Regulatory update

August 2023

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Solvency UK

Consultation Paper CP12/23 “Review of Solvency II: Adapting to the UK Insurance Market” sets out the PRA’s proposals to deliver significant reforms of Solvency II.

The key aims of the proposals are to:

- Reduce administrative and reporting requirements
- Decrease complexity and costs whilst maintaining strong prudential standards

The PRA is also looking for feedback on how to create a more ‘coherent’ reporting framework.

The consultation is split into two parts. Consultation on the administrative amendments to the rules closes on 31 July 2023 and consultation on the other aspects covered by the paper closes on 1 September 2023.

We expect that a policy statement will be published in early 2024 with an effective implementation date of 31 December 2024.

Summary of the key proposals in this CP affecting OAC’s clients

To streamline and remove certain reporting requirements that the Prudential Regulation Authority (PRA) considers are not needed for the UK insurance sector, including a proposal to move the Regular Supervisory Report (RSR).

OAC comment: “This is a welcome change, and whilst this would not come in until 31st December 2024, for many firms a full RSR would have been prepared in respect of year end 2022. As such there should be no need to produce another full report (assuming no significant issues arise requiring additional reporting in the interim).”

Increase the size of thresholds at which insurers are required to report under the SII regime. The consultation proposes an increase to the premium threshold from €5m to £15m and the technical provisions limit from €25 to £50m.

The paper sets out that a firm will either be Solvency II or be required to report under the Non-Directive Firm (NDF) sector rules. Any current Solvency II firms that fall below the new thresholds will have the choice whether to continue to report under SII or opt for NDF sector rules. Firms that sit close to these new thresholds will have to consider very carefully the implications of falling under one or other regime.

OAC comment: “This is likely to be the most significant proposal within this paper impacting smaller Solvency II firms and is a subject we will cover in our feedback to the consultation.”

Replace all limits defined in Euros as Sterling.

OAC comment: “This should not have a significant value impact but will reduce some of the noise caused by exchange rate movements.”

Some minor (but welcome) changes are proposed to the reporting timelines. Quarterly reporting periods to be extended by a week and both quarterly and annual deadlines are to be defined in working days (30 for quarterly reports and 70 annual reports).

Some reporting templates will be removed and others will be updated as well as some changes to the National Specific (NS) templates. These proposals particularly impact third country branches.

OAC comment: “The effect of these changes on individual firms will depend on the specific templates they report, but this is not expected to have a big impact on most firms. There will necessarily be a change to the SII Taxonomy which will require reporting software to be updated, but the PRA will continue to use the BEEDS system for reporting.”

To amend the Composites Part of the Rulebook to ensure the MCR floor is consistent for all permitted types of composite insurer.

OAC comment: “This will ensure that all composites can fix their MCR floor at the £3.5m limit if their general insurance business is restricted to accident and sickness cover, and the gross written premiums for either their general or long-term insurance business is less than 10% of the overall premiums.”

Other proposals include simplifications and process improvements to the calculation of the transitional measures on technical provision (TMTP) and new simplifying rules for Internal Models and Capital Add-Ons (CAOs). Such models are not used by small to medium sized firms so are of less relevance to our clients.

In summary there appear to be a lot of positives within these proposals. However a key focus for the sector will be on the proposed threshold changes and the impact (or not) this will have on smaller existing Solvency II firms. At current levels the threshold changes will have limited impact on existing firms and Solvency II will remain an expensive ongoing reporting requirement. Firms that fall below the thresholds, and elect to move out of Solvency II, will incur additional transitional costs. The Association of Financial Mutuals is calling for the PRA to consider raising the proposed thresholds such that many more smaller firms will benefit from not having the overhead of Solvency II.

https://www.bankofengland.co.uk/prudential-regulation/publication/2023/june/review-of-solvency-ii-adapting-to-the-uk-insurance-market

Effects of Inflation on General Insurance (GI) Claims

On 23 June, the PRA published a letter sent to the Chief Actuaries of GI firms providing feedback from their thematic review of general insurance reserving and capital modelling. The regulator focused on the effect of claims inflation including the need to ensure reserves are robust enough to withstand inflationary effects that may not yet be showing in the claims settlement data. The letter contains a lengthy annex setting out detailed observations intended to support the strong messages.

