Member of the Broadstone Group

Regulatory update

September 2023

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Solvency UK

Gareth Truran from the Prudential Regulation Authority (PRA) spoke on the new prudential regime, Solvency UK, ahead of the further consultation expected this month. The speech covered proposed changes to the matching adjustment (MA) at a high level. The changes are intended to enable obtaining an MA benefit for a wider range of assets and liabilities. To date, the adjustment typically corresponds to asset cashflows matching annuity outgo and many insurance providers will not use the MA. The PRA hopes to bring MA changes in by June 2024.

The PRA expects to publish final policy, following the Solvency II review, during the first half of 2024, with full implementation by the end of 2024, noting that the Treasury intends to effect the risk margin change before the end of 2023.

Beyond 2024, the PRA will consider whether they can further improve the proportionality of the regime for smaller insurers and reforms to the standard formula to used calculate capital requirements.

The PRA expects the first of the new enhanced stress tests (expected to apply to large insurers) will be launched in Q1 2025 with the publication in Q4 that year. One notable change will be the individual disclosure of results for the largest life insurers.

https://www.bankofengland.co.uk/speech/2023/september/gareth-truran-keynote-speech-at-bank-of-america-financials-ceo-conference

Climate Change

At the start of September, the Network for Greening the Financial System (NGFS) published two reports on the topic of climate-related litigation. The first report outlines recent trends in the area, highlighting the rise in climate-related litigations. The second report suggests how supervisors address this risk.

A Board member of the European Central Bank (ECB) spoke of this major source of risk, noting “While governments were the most common targets of such litigation in the past, cases are now also increasingly being filed against corporates”. This could prove a challenge for insurers in terms of direct exposure to claims and indirectly via asset valuations.

https://www.ngfs.net/en
https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp230904~1ae5fa553e.en.html

On 7 September, the Green Technical Advisory Group (GTAG) published its penultimate advice to HM Treasury. GTAG’s role is to provide non-binding advice to the UK government for developing and implementing a UK Taxonomy which facilitates more informed investment decisions.

The paper 'Treatment of green financial products under an evolving UK Green Taxonomy' contains the group’s recommendations on how activities previously considered ‘green’ are affected when the UK Green Taxonomy is implemented, and their advice on the treatment as the taxonomy evolves over time. 'Operational considerations for taxonomy reporting: assessing and dealing with data gaps and the use of proxies' was published alongside and contains recommendations related to usability and limited data. The group recently published 3 advice papers (including KPIs) to assist reporting developments.

https://www.greenfinanceinstitute.co.uk/programmes/uk-green-taxonomy-gtag/

On the same date, the NGFS published 'The NGFS Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors'. The framework is seen as an important first step towards an integrated assessment of climate and broader nature-related risks.

Diversity and inclusion

On 25 September, the PRA and FCA published consultation papers setting out their proposed rules and expectations aimed at improving diversity and inclusion in regulated firms **to support better governance and decision-making**.

The proposals are wide-ranging.

The PRA's proposals include:

- A firm-wide strategy promoting diversity and inclusion among employees,
- Supportive risk and control functions ensuring the risks involved in having poor diversity and inclusion are managed alongside other business risks,
- Measurable targets (applying to largest firms) for monitoring effectiveness and accountability,
- New and updated rules for Board governance,
- Clarity around senior manager responsibilities for diversity and inclusion within an organisation,
- Reporting requirements applicable to all Capital Requirements Regulation and Solvency II firms (with a proportionate approach for smaller firms).

