HYMANS ROBERTSON

Briefing note

Understanding solvency-triggered termination rights in Bulk Purchase Annuity transactions

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The Prudential Regulation Authority ("PRA") issued a Dear CRO letter on 4 July to UK life insurers who write Bulk Purchase Annuity ("BPA") transactions, outlining the outcome of their thematic review of the use of Solvency Triggered Termination Rights ("STTRs").

Background

The UK BPA market continues to be busy, with £47.8bn[1] of buy-in deals completed in 2024. As a result, the past few years have seen an increase in the number of BPA providers, leading to a highly competitive and price-sensitive market. This has resulted in insurers seeking to differentiate themselves and gain a competitive advantage through various non-price factors and deal features, such as STTRs. The rapid market growth, changing deal structures and complexity, and high levels of competition resulted in the PRA highlighting the BPA market as a key focus area in their Insurance Supervision 2025 Priorities[2].

What are Solvency Triggered Termination Rights, and why might Trustees request them?

STTRs allow Trustees to terminate a buy-in contract in the event of the insurer's solvency coverage ratio falls below a pre-defined level for a period of time, known as the "Cure Period". At the point when the termination right becomes effective, the Trustees will regain management of the scheme liabilities and receive a "Termination Payment", with the amount and assets to be transferred negotiated between the insurer and the Trustees as part of the BPA terms.

Trustees value STTRs as they provide a safety net for their members and, in their letter, the PRA notes they have seen a growth in demand for STTRs to be included in the terms of buy-in transactions, with an estimated total exposure to STTRs of c. £50bn across the life insurance market.

The thematic review

The PRA's thematic review aimed to better understand the risks associated with STTR clauses and the practices of firms in managing these risks. The review concluded that the use of STTRs introduces a number of potential risks for insurers, highlighting four main potential areas of risk.

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[1] Hymans Robertson – Bulk annuity and longevity hedging H2 2024

[2] PRA's Insurance Supervision: 2025 priorities

Liquidity risk

A key concern is the potential liquidity strain when STTRs are triggered, and a Termination Payment is required. The value of the termination portfolio and assets to be transferred are negotiated in the buy-in contract and can vary between transactions. Liquidity risks may arise if the insurer's residual portfolio is disproportionately weighted towards illiquid assets or weighted towards certain asset classes, leaving the insurer with insufficient liquid assets to meet liquidity obligations after a STTR is exercised. This could force sales or require portfolio rebalancing, both of which may be difficult and unfavourable under stressed market conditions.

Asset concentration

Linking to the point above, the structure of the Termination Payment can leave the insurer with asset concentrations outside their risk tolerance limits, particularly if several buy-in contracts specify a given asset type for inclusion. The PRA also notes that where a firm is using funded reinsurance, there is an additional risk that the required collateral may not be recoverable quickly enough or may be unsuitable for use in the Termination Payment, further worsening asset concentration risks.

Contractual ambiguity

There is a risk that STTR clauses lack clarity. Examples highlighted include clauses around asset valuation, the type and quality of assets that can be used in the Termination Payment, or who bears the costs incurred as a result of the termination. This could lead to delays in the process and legal costs, which can impact the insurers reputation.

Operational stress

STTRs can create considerable operational challenges at a time when an insurer will already be tackling financial stress. Managing a solvency event while simultaneously executing termination clauses could put significant strain on internal management and resources. If STTRs aren't embedded within an insurer's risk governance processes, they may find it difficult to act quickly and effectively, risking further financial deterioration and poor policyholder outcomes.

Mitigating against STTR risks

In response to the risks identified, the PRA has set out risk management expectations for insurers, providing examples of the risk management strategies currently being taken by firms.

Align asset composition in Termination Payments with their broader investment portfolio

This approach helps prevent the depletion of certain asset types, particularly those needed for day-to-day expenses or meeting policyholder obligations. By designing Termination Payments to mirror the insurer's overall asset mix, insurers can reduce the likelihood of their portfolio needing to be rebalanced or breaching asset exposure limits. Insurers should also consider the PRA rulebook and Matching Adjustment ("MA") requirements in designing Termination Payments, ensuring that the contribution of the MA portfolio to the Termination Payment is limited to the amount of assets held in respect of the terminating contract.

Build flexibility into buy-in contracts to manage liquidity and concentration risks

This includes allowing for a range of asset types to be used in meeting Termination Payments rather than specifying narrow asset classes, with the PRA noting the terms should not prevent an insurer from transferring a Termination Payment that is consistent with the composition of its overall asset portfolio.

Set and monitor STTR exposure risk appetites and limits

While some firms have limits in place, the PRA noted these often focused on liquidity impacts and could be developed to also consider analysis of the impact on asset concentrations. The PRA highlights that effective scenario analysis for setting exposure limits should include an assumption of concurrent terminations across the insurer's deals with STTR clauses and prudent assumptions around the ability to transfer illiquid assets.

New requirements for insurers offering STTR clauses

Alongside their expectations for the management of STTR-related risks, the PRA also included two new requirements within their letter.

Notify supervisors if entering new BPA deals with STTRs after 4 July 2025

This ensures that the PRA are aware of the nature of any new arrangements and can assess whether the proposed terms introduce new or elevated risks.

Prepare for the 2026 review of market practices and risk mitigation strategies for STTRs

The PRA expects insurers to evaluate and, where necessary, enhance their existing STTR-related risk controls, governance processes, and stress-testing capabilities in advance of this review. Preparing early for the upcoming review will demonstrate good risk governance and help firms avoid possible redress at a later date.

Next steps

UK BPA insurers incorporating STTR clauses should begin work to prepare for the 2026 market review now, starting with assessing their existing approach to STTRs and the terms offered, and how STTR-related risks are considered within their broader risk management framework.

Hymans Robertson's Insurance and Financial Services team are well placed to support you in preparing for the market practice review. We have a wealth of experience in supporting BPA providers, including supporting regulatory reviews into risk management practices across the end-to-end BPA deal origination process, and in supporting the build-out and enhancement of BPA investment frameworks to support large deals.

If you would like to discuss the content of this briefing note further, please get in touch with one of the authors or your usual Hymans Robertson contact.

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