Chief Actuaries are encouraged to review the points raised and share and discuss with senior management. The regulator cautions "As part of our 2023 year-end reserve adequacy supervisory work, we may ask you to explain how you have considered the key findings."

https://www.bankofengland.co.uk/prudential-regulation/letter/2023/june/insights-from-thematic-review

Customers in Financial Difficulty

As trailed in our last newsletter, the Financial Conduct Authority (FCA) has published a final Policy Statement (PS23/9) on insurance guidance on supporting customers in financial difficulty which comes into force on 31 July 2023. It is intended to complement the Consumer Duty which comes into effect for new and existing open products on the same date.

The regulator states that this "is guidance on existing rules (including rules coming into force on 31 July 2023)." This chimes with the AFM's response to the consultation which questioned the need for this guidance.

The FCA states a number of changes in response to the consultation which includes the insertion of the following text in the Insurance: Conduct of Business sourcebook (ICOBS):

The options available to, and the level of support reasonably expected to be provided by, firms to achieve the outcomes in ICOBS 2.7.4G will vary, depending on the nature of the firm's relationship with the customer, the firm's role in the distribution chain, the type of and characteristics of the customer and the type of product.

The use of "will" should provide a firmer basis for firm's actions.

https://www.fca.org.uk/publications/policy-statements/ps23-9-finalised-insurance-guidance-supporting-customers-financial-difficulty

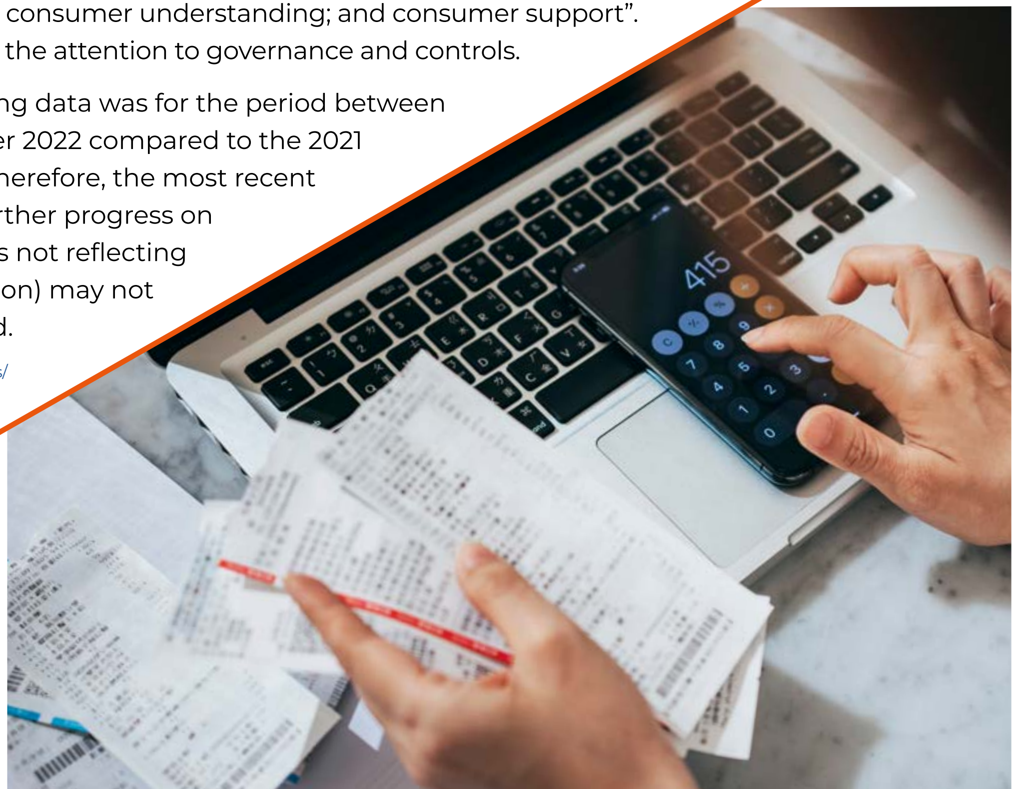
Cost of Living: good and poor practice in the general insurance market

A review by the FCA found examples of good practice, but also areas where general insurance firms need to improve in their support for customers in financial difficulty and claims handling. The publication flagged the subsequent final guidance above.

