Recent Regulatory Developments Affecting the Insurance Industry in the UK and EU

23 August 2021

This note examines selected regulatory developments affecting the insurance industry in the United Kingdom (the "UK") and the European Union (the "EU").

United Kingdom

PRA Consultation Paper on Phase 1 of a Review of Solvency II Reporting and Disclosure Requirements

On 8 July 2021, the Prudential Regulation Authority (the "PRA") published a consultation paper on a review of reporting requirements under the Solvency II regime (CP11/21). The consultation paper sets out proposed changes to the Solvency II reporting requirements and expectations.

This consultation paper represents the first of two phases of the PRA's consultation on changes to Solvency II that aims to reduce the volume of financial information reported to the PRA and that could potentially be implemented by firms and the PRA relatively quickly, and with a low operational impact.

The proposals in this consultation paper would result in the following changes to existing policy material:

Policy material	Proposal
The UK Commission Implementing Regulation (EU) 2015/2450 Instrument 2021	The proposed PRA Technical Standards instrument would amend the UK Commission Implementing Regulation (EU) 2015/2450 Instrument 2021 by removing the requirement to report certain Solvency II Quantitative Reporting Templates and by increasing the proportionality threshold for reporting on certain non-life insurance obligations.

Policy material	Proposal
Minimum Capital Requirement Part of the PRA Rulebook	The proposed instrument would amend Rule 4.1 of the Minimum Capital Requirement Part of the PRA Rulebook by reducing the reporting frequency of the minimum capital requirements from a quarterly to a semi-annual basis.
Supervisory statement SS11/15: regulatory reporting and limitations	The proposed supervisory statement would expand the PRA's current reporting exemption for Category 4 and 5 firms to include Category 3 firms.

PRA Speech on Aspects of the Solvency II Review Process

On 15 June 2021, the PRA published a speech by its Executive Director of Insurance, Anna Sweeney, on plans to assess the impact of potential prudential policy changes under the current review of Solvency II.

The speech outlines that as long as the foundation of adequate policyholder protection remains in place, there will be scope for making changes that meet the review objectives of fostering an innovative and competitive insurance sector and supporting insurance firms to provide long-term capital to support growth. To better understand the capacity to make any changes to the existing regime, the PRA is carrying out a quantitative impact study ("QIS") to project the impact of various proposals.

The QIS covers the Risk Margin, the Matching Adjustment (including a particular focus on how the Matching Adjustment could be reformed to provide adequate protection given the wide range of assets annuity writers hold) as well as elements of the Transitional Measure on Technical Provisions. Participation is voluntary, but the PRA has written to a variety of firms in each sector strongly encouraging them to participate.

Additionally, Ms. Sweeney provided an update on the PRA's intention to stress test firms in 2022. Noting the PRA's aspirations to use stress testing increasingly centrally in its supervisory approach, she cautioned that there is no intention for a radical departure from the current ways of setting capital requirements. A consultation on the changes is expected in early 2022.

PRA Statement on Firm Authorisation under the Temporary Permissions Regime

On 14 June 2021, the PRA published in a statement that it has an extended time period to process authorisation applications from insurers in the Temporary Permissions Regime (the "TPR") (currently up to the end of 2023).

The PRA notes that it has received a considerable volume of applications of varying scale and complexity across a range of different business models following the end of the Brexit transition period on 31 December 2020 and that some firms in the TPR may choose not to apply for authorisation until the end of 2022.

Given the above, and the PRA's stated approach of taking authorisation decisions on a case-by-case basis dependent on PRA resourcing and governance processes, it is likely that multiple authorisation decisions may be taken on the same date. Consequently, some firms may receive an authorisation outcome before others, though that is not an indication of the PRA's perception of risks at individual institutions.

FCA Policy Statement on General Insurance Pricing Practices

On 28 May 2021, the Financial Conduct Authority (the "FCA") published a policy statement on general insurance pricing practices that sets out a number of rule changes:

- A pricing remedy requiring firms to ensure that their renewing clients pay no more than the equivalent new business price (the "ENBP") for a new customer.
- Changes to the FCA product governance rules to ensure that firms implement processes which ensure that customers receive fair prices for products.
- Rules requiring firms to ensure customers wishing to cancel auto-renewal on their policies are offered a range of accessible and easy options for doing so.
- Reporting requirements to help the ongoing supervision of the home and motor insurance markets and to help the FCA monitor firms.

Pricing Remedy

The new pricing remedy is designed to ban "price walking", a practice which meant long-standing customers were offered a higher renewal rate than the price offered to new customers. Under the new rules, when an insurer offers a renewal price to an existing customer, this price should not be greater than the ENBP offered to a new customer. The rules on pricing will come into effect on 1 January 2022.

Product Governance Rules

The current product governance rules require firms to have appropriate processes in place when manufacturing, distributing and managing products. Firms are now required to consider whether their products would represent fair value for customers. These rules on product governance will come into effect on 1 October 2021.

Cancelling Auto-Renewing Policies

The FCA now requires that firms must provide consumers with a range of accessible and easy options for opting out of the automatic renewal of policies. The process should not place unnecessary barriers on consumers wanting to opt out of or stop any auto-renewal, and importantly, consumers should be informed at the outset whether their policy is set to renew automatically and what this means. The rules on auto-renewal will come into effect on 1 January 2022.

