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PRA Proposes Funded Reinsurance Reform

Executive Summary

- **What’s new:** On 29 April 2026, the PRA released Consultation Paper CP8/26, proposing a fundamental recalibration of the regulatory capital treatment of funded reinsurance transactions under Solvency UK.
- **Why it matters:** The proposed changes could double or even triple the capital insurers are required to hold for the average funded reinsurance transaction, creating new barriers to entry and becoming a driver for further consolidation among reinsurers and UK life insurers.
- **What to do next:** UK insurers should consider reviewing their pipeline funded reinsurance transactions already contemplated in discussions with the PRA to assess whether it would be beneficial to execute such transactions on or prior to 30 September 2026, monitoring upcoming PRA consultations and industry roundtables, and assessing the potential impact of the proposed changes on their capital and risk-management strategies. Responses to the consultation are due by 31 July 2026.

On 29 April 2026, Gareth Truran, executive director of insurance supervision at the UK’s Prudential Regulation Authority (PRA), delivered a speech announcing the release of PRA Consultation Paper CP8/26 (CP), being an update on the PRA’s proposed future supervisory approach to funded — or “asset intensive” — reinsurance. The proposals aim to fundamentally recalibrate the regulatory capital treatment of funded reinsurance transactions which the PRA now openly characterises as giving rise to “misaligned incentives” and “underestimated risks.” Having a credit rating — and a strong credit rating — as a reinsurer has become even more important, with collateral taking a secondary role. This is irrespective of whether the reinsurer is authorised in an “equivalent” jurisdiction, such as Bermuda. The PRA has responded to perceived complexity in the assets comprising collateral by placing additional weight on ratings provided by third-party credit rating agencies.

It is clear from the proposals that the PRA and other regulators are taking inspiration from one another on how to address perceived risks with respect to funded reinsurance. Therefore, market participants operating in multiple jurisdictions have a unique advantage in assessing and understanding current and potential future regulatory changes with respect to funded reinsurance. The proposals follow consideration of the status of funded reinsurance in the last 3½ years, which has included international dialogue from the International Association of Insurance Supervisors (IAIS) about the structural shifts occurring in global life insurance markets, as well as recent reforms in early April with respect to funded reinsurance in Japan.¹

¹ The Japanese Financial Services Agency (JFSA) has in its recent reform put forward regulatory provisions to address the intersection of credit quality assessment, duration mismatch and offshore reinsurance in the context of its own life insurance sector. The parallels between what the PRA is now proposing and the direction of Japanese regulatory thinking deserve attention from any market participant operating across borders.

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Key Takeaways

- **A mixed bag.** The PRA has moved away from its proposal for the “unbundling” of funded reinsurance contracts into two component parts: namely, a collateralised loan in addition to a longevity swap. This will almost certainly be welcomed by market participants. However, in light of the capital implications of the PRA’s proposals, these changes will have a profound impact not only on funded reinsurance activity, but also on other parts of the UK life insurance market in ways that will only become apparent over time. For example, this may lead to an acceleration of a trend whereby new entrants are seeking to acquire UK insurers, or establish newly authorised UK insurers, to underwrite BPA insurance directly, in substitution for a reinsurance strategy.
- **Favourable to strong reinsurers; favourable to stronger insurers.** The largest reinsurers with the strongest credit ratings will benefit most from the proposals, whereas there may be difficulties for less established reinsurers to gain a foothold in the funded reinsurance market in the future — irrespective of even impeccable collateral quantum and quality. This creates new barriers to entry and is likely to drive further consolidation. Smaller, less financially established insurers may struggle to afford to execute funded reinsurance on a competitive basis, with the pool of viable reinsurance counterparties likely diminishing.
- **Capital requirements.** The PRA expects that the proposed changes will represent a significant recalibration of the capital treatment of funded reinsurance that could double, or even triple, the capital insurers are required to hold for the average transaction. For many insurers and reinsurers, these capital charges will simply be too great for funded reinsurance transactions to be commercially viable. Importantly, the proposed changes do not take account of regulatory capital held by a reinsurer (including in “equivalent” jurisdictions like Bermuda). This arguably runs contrary to the overall spirit of equivalence, the effect of which should be reflected in lower capital charges where funded reinsurance transactions are entered into with relevant counterparties. Moreover, there are no additional provisions for diversification in a funded reinsurance context provided for in the draft rules.
- **Exemptions.** A notable exemption for intragroup transactions applies to 50/50 intragroup quota share deals, subject to guardrails. In addition, subject to the satisfaction of the prescribed conditions, the drafting of the rules as presented could still offer advantageous structuring opportunities.
- **Timing.** The PRA proposes that the new rules will not apply to arrangements where risks are fully transferred on or before 30 September 2026, with formal implementation from 1 July 2027. In our view, this should allow for the completion of transactions already contemplated in discussions between the UK insurer and the PRA, while any transactions that have not been previously discussed with the PRA may require careful regulatory engagement with the PRA in order to execute.