This review is more widely applicable with the conduct regulator stating "These findings are also relevant for the implementation of the Consumer Duty and the ability to demonstrate [firms] are meeting the cross-cutting outcomes: products & services; price & value; consumer understanding; and consumer support". It is important to note the attention to governance and controls.

We note the underlying data was for the period between August and November 2022 compared to the 2021 12-month averages. Therefore, the most recent practices (perhaps further progress on The Duty and perhaps not reflecting continued high inflation) may not be directly considered.

https://www.fca.org.uk/publications/good-and-poor-practice/cost-living-good-and-poor-practice-general-insurance-market



Climate Change

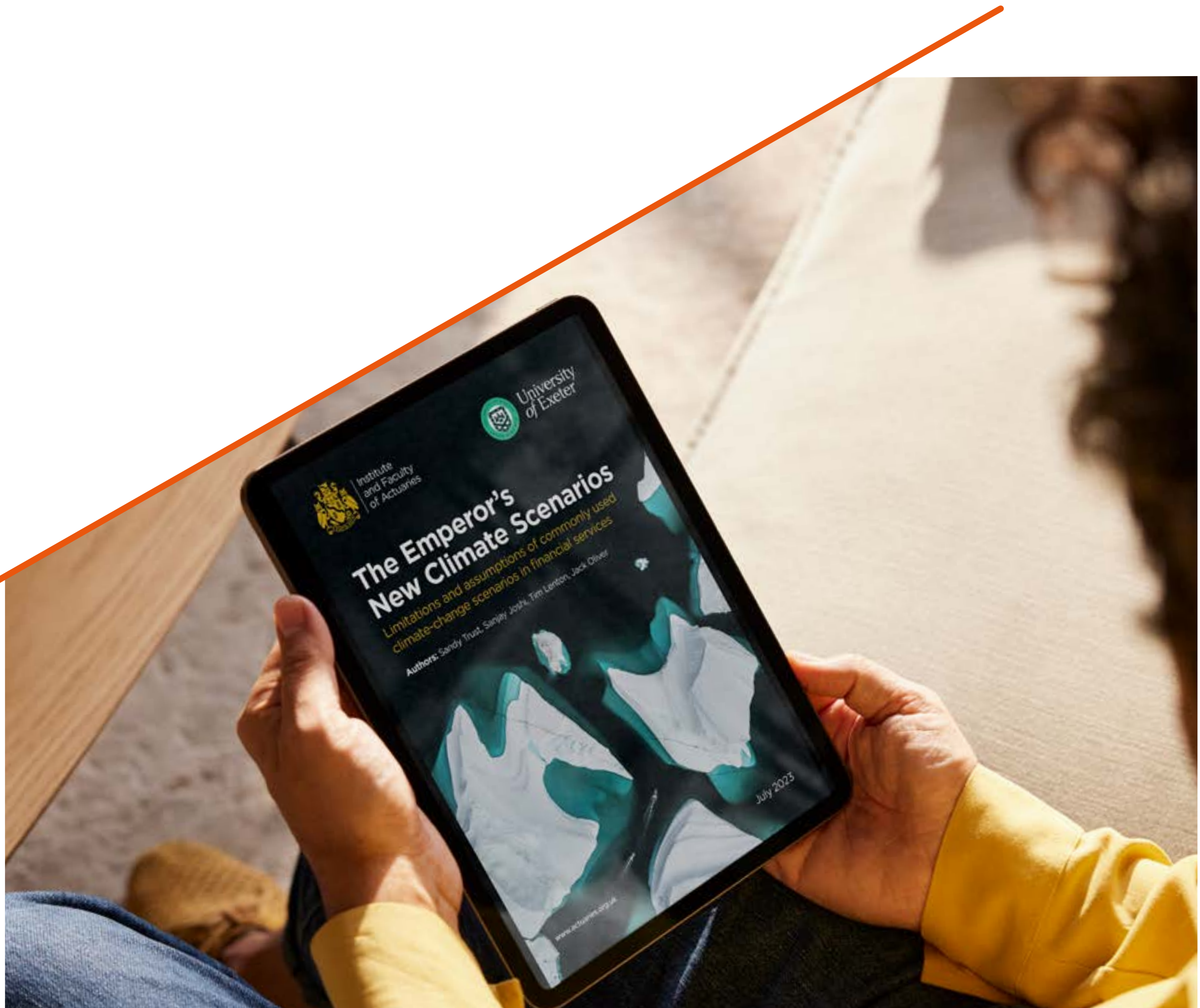
The IFoA has partnered with the University of Exeter to produce a paper demonstrating how a deeper understanding of climate change, including tipping points, can improve financial services climate-scenario modelling. The objective in writing this paper is to help accelerate the progress of more realistic scenario modelling, in turn accelerating the progress on decarbonisation.

