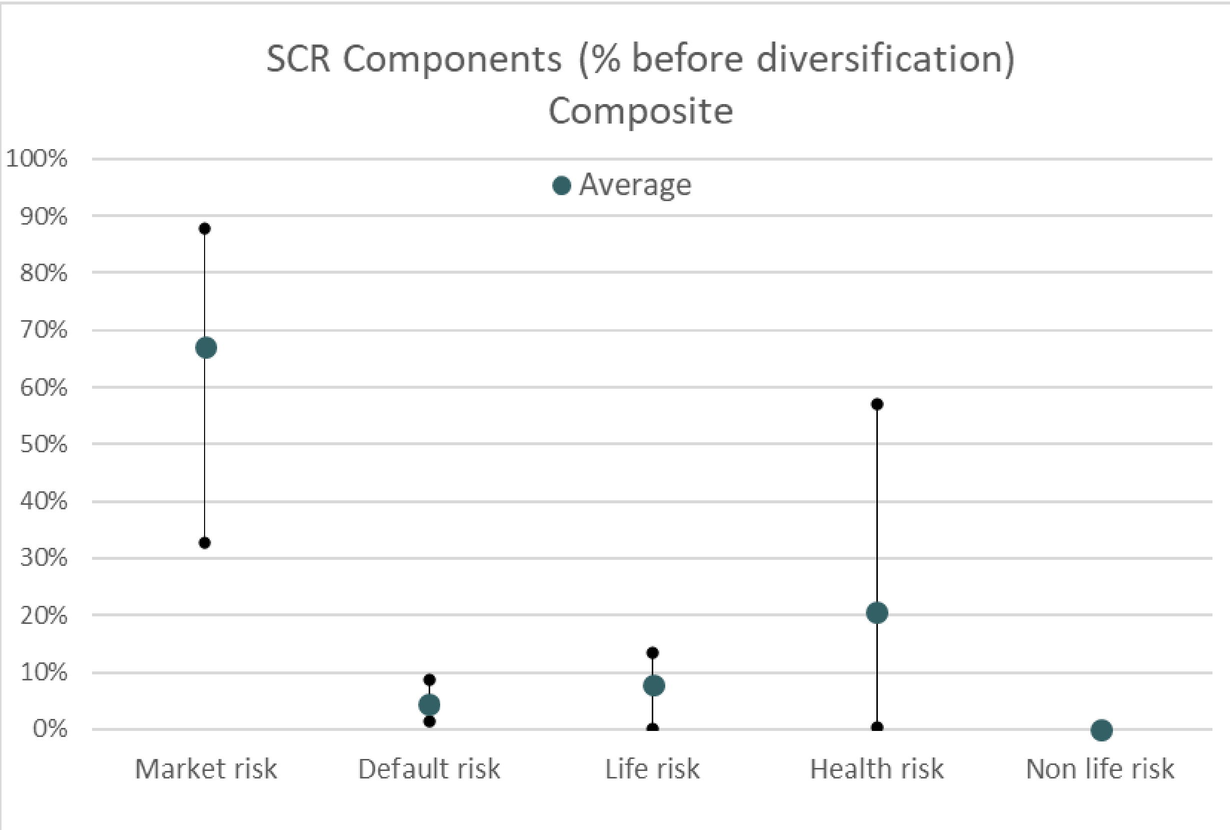

Chart 9: SCR Components – Composite insurers

Chart 10 shows the SCR component mix by insurer, showing the substantial contribution of SCR market risk across the sample.