Background – How Did We Get Here?

Since September 2022, the PRA has expressed growing concern about the systemic risks posed by funded reinsurance, citing the complexity and lack of transparency in such arrangements, including the prevalence of private, complex and untraded assets forming a substantial part of the underlying collateral in many instances.²

In September 2025, the PRA signalled a significant shift in emphasis, indicating that its existing principles-based approach to addressing funded reinsurance, including the supervisory expectations previously set out in Supervisory Statement SS5/24, may be insufficient to address the potential for systemic risks from the widespread use of funded reinsurance.³ As part of its evolving approach, the PRA had been exploring whether the investment component of funded reinsurance should be “unbundled” from longevity reinsurance for Solvency UK balance sheet purposes, effectively decomposing future funded reinsurance transactions into a collateralised loan and a longevity swap for solvency capital purposes. Such an approach could have had significant capital and practical implications for UK life insurers and, controversially, effectively disregarded the fact that reinsurers are subject to their own solvency capital requirement.⁴ This prospect, and the potential uncertainty surrounding the capital treatment of funded reinsurance, has had a chilling effect on the funded reinsurance market in the UK, resulting in both previously planned and new transactions being put on indefinite hold pending further PRA guidance.

The BPA Market in Context: Growth, Competition and the Seeds of Risk

The UK Bulk Purchase Annuity (BPA) market has experienced explosive growth. Higher gilt yields have propelled the share of “buyout-ready” pension schemes from below 5% in 2021 to around 45% today, with premiums over the past three years totalling approximately £135 billion — which is more than a third of total flows over the past two decades. The market is forecast to reach approximately 80% of schemes being buyout-ready within five years, with annual premiums projected at £45 billion to £50 billion. Data published by the PRA shows BPA pricing reached historically low levels in 2025, a development the PRA views with concern as it “increases the possibility that [insurers] take on a higher level of risk for which they are not adequately compensated.”

Against this backdrop, funded reinsurance had become an increasingly prominent feature of the market, particularly given the cost of equity capital for life insurers in the UK. In 2025, £6.5 billion of funded reinsurance premiums were written, and approximately 15% of new BPA business has been ceded via

² See our 22 September 2025 client alert “[PRA Signals Important Change in Approach to Funded Re.](#)”

³ *Ibid.*

⁴ *Ibid.*

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funded reinsurance arrangements in recent years. Absent policy change, the PRA projected that funded reinsurance exposures at UK firms would increase from approximately £40 billion to approximately £110 billion over the next decade.

Regulatory Concerns

The PRA's central thesis has clear for some time: The current Solvency UK framework does not properly reflect the risks inherent in funded reinsurance, and it creates distorting incentives that favour these structures over economically similar direct investments. The PRA estimates that capital held for the average funded reinsurance transaction is "only around 2–4% of liabilities, compared to 11–15% for similar investments." The CP elaborates that this discrepancy arises from the materially different treatment of reinsurance recoverables versus assets held directly on the Solvency UK balance sheet. In addition, the PRA has raised concerns that the reinsurers to these transactions are often based offshore, noting that this has diverted UK insurers' investments away from UK assets and implying that firms are benefitting from less onerous requirements in non-UK jurisdictions (notwithstanding equivalency under Solvency II).

This gap has allowed firms to recognize "day-one gains" when entering funded reinsurance transactions, whereby the reinsurance asset created at inception can have a greater value than the liabilities transferred. The existing counterparty default adjustment, which is supposed to capture the risk of counterparty default, is described as "principles-based, produc[ing] inconsistent outcomes across firms, and . . . currently very small in size."