The paper states that commonly used climate models in financial services are underestimating risk. Particular concerns are the real extent of the impact of tipping points, sea-level rises, involuntary mass migration and a faster warming planet and the considerable levels of uncertainty.

The paper proposes a way forward by developing the understanding of assumptions and limitations of climate change modelling, develop plausible qualitative and quantitative scenarios with internal debate and develop the models to reflect the emerging reality.

OAC recognise that climate change is a risk facing Insurance Consulting clients and expect this to be addressed in forward-looking assessments and risk management. Due to uncertainty, modelling for the ORSA must be complemented by a qualitative approach. We recommend developing narrative exploring in more depth both the financial and non-financial risks from climate change. We agree with the importance of education and see this as recognising practical limitations. OAC's Chief Actuaries will consider the paper and continue to progress our knowledge to assist clients dealing with risks and opportunities.

https://actuaries.org.uk/news-and-media-releases/news-articles/2023/july/04-july-23-emperor-s-new-climate-scenarios-a-warning-for-financial-services/



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Also in the News

On 29 June 2023, the **Financial Services and Markets Bill** received Royal Assent and is now an Act of Parliament (FSMA 2023). This law revokes the Solvency 2 Regulations 2015 and transfers responsibility for these areas of regulation to FCA and the PRA. The bill also includes a new, secondary objective (and so shaping how primary objectives are advanced) for both regulators to promote the growth and competitiveness of the UK economy and a regulatory principle on net zero emissions.

Following on from FSMA 2023, HM Treasury published "Building a Smarter Financial Services Regulatory Framework for the UK: HM Treasury's Plan for Delivery". The government has already published draft SIs related to Solvency II.

https://bills.parliament.uk/bills/3326

https://www.gov.uk/government/publications/building-a-smarter-financial-services-regulatory-framework-delivery-plan

The FCA has published a webpage providing information about the repeal and replacement of retained EU law with the FCA's rules under the Financial Services & Markets Act 2023. The page includes information on the Insurance Distribution Directive (IDD) and Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation.

https://www.fca.org.uk/firms/repeal-and-replacement-retained-eu-law

On 17 July, as trailed in our previous newsletter, the FCA and PRA provided a short update to the Regulatory Initiatives Grid (the Grid) following Royal Assent of FSMA 2023. In addition to content covered in this newsletter, the FCA announced the delay of the **Sustainability Disclosure Requirements Policy Statement** to Q4 2023.

https://www.fca.org.uk/publication/corporate/regulatory-initiatives-grid-jul-2023-update.pdf

On 19 June, the Bank launched its first **system-wide exploratory scenario (SWES)** exercise to improve understanding of the behaviours of financial institutions in stressed financial market conditions. Participating firms will include large banks, insurers, central counterparties and a variety of funds.