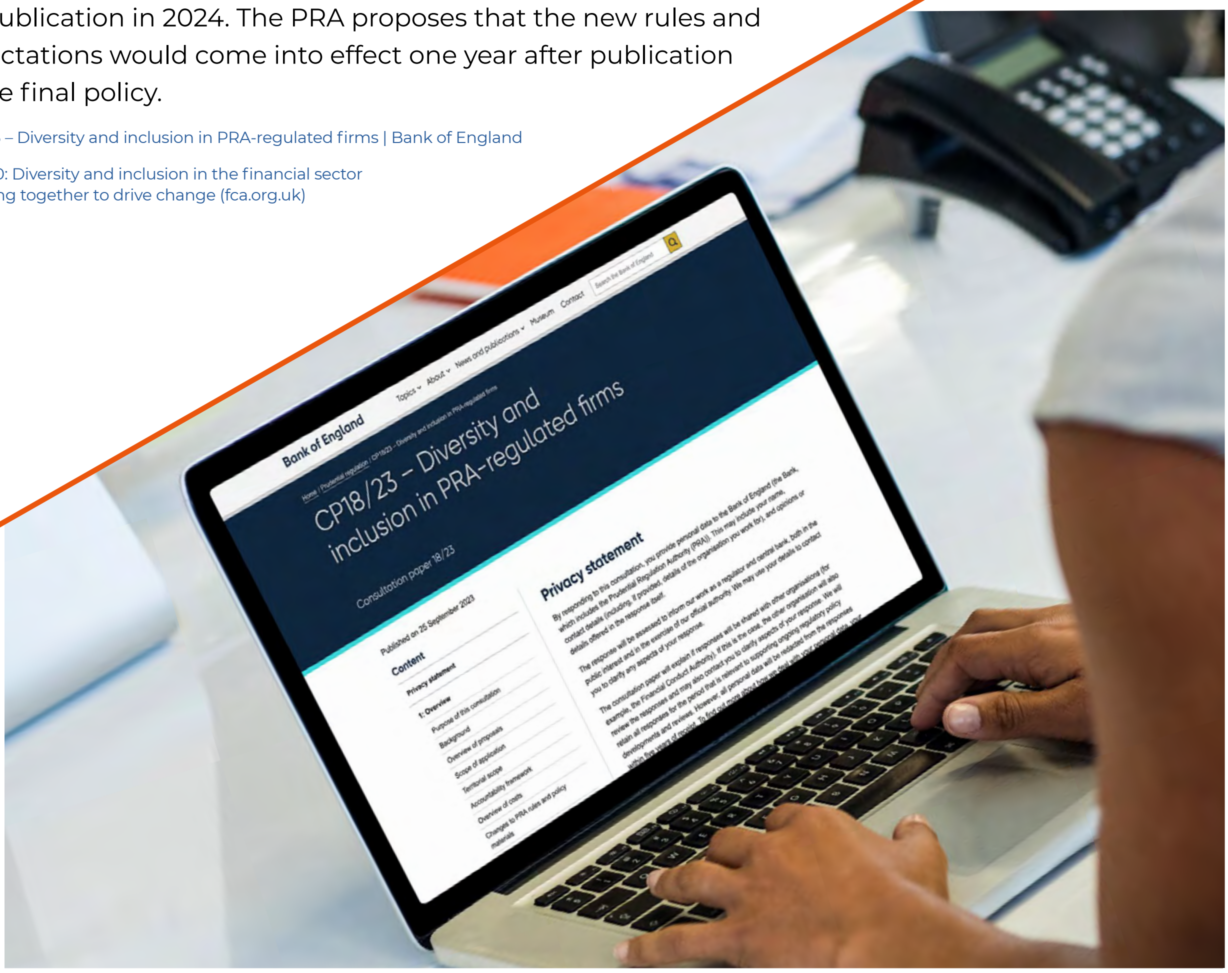
The FCA have proposed a consistent set of proposals aimed at reducing discrimination and misconduct.

The PRA appear to exclude friendly societies from the above proposals but there is some ambiguity over this, with the 'scope of application' defined in the consultation appearing to include Solvency II regulated friendly societies. We are following this up with the regulator to obtain clarity.

The consultation is open until 18 December 2023. Final rules are planned for publication in 2024. The PRA proposes that the new rules and expectations would come into effect one year after publication of the final policy.

CP18/23 – Diversity and inclusion in PRA-regulated firms | Bank of England

CP23/20: Diversity and inclusion in the financial sector – working together to drive change (fca.org.uk)



FCA’s priorities for 2023-2025

On 20 September, the Financial Conduct Authority (FCA) sent letters to CEOs of all insurance firms with an update on the conduct regulator’s priorities for 2023-2025, the sector-specific risks of harm causing supervisory concern and actions firms are expected to take.