PRA Proposals

The PRA has opted for alternative reform centred on the Counterparty Default Adjustment (CDA), which to at least some degree is more pragmatic than many in the industry feared. Industry feedback played a significant role in this pivot, with stakeholders noting that unbundling would be "excessively complex and operationally burdensome." "Unbundling" would have involved breaking funded reinsurance transactions and contracts into their constituent elements: the distinct reinsurance and investment component (*i.e.*, a collateralised loan in addition to a longevity swap).

Under the PRA's proposals, the CDA applied to funded reinsurance arrangements in the future must equal the fundamental spread (FS) for financial corporate bonds corresponding to the credit quality step (CQS) and maturity of each funded reinsurance cash flow. The rationale is that an insurer's primary exposure under a funded reinsurance arrangement is to the reinsurance counterparty, "which are by nature financial institutions." This comparison is problematic given, for example, the very different regulatory capital regimes that apply to reinsurers on the one hand and other financial institutions on

the other. The PRA estimates that this would bring capital held for the average funded reinsurance transaction to around 10% of liabilities, which in the PRA's view would materially close the gap with similar direct investments.

Credit Rating: The IFS-Based Framework and Notching Mechanism

One of the most technically significant aspects of the proposals is the credit rating methodology to be applied to funded reinsurance transactions.

The proposed framework starts with the reinsurer's insurer financial strength (IFS) rating, issued by an external credit assessment institution (ECAI). The IFS reflects the ECAI's assessment of the reinsurer's ability to pay policyholder claims. Where no ECAI IFS rating is available, firms must use CQS 3 less one rating notch — equivalent to a BBB- rating.

Under the proposals, the capital impact is highly sensitive to credit quality, but the relationship is nonlinear; this means that the penalty for being lower-rated is disproportionately severe compared to the marginal benefit of being top-tier. Indeed, it may be arguable that there is little to no benefit of being "best in class" rather than simply "good" particularly if the collateral arrangements underpinning the reinsurance are of the highest quality.

Firms may then apply up to *three independent upward notches*, reflecting collateral features that mirror the notching criteria used for covered bonds and structured finance. The three notches, as set out in the proposed rulebook amendments, are:

1. **Adequate collateral.** Where collateral fully covers the premium at inception and is adjusted only for changes in market conditions and claims experience, firms may recognize a one-notch upgrade.
2. **Absence of a need for collateral transformation.**

The PRA proposes to use the quality of the cash-flow matching of the worst-case collateral portfolio and the level of matching adjustment (MA) eligibility as proxies for assessing the need for collateral transformation.

Where the collateral is 100% matching-adjustment-eligible, and any mismatch between the cash flows of the collateral and the contractual cash flows of the funded reinsurance does not give rise to material risks, the PRA proposes that firms recognise a one-notch upgrade. Essentially this will mean that there is no advantage in having excellent collateral.
3. **Credit-enhancing nature of collateral.** Where the weighted average credit quality of the worst-case collateral portfolio is better than the reinsurer's own financial strength rating, a further one-notch upgrade may be recognized.

The "worst-case collateral portfolio" is defined as comprising assets with the lowest credit quality and largest cash-flow

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mismatches permitted under the funded reinsurance contract. This is a deliberately conservative calibration. We also note that there has been no discussion with respect to the application of a look-through approach to a well-capitalised parent, cut-throughs or intragroup guarantees in this analysis, each of which are regularly used to provide credit support for funded reinsurance transactions.

To give some practical examples:

- For an **AA-rated counterparty** with strong collateral controls (eligible for all three notches, treated as AAA), the PRA notes that the CDA would reduce the reinsurance asset value by approximately 3% compared to the current position. Whether or not intentional, the impact for an A-related counterparty would be the same — thereby applying more importance to the collateral arrangements in that context, while reducing the incentives for an insurer entering into a funded reinsurance transaction with an AA-rated counterparty to focus on collateral strength. This disincentivises innovation in the composition of collateral, which in turn has impacts on the ability of insurers to offer better pricing to policyholders and close coverage gaps.
- For a **BBB-rated counterparty** with weak collateral (no notches), the reinsurance asset value reduction would be approximately 13%.

The average current counterparty (A+/AA- with one notch) falls at approximately 7% CDA and 2% SCR.