https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise

On 14 July, the Treasury Committee called for evidence on the barriers faced by women in financial services as it launched a new inquiry **"Sexism in the City"**. The Committee will evaluate progress on implementing previous recommendations as well as the impact of the Women in Finance Charter.

https://committees.parliament.uk/work/7842/sexism-in-the-city/

6 July 2023, **the Bank of England published its Climate-related financial disclosure 2023 and Climate transition plan, alongside its 2023 Annual Report**. The disclosure reports on the Bank's work on climate change in pursuit of its core mission, the climate risks it is exposed to and the emissions from its own physical and financial operations. It is reported that the Bank's sovereign bond holdings could fall by up to 6.8% in the most adverse climate scenarios [the bank references NGFS interest rate projections] although limitations are noted. Carbon budget pathways for sovereign issuers imply that the Bank's sovereign asset portfolios are aligned with the 2°C Paris goal, but not with the 1.5°C ambition.

https://www.bankofengland.co.uk/climate-change/the-bank-of-englands-climate-related-financial-disclosure-2023

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The FCA welcomed the **International Sustainability Standards Board (ISSB) launch of its first sustainability-related reporting standards**: the General Requirements for Disclosure of Sustainability-related financial information (IFRS S1), and the requirements for Climate-related Disclosures (IFRS S2). Once available for use in the UK, the FCA's intention is to update climate-related disclosure rules to reference the ISSB standards.

IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term.

IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1.

The ISSB is currently consulting on future standard-setting priorities beyond these inaugural Standards. Both fully incorporate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Responsibility for monitoring progress on firms' disclosures will transfer from the TCFD to the ISSB in 2024.

The IFRS aims to "facilitate a good conversation or dialogue between a company and its existing or potential investors" – "decision-useful" for investors and "cost-effective" for companies to explain their prospects.

The Financial Reporting Council (FRC) has issued a call for evidence to inform the proposed endorsement of the IFRS Sustainability Disclosure Standards in the UK.

https://www.ifrs.org/news-and-events/news/2023/06/issb-issues-ifrs-s1-ifrs-s2/

On 12 July, the FCA published their feedback statement on **Big Tech in Financial Services**. F23/4, "The potential competition impacts of Big Tech entry and expansion in retail financial services", which contains a summary of the FCA's current actions and 3 additional steps including a call for Input by the end of 2023. The regulator seeks information on Big Tech firms as 'gatekeepers' and key drivers including the role of data asymmetry between Big Tech firms and financial services firms.

https://www.fca.org.uk/publications/feedback-statements/fs23-4-potential-competition-impacts-big-tech-entry-and-expansion-retail-financial-services

On 29 June, the FCA published PS23/7: **"Broadening retail access to the long-term asset fund"**. The new rules seek to enable a broader range of retail investors and pension schemes to appropriately access the Long-Term Asset Fund (LTAF) whilst ensuring they understand the risks involved.

The LTAF is a new type of open-ended authorised fund, which the FCA introduced in 2021, designed to invest efficiently in long-term, illiquid assets, such as venture capital, private equity and private debt, real estate and infrastructure. They are a higher risk product that can provide greater diversification to investment portfolios in exchange for potentially higher returns but less immediate liquidity and longer redemption periods. Under the current Individual Savings Account (ISA) regulations, units in LTAFs would not be qualifying investments for a Stocks and Shares ISA.

https://www.fca.org.uk/publications/policy-statements/ps23-7-broadening-retail-access-long-term-asset-fund

The PRA's business plan 2023/24 was published in May and stated the following strategic priorities:

- Maintain and build on the safety and soundness of the banking and insurance sectors, and ensure continuing resilience
- In respect of insurers, this includes Solvency UK, insurer resolution, insurance stress test (H2 2023), reinsurance risk, impact of GI claims inflation (see above), operational risk and resilience (including critical third party policy and cyber stress testing)
- Be at the forefront of identifying new and emerging risks, and developing international policy
- This includes effective international collaboration, technology risks and opportunities, explicit management of AI and machine learning developments, cryptoassets and climate change.
- Support competitive and dynamic markets, alongside facilitating international competitiveness and growth, in the sectors that we regulate
- Run an inclusive, efficient, and modern regulator within the central bank

https://www.bankofengland.co.uk/prudential-regulation/publication/2023/may/pra-business-plan-2023-24