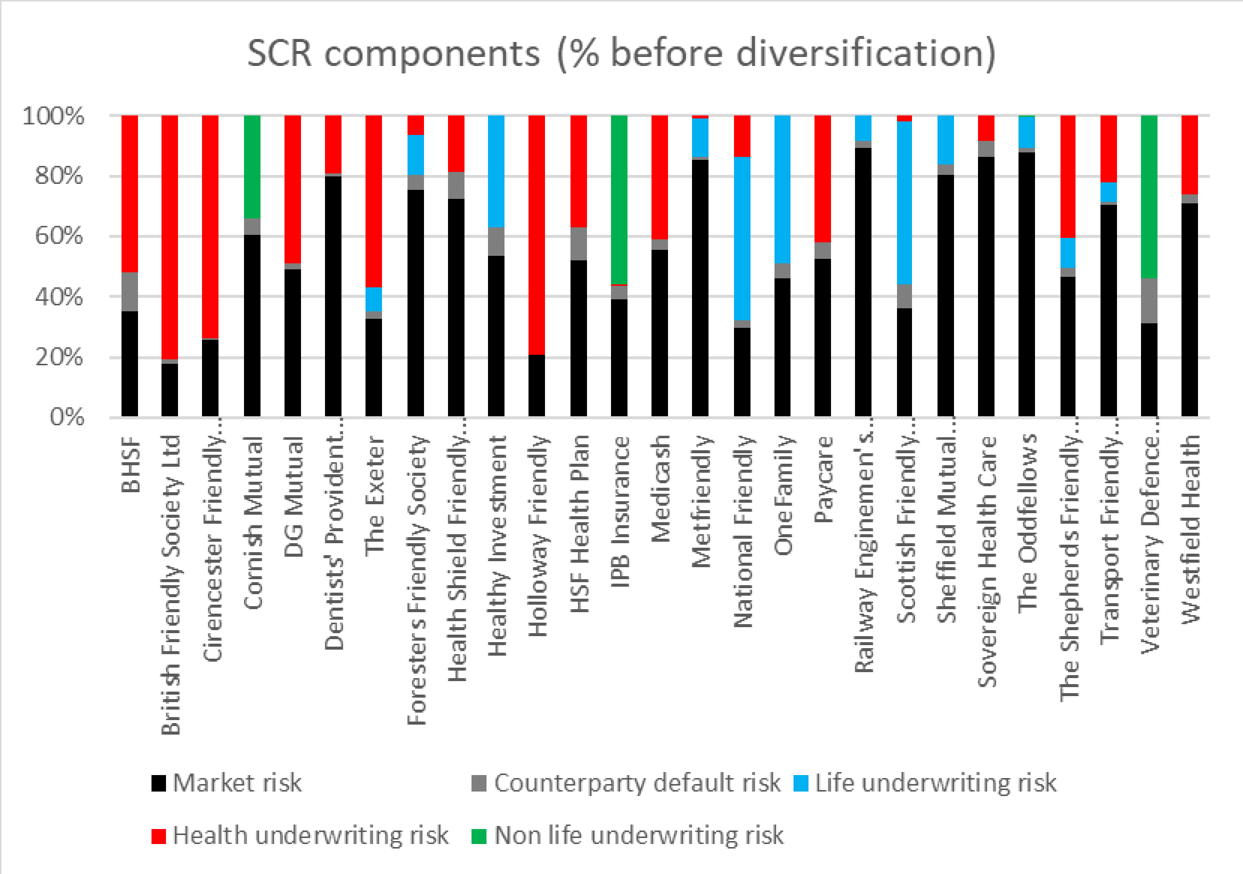

Chart 10: SCR components by insurer

Overall, the SCR market risk has decreased from 2021 to 2022 (25% lower on average). On average, reductions were lowest for composite insurers, as can be seen in Chart 11.

Chart 11: Increase in SCR market risk from 2021 to 2022

The fall in the average market risk is expected given the falls in asset values in the year to end 2022.

The falls in the equity markets and consequently lower symmetric adjustment will result in a lower equity stress component.

The increase in yields reduced the value of bonds, more so the longer the term to redemption, although the interest rate stresses were typically a much higher % of the market value due to the large upwards shift in risk free yields.

Risk Margin

Chart 12 shows the amount of risk margin (where individually reported) by insurer and also the size of the total assets. Some insurers have a higher proportion of risk margin to assets than others.