Duration: The Overlooked Risk Amplifier

Equally significant is the duration dimension of the proposals. The proposed rules require firms to “determine the duration for the fundamental spread in accordance with the timing of the reinsurance recoverables cash-flows from the funded reinsurance.” This is important because UK annuity liabilities are inherently very long-duration, and the fundamental spread widens with duration. The consultation paper notes that funded reinsurance collateral is “typically more illiquid, exposed to market risks to a larger extent and more complex in nature than that observed in structured finance arrangements, involving very long duration and bespoke terms.”

Scope, Transition and Exclusions

By tying the CDA to the actual duration profile of the reinsurance recoverables rather than permitting firms to use a generic or compressed duration assumption, the PRA is seeming to ensure that the capital charge properly scales with the long-term nature of the exposure. This has a compounding effect: Longer duration means larger FS deductions, which means a more substantial reduction in the value of the reinsurance asset on the Solvency UK balance sheet.

The proposals would apply to new funded reinsurance arrangements where all risks are transferred after 30 September

2026, with implementation of the new rules from 1 July 2027. Existing arrangements are grandfathered through a savings provision, which the PRA considers a “pragmatic approach” to avoid disrupting in-force contracts that “were negotiated on the basis of previous expectations.”

Notably, the definition of “funded reinsurance” itself is formally introduced into the PRA Rulebook for the first time. Two notable carve-outs are proposed:

- First, for intragroup quota share funded reinsurance, which the PRA considers does not present the same prudential risk profile as third-party funded reinsurance. To qualify, the arrangement must satisfy several conditions:
 - The cedant and the reinsurer must be part of the same group.
 - The transaction must not result in an increase in surplus capital at group level; the cedant must retain at least 50% of the risks in respect of the business within scope.
 - The reinsurer must apply an investment strategy identical to that of the cedant and maintain systems and controls to ensure it does not diverge.
 - The transaction must not generate a day-one profit, being the present value of the recoverables plus any reinsurance commission must not exceed the total premium paid.

The PRA’s rationale is that in such structures, the reinsurer simply holds a mirror portfolio of MA-eligible assets matching the ceded liabilities, meaning the recapture risks and incentive distortions that animate the broader proposals do not arise. For groups which are considering cross-border funded reinsurance transactions, the conditions listed above require careful consideration although may still offer opportunities to employ more nuanced capital management strategies.

- Second, for Part VII reinsurance, defined as funded reinsurance entered into between two parties on a temporary basis in advance of a formal Part VII transfer of insurance business. These short-term arrangements are not considered to give rise to the same ongoing risk exposures as long-term transactions and are excepted from the new rules until the earlier of: (i) the date on which a court makes a final decision not to sanction the transfer, (ii) or two years from the date the reinsurance obligations come into effect.

Next Steps

The CP is open for consultation until 31 July 2026.⁵ The PRA proposes an implementation date of 1 July 2027 for the new rules, though there will be a “grandfathering” provision for funded reinsurance arrangements where all risks are fully transferred to the reinsurer on or before 30 September 2026.⁶

⁵ CP.

⁶ *Ibid.*

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Any funded reinsurance business written after 30 September 2026 would be in scope of the new rules from the implementation date.⁷

For international market participants, the message is clear: The regulatory convergence between the UK, Japan and the broader IAIS framework on the treatment of credit quality, duration risk and collateral standards in funded reinsurance is not a coincidence but a coordinated regulatory response to a genuinely global phenomenon. Market participants operating in multiple jurisdictions have a unique advantage in assessing and understanding regulatory changes with respect to funded reinsurance. The IAIS' observation that funded reinsurance growth "may be driven by opportunities for capital arbitrage or jurisdictional differences" is, in effect, a statement that

the perceived arbitrage window is closing, though the PRA is taking a more cautious approach than other international regulators or is perhaps just ahead of other regulators and/or more clearly communicating its caution.

UK insurers should consider engaging actively with the consultation process and assessing the capital implications of the proposed CDA methodology for their existing pipeline and future business plans. There are areas where the PRA would be justified in making changes, such as by explicitly allowing regulatory capital held by a reinsurer to be taken into account when calculating the CDA. Firms should also be mindful that the PRA has expressly reserved the right to take further action if the proposed measures do not achieve the intended moderation in funded reinsurance growth.

⁷ *Ibid.*

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