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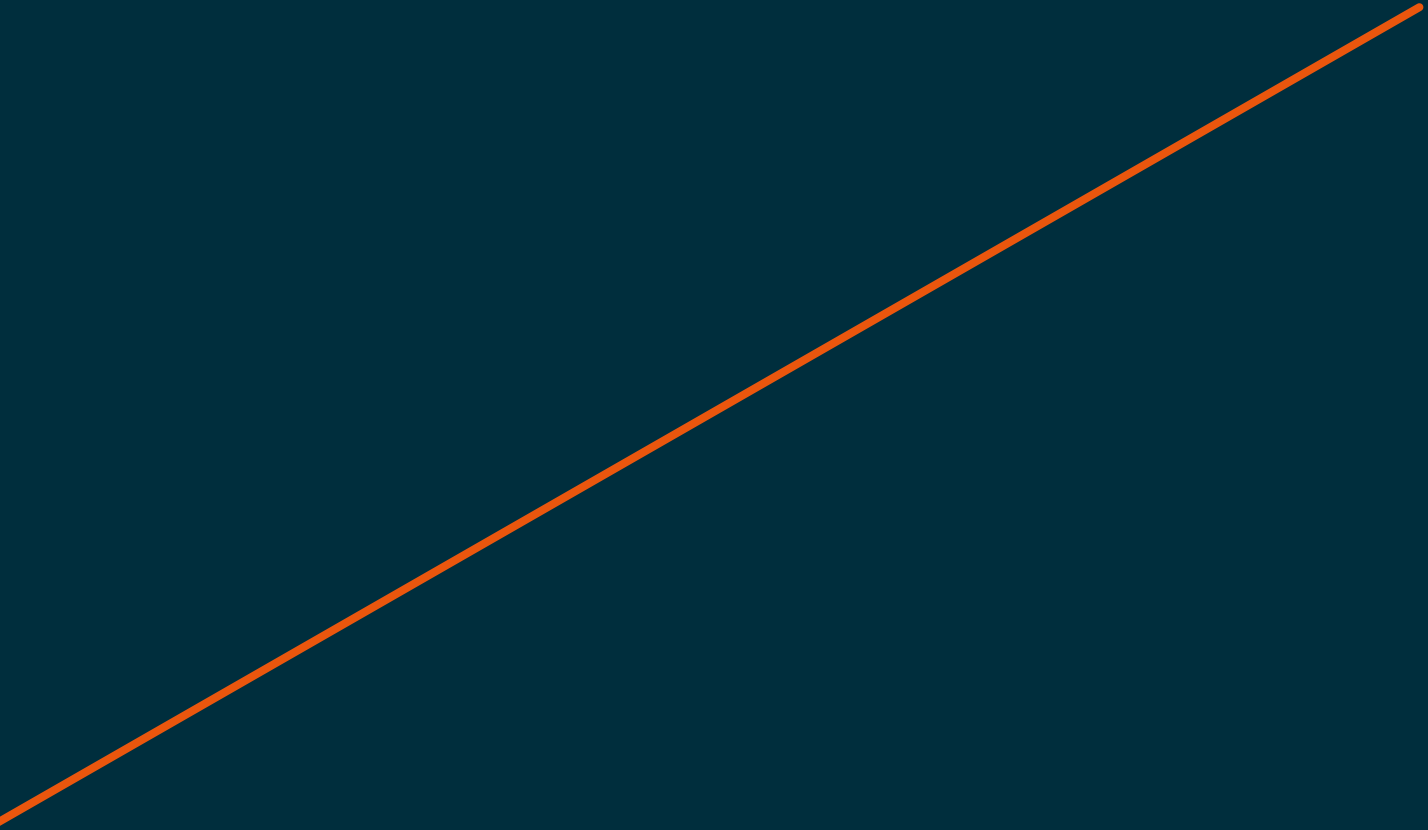

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