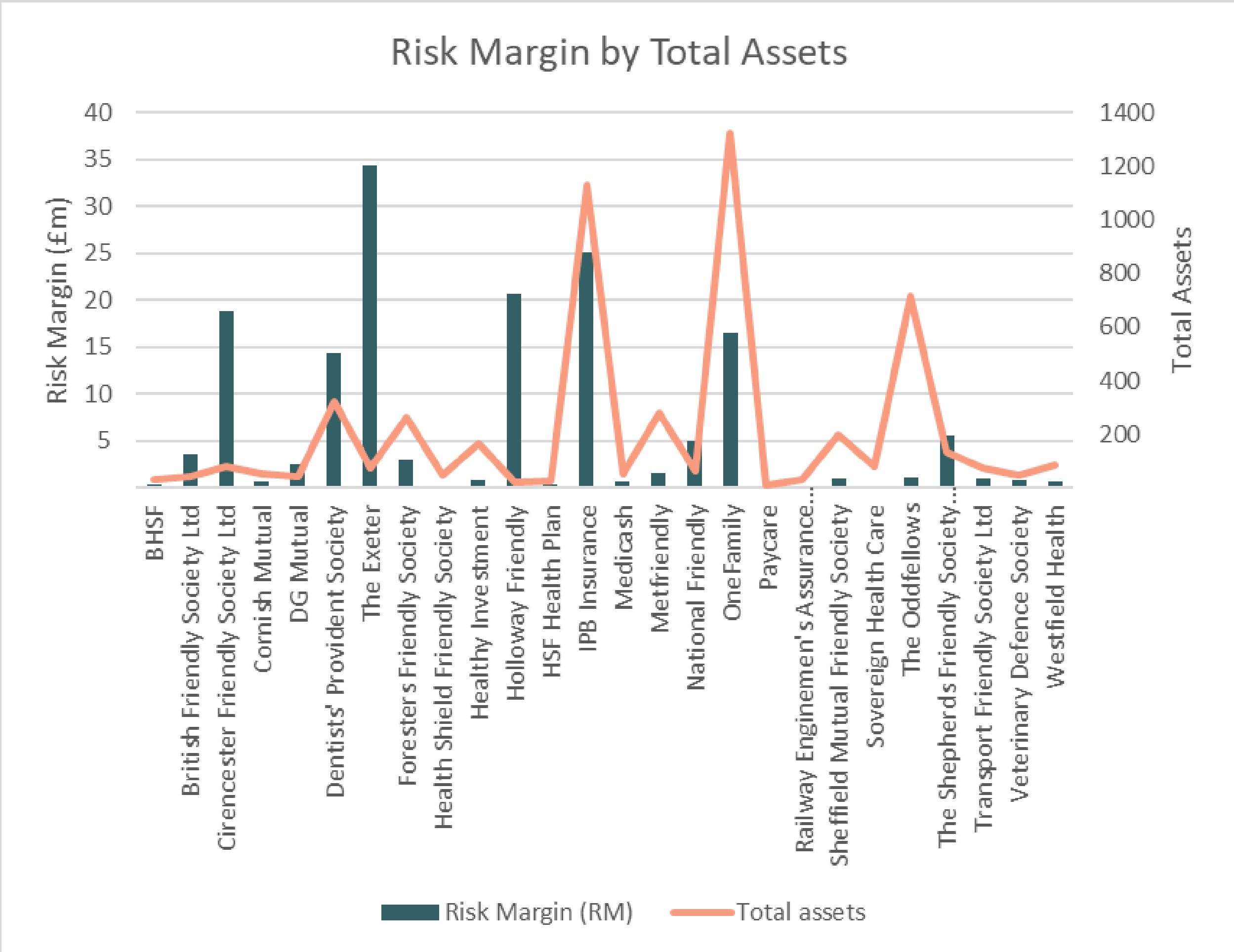

Chart 12: Risk Margin compared with Total Assets

The total risk margin across the report's population is £190m (£280m), with £120m (£190m) relating to life business (incorporating health insurance contracts written as long term business). This large fall (30%-40%) primarily reflects the large increase in risk free rates (c3% nominal) used to discount the cost of capital and a medium term projected SCR profile. There will be a smaller impact due to the market risk reduction.

The latest position on risk margin reforms continues to suggest a reduction in the risk margin of around 60% for long-term life business and 30% for non-life business. On this basis, and assuming 45% reductions for composites, this could reduce the risk margin for this report's population by £99m (£150m).

The proposed reduction in risk margin will reduce technical provisions, thereby increasing own funds and solvency ratios. Note that these changes are now expected to come into effect before the 2023 year end.

Charts 13, 14 and 15 show the risk margin as a percentage of own funds by insurer for each line of business for 2022 and 2021 (where typically higher). On average, the risk margin is 15%, 2% and 13% of own funds for life, non-life and composite insurers respectively demonstrating (the same scale is used) that the reforms are of more significance to those writing life insurance business.