The market-wide priorities are:

- Embedding the Consumer Duty
- Governance and culture
- Operational resilience
- Improving oversight of Appointed Representatives

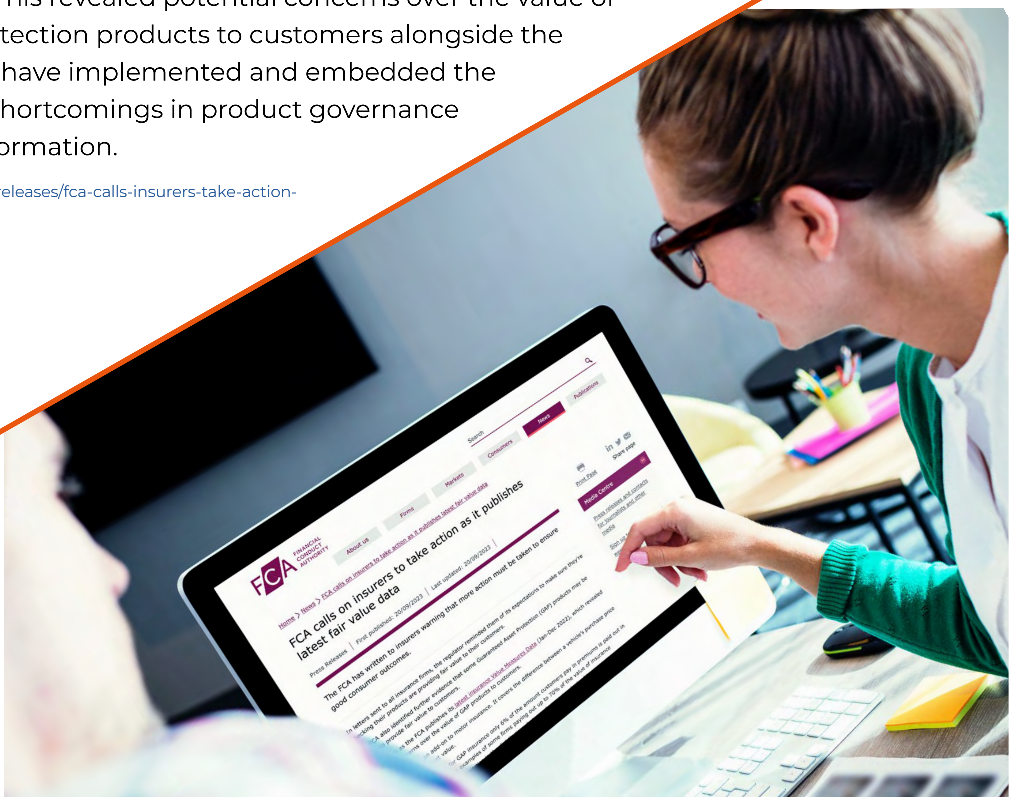
Life insurance specific priorities include:

- Price and (fair) value, including consumer understanding and transparent charges
- Consumer support and service quality, including intended standards
- Effective customer journeys, including appropriate guidance
- Supporting customers in financial difficulty
- Effectiveness of outsourcing oversight, including the need for both insurers and Third Party Administrators to understand and have implemented their respective responsibilities
- Suitability and value of life protection products, including monitoring brokers and commission structures
- Sustainability-related investments and disclosures

Smaller life insurers should note that the life insurance portfolio letter explicitly states “We will be specifically engaging with smaller firms to understand how they are meeting Consumer Duty requirements and delivering good customer outcomes in a sustainable way.”

On the same date, the FCA published its latest insurance Value Measures Data (Jan-Dec 2022). This revealed potential concerns over the value of Guaranteed Asset Protection products to customers alongside the extent to which firms have implemented and embedded the Consumer Duty and shortcomings in product governance and management information.

https://www.fca.org.uk/news/press-releases/fca-calls-insurers-take-action-publishes-latest-fair-value-data



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Artificial Intelligence (AI)

On 4 September, the Financial Services Consumer Panel (FSCP) published research on data ethics. The panel commissioned Thinks Insight and Strategy to conduct a review into how the use of personal data by financial services, particularly algorithms or AI-driven decisions combined with personal data, may impact different outcomes and lead to unfair treatment or discrimination against certain groups. The report points to some areas for concern and includes calls for firms to evidence that the tools they use to determine access, price and service of their products do not cause bias.

The UK supervisory authorities published a discussion paper, DP5/22, in October 2022 and the FCA explicitly mentioned the risk that the use of AI could be associated with discriminatory decisions. DP 5/22 stated “any use of AI in relation to an activity, business area, or management function of a firm would fall within the scope of a SMF manager’s responsibilities”.

https://www.fs-cp.org.uk/sites/default/files/202307_for_publication_data_use_research_report.pdf

Changing the tax system to support occupational health provision

On 20 July, the UK government published a consultation on how the tax system can support employers to increase provision of occupational health for their employees. It was accompanied by a consultation published by the Department for Work and Pensions on the role of non-fiscal levers in supporting greater occupational health provision.