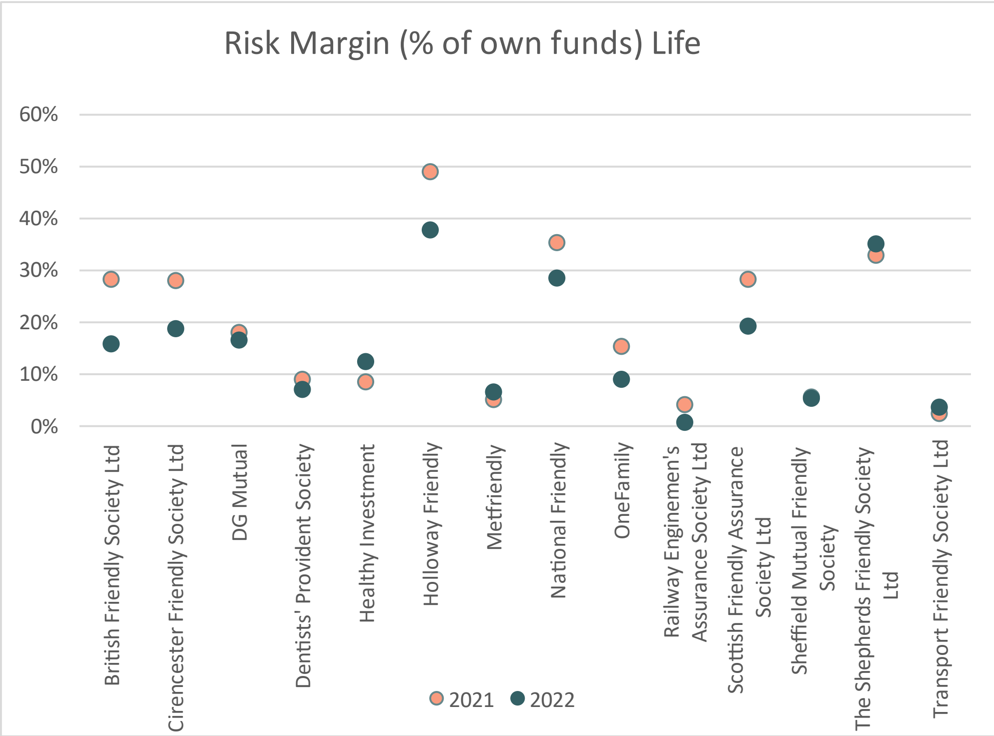

Chart 13: Risk Margin as % Own Funds - Life

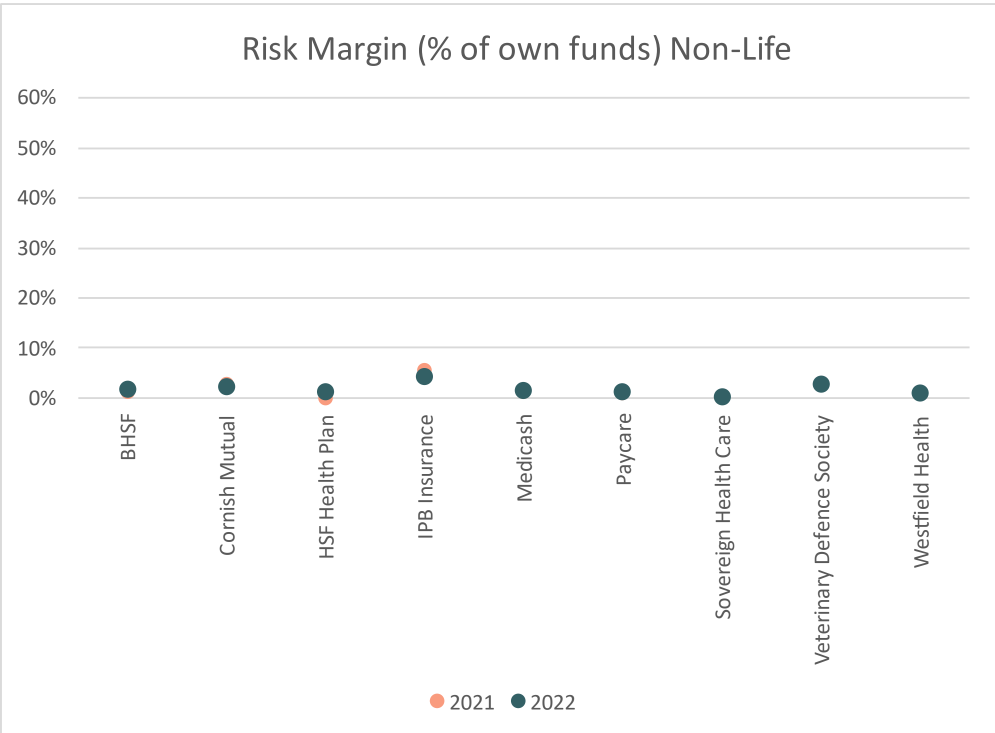

Chart 14: Risk Margin as % Own Funds – Non Life

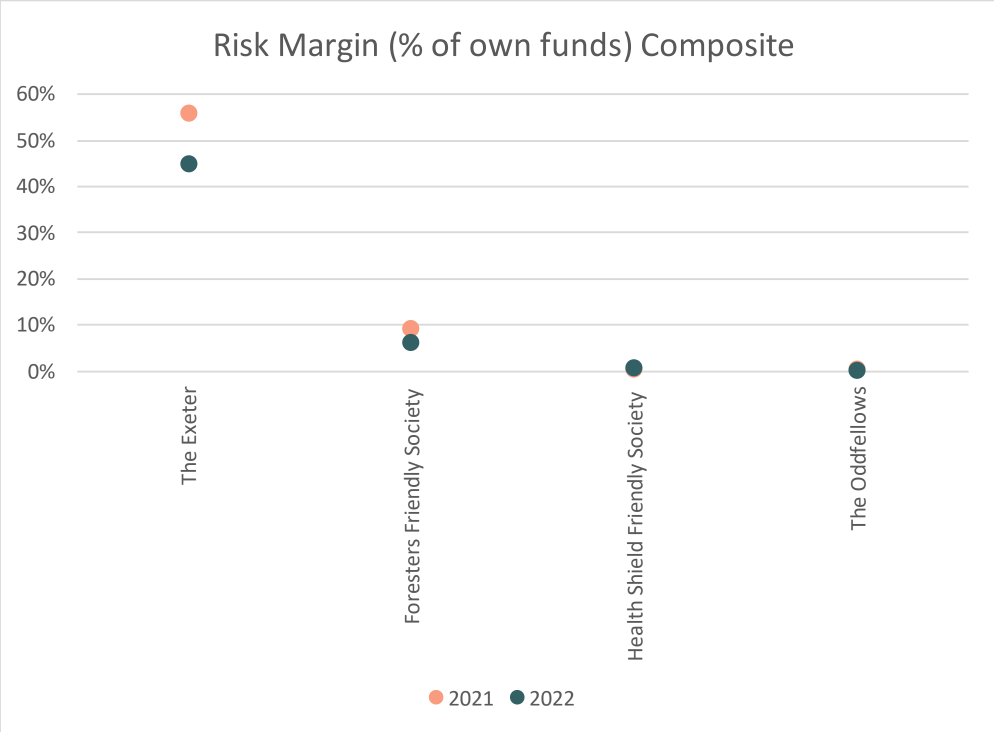

Chart 15: Risk Margin as % Own Funds – Composite

Loss-absorbing capacity of technical provisions (and deferred taxes)

The standard formula SCR is calculated as the sum of the Basic Solvency Capital Requirement, the capital requirement for operational risk and the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes.

The adjustment can take account of the risk mitigating effect provided by future discretionary benefits of insurance contracts (which are valued as part of the liabilities under Solvency II). Management actions should document the extent to which they will allow a reduction in such benefits in the stressed circumstances.

The adjustment reflects potential compensation of unexpected losses through a simultaneous decrease in technical provisions or deferred taxes or a combination of the two.

Chart 16 shows the nominal amount of the adjustment by insurer and the amount expressed as a percentage of own funds.

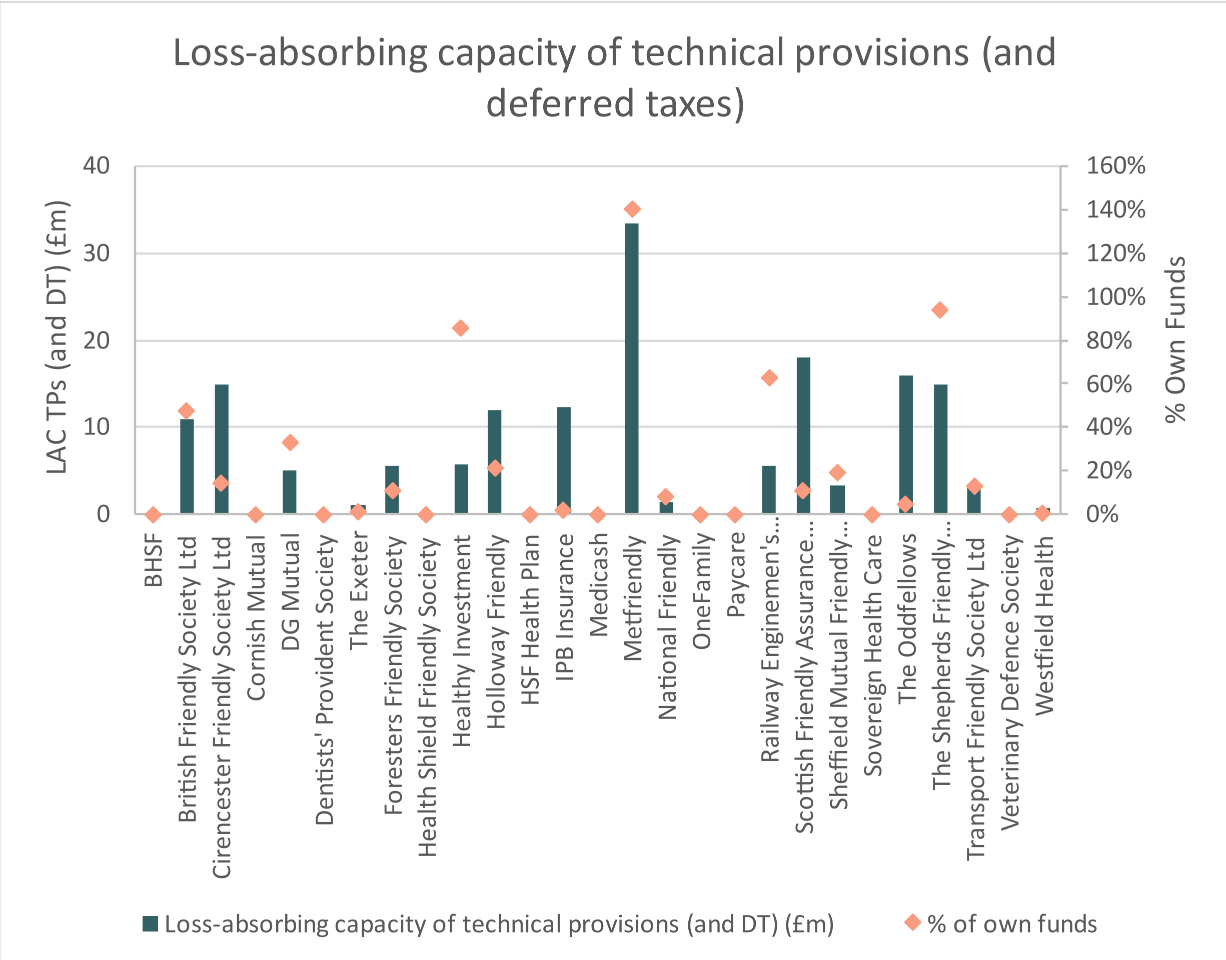

Chart 16: Loss-absorbing capacity of technical provisions (and deferred taxes)

On average, the adjustments are 21% of own funds, although there are 4 insurers markedly higher. The extent to which technical provisions are loss-absorbing varies significantly amongst insurers and those with Holloway or with-profits business will have more scope for this adjustment.

The total adjustment is £164m (£170m) which corresponds to 17% (15%) of the total SCR (after the adjustment). This suggests the adjustment has a material effect.

Expenses

Chart 17 shows the distribution of expense ratios (defined as expenses divided by net written premiums) for 2022 (and 2021). The average across the sample is 42% (37%).

There is considerable variability and, whilst the expense ratio has increased since last year, this may be distorted due to timing of expenditure on projects and other factors. Particularly noteworthy are the levels of expense inflation experienced by insurers and the impacts of unusually high inflation. Different business models and types of insurance business may also require different levels of expenditure, for example to service policies with high claim frequencies or complex administration.

With Consumer Duty coming into effect from end July 2023 for open products and services, management teams may wish to challenge their relative expense levels and their ambitions to provide good customer outcomes. Indeed, a significant portion of recent expenses may relate to preparations to implement the Duty.

The nature of the ratio means some strong upward movements reflect a large decrease in premiums and some strong downward movements reflect increased premiums alongside reduced expenses.