The underlying papers, referenced in the consultation, may be of wider interest to employers and **income protection and health cash plan providers and their customers** noting recommendations to:

“[implement] multi-domain interventions (i.e. with healthcare provision, service coordination, and work accommodation components) to help reduce lost time for MSK or pain-related conditions and MH conditions. Practitioners should also consider implementing these programs to help improve work functioning and reduce costs associated with work disability.”

“There is an urgent need to improve vocational rehabilitation interventions for mental health problems, which are now the largest and fastest growing cause of long-term incapacity. Promising approaches include healthcare which incorporates a focus on return to work, workplaces that are accommodating and non-discriminating, and early intervention to support workers to stay in work and so prevent long-term incapacity.”

https://www.gov.uk/government/consultations/occupational-health-working-better

Consumer Duty and fair value

At the start of September, following concerns that not all savers are getting good deals, the FCA required 9 firms (banks and building societies) to provide them with their assessments of what value their savings products offer. This assessment follows the introduction of the Consumer Duty in July 2023 when the FCA said that they will take robust action by the end of 2023 against those who cannot demonstrate fair value.

The FCA also published the voluntary requirement whereby Direct Line Group must conduct a past business review of renewal prices charged since 1 January 2022. The FCA states that the firm charged some existing home and motor customers more than they would have done if they were a new customer.

Insurance Distribution Directive (IDD)

On 5 September, the FCA published Consultation Paper CP23/19 'Future Regulatory Framework - The Insurance Distribution Directive'. The proposals appear in line with the government's policy approach, following the UK's exit from the EU, to replace retained EU law with rules and "maintain the existing regulatory requirements".

https://www.fca.org.uk/publications/consultation-papers/cp23-19-future-regulatory-framework-insurance-distribution-directive

Sustainability-related disclosures

On 7 September, the FCA published their response to the International Sustainability Standards Board (ISSB) priorities for its next two-year work plan. The securities and conduct regulator views were that the strategic direction of the ISSB's work for the next 2 years should be towards embedding IFRS S1 and IFRS S2, while also launching a comprehensive work programme to build out a suite of investor-material sustainability-related disclosure standards beyond climate change (nature and social issues in the short and medium term respectively).

https://www.fca.org.uk/publication/corporate/fca-response-issb-exposure-drafts.pdf

Disclosure framework for climate transition plans

The Transition Plan Taskforce (TPT) is due to launch the best practice disclosure framework on 9 October 2023.

Transition plans typically set out a) high-level targets organisations are using to mitigate climate risk, including greenhouse gas reduction targets, b) interim milestones, and c) actionable steps the organisation plans to take to hit those targets.

Transition plans are included in the FCA Handbook and apply, amongst others, to larger insurers (ie those where relevant assets exceed £5bn) providing insurance-based investment products.

Insurers in financial difficulties

On 14 September, the PRA published PS12/23 – 'Dealing with insurers in financial difficulties'. This policy statement applies to all PRA-authorised insurers **(other than friendly societies)** with a Part 4A permission, regardless of their size or location. This policy statement aims to improve the likelihood that firms can exit the market safely or return to viability, while promoting continuity of cover for policyholders. These changes, related to write-downs, will be effective from 19 September.

https://www.bankofengland.co.uk/prudential-regulation/publication/2023/september/dealing-with-insurers-in-financial-difficulties

Economic inactivity

In 2023 there were 3.5m and 1.6m people aged 50 to 64 years and 35 to 49 years respectively who were economically inactive in the UK, of which the majority were women.

1.5m inactive individuals aged 50 to 64 gave **'sick or disabled'** as the main reason for not looking for work. For the 35 to 49 age group the figure was 0.7m. (The 'sick or disabled' comprise 8% of the total labour market for 35 to 64 year olds.)

The numbers "sick or disabled" represented over a 10% increase on 2022 for females in both age groups and males in the younger age group. The number of "sick or disabled" males age 50 to 64 was 4% lower than 2022.

Source: Table 10 Economic labour market status of individuals aged 50 and over, trends over time: September 2023

https://www.gov.uk/government/statistics/economic-labour-market-status-of-individuals-aged-50-and-over-trends-over-time-september-2023/economic-labour-market-status-of-individuals-aged-50-and-over-trends-over-time-september-2023

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