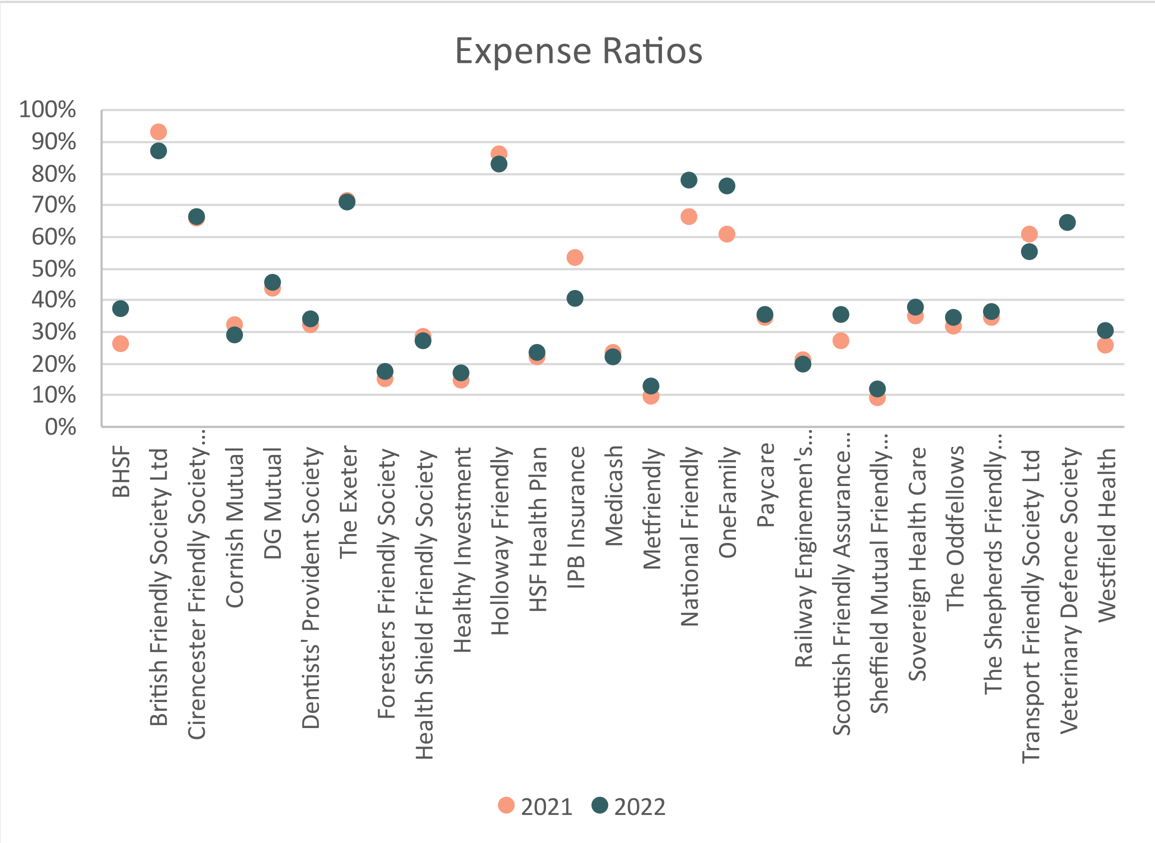

Chart 17: Expense Ratios

Reinsurance

Reinsurance has both advantages and disadvantages. It can be used to reduce the amount of claims paid, reduce technical provisions and assist the setting of premium rates, amongst other benefits. These benefits come with a cost including profits being ceded to reinsurers and counterparty credit risk.

13 insurers (7 life, 4 non-life and 2 composite) in the sample use reinsurance to effect changes to their technical provisions. However, almost all of the £930m (£1.1bn) of reinsurance recoverables is in respect of Scottish Friendly. As per Chart 18 below (with Scottish Friendly omitted), there are only 4 of the other insurers where the reinsurance recoverables affect technical provisions by more than £10m.

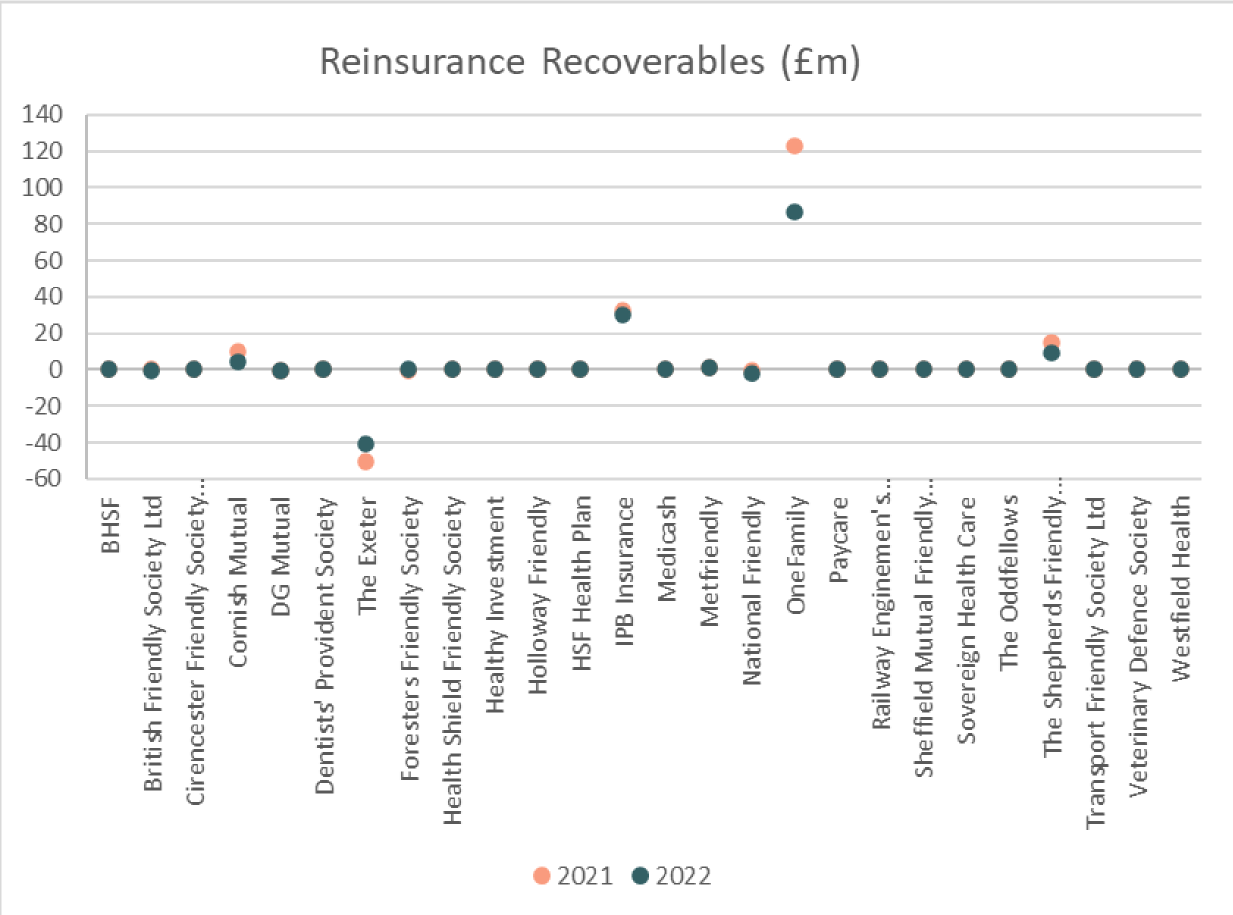

Chart 18: Reinsurance Recoverables

Own Funds

"Own funds" refers to assets in excess of the sum of the technical provisions and current liabilities. A high nominal amount of own funds suggests strong financial resources; however the critical relationship is between the own funds and the capital requirement (see solvency ratio above).

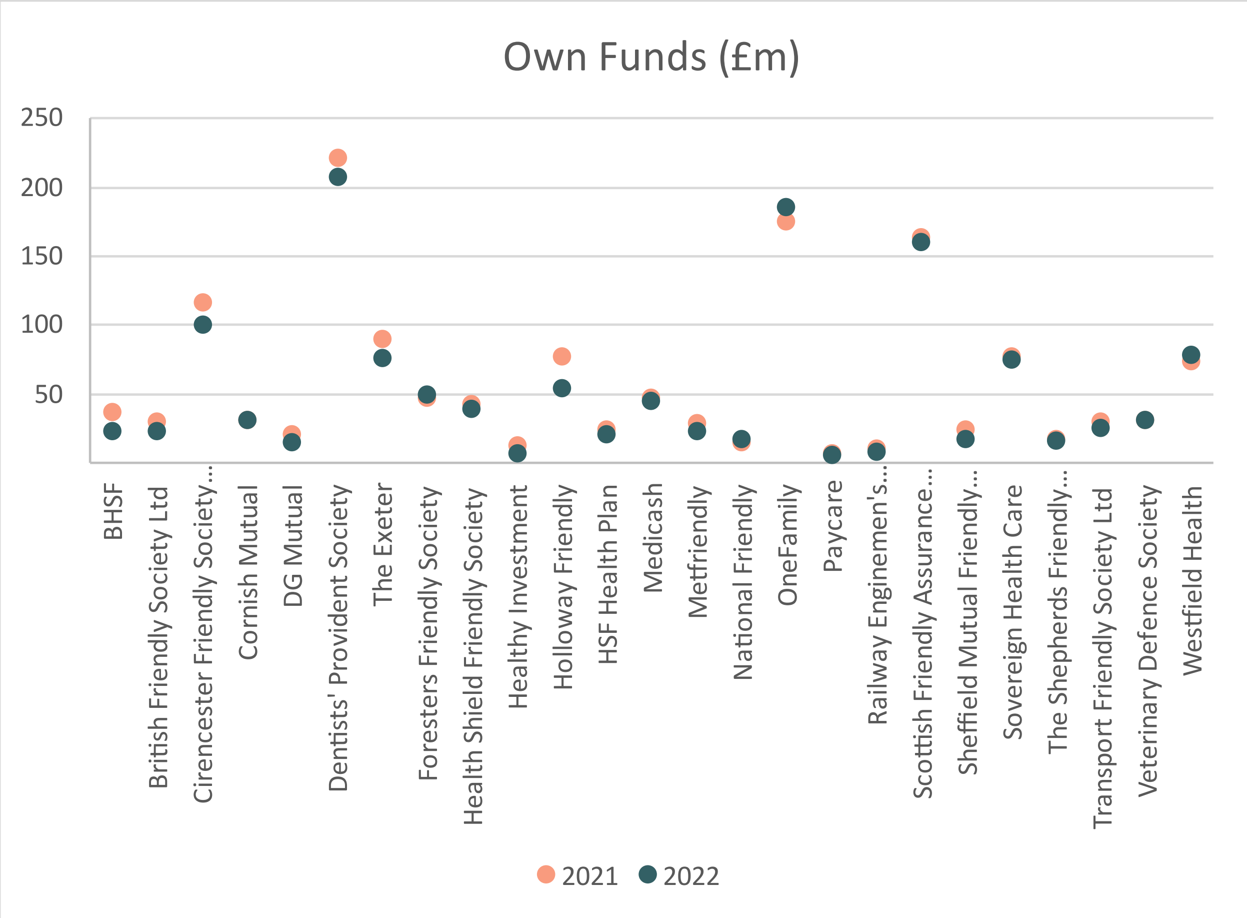

Chart 19: Own Funds

Note: IPB Insurance and The Oddfellows, with own funds above £300m, have been excluded from the chart to allow a more proportionate comparison for the majority of the group analysed.

For more information:
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