Reporting Requirements

Firms will be required to submit regular reports showing pricing information for retail home and motor insurance, as well as information about add-on policies and premium finance marketed alongside these products.

The reports, which are only intended to be a snapshot of the pricing practices used, will need to cover average premiums charged to customers, net and gross price information and expected claims ratios. The rules on reporting will come into effect on 1 January 2022.

PRA Policy Statements on Outsourcing and Third-Party Risk Management

On 29 March 2021, the PRA published a policy statement (PS7/21) and its final supervisory statement (SS2/21) on outsourcing and third-party risk management.

The statements, which follow a 16-month consultation (CP30/19), set out how the PRA expects PRA-regulated firms (including (re)insurance firms and groups in scope of Solvency II, Lloyd's of London and its Managing Agents) should comply with regulatory requirements and expectations relating to outsourcing and third-party risk management.

The PRA has three stated aims for the statements:

- To facilitate greater resilience and adoption of cloud technology and other new technologies.

- To complement the requirements and expectations on operational resilience in the PRA Rulebook.

- To implement selected European Banking Authority (the "EBA") guidelines.

Definitions and Scope

As originally proposed in the consultation paper, arrangements performed or provided in a prudential context were to be presumed to fall within the definition of 'outsourcing' in the PRA Rulebook. The final supervisory statement does not retain this presumption but instead states that firms should assess the materiality and risks of all third-party arrangements using the criteria outlined in the supervisory statement, irrespective of whether they fall within the definition of outsourcing. The supervisory statement also goes further, requiring firms to implement effective, risk-based controls where non-outsourced, third-party arrangements are deemed to be material or high risk.

Of interest to respondents to the consultation paper was how cloud service providers should be treated. The supervisory statement reiterates that firms should use the criteria set out in the supervisory statement when determining whether an arrangement is either outsourcing or a material third-party arrangement. Nevertheless, the PRA's Deputy CEO recently noted that firms' operational resilience policies would help with the challenges of overseeing outsourced service providers.

Proportionality and Materiality

The PRA recognises that the concepts of proportionality and materiality overlap and that both concepts inform how firms apply the expectations in the supervisory statement. They also accept that firms' approaches to outsourcing and third-party risk management should match their size, risk profile and systemic significance. The PRA has also included additional examples of how proportionality can apply to intra-group arrangements and third-country branches.

Governance and Record-Keeping

The PRA is planning a follow-up consultation setting out proposals for an online portal that would require firms to submit information on their outsourcing and third-party arrangements. In the meantime, the policy statement requires firms to continue to follow existing record-keeping requirements and expectations on outsourcing arrangements appropriate to their complexity, organisational structure and size.

Data Security

The supervisory statement requires that firms adopt a risk-based approach to the location of data that allows firms to leverage the operational resilience advantages of outsourced data being stored in multiple locations and manage relevant risks. The supervisory statement also adopts certain EBA ICT Guidelines in applying data security requirements to all outsourcing and third-party arrangements, as data security can be a highly relevant consideration in non-outsourcing, third-party arrangements.

Firms are expected to comply with the expectations in this supervisory statement by 31 March 2022. Given the widespread use and operational importance of outsourcing, insurers, banks and third-country branches should ensure the requirements introduced are incorporated into existing frameworks as soon as possible to ensure compliance by 31 March 2022.

European Union

European Commission Communication and Legislation on Sustainable Finance and Taxonomy

On 21 April 2021, the European Commission (the "Commission") published a communication regarding a package of measures aimed at improving the flow of money towards sustainable activities across the EU. These measures include:

- The EU Taxonomy Climate Delegated Act.
- A proposal for a Corporate Sustainability Reporting Directive.
- Commission Delegated Regulation amending the Solvency II Delegated Regulation as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings (C(2021) 2628).

EU Taxonomy Climate Delegated Act

The Commission announced that it has adopted Commission Delegated Regulation supplementing the Taxonomy Regulation ((EU) 2020/852) relating to climate change mitigation and adaptation (the "Delegated Act") which will apply from 1 January 2022. The EU's Taxonomy Regulation, which entered into force on 12 July 2020, helps create a classification system for environmentally sustainable economic activities. *For further information, please see our updates on ESG in the Insurance Sector: Growth, Opportunities and Risks and EU Taxonomy Regulation.*

The Delegated Act is a transparency tool to help companies and investors make sustainable investment decisions. It does so by introducing technical screening criteria defining whether a specific economic activity qualifies as contributing substantially to climate change mitigation or adaptation, as well as technical screening criteria for determining whether a particular economic activity causes significant harm to one or more environmental objectives as prescribed by the Taxonomy Regulation.

The Commission envisages that the Delegated Act, together with the Taxonomy Regulation, will attract investors interested in green opportunities by ensuring more reliable and comparable sustainability information is publicly available on the market for investors and stakeholders. For example, investors who want to make a positive environmental impact will be interested in Taxonomy-aligned economic activities, as they will know that the given activity meets the established standards.

Corporate Sustainability Reporting Directive

The Commission has also adopted the text of a proposal for a Corporate Sustainability Reporting Directive (the "CSRD") (2021/0104 (COD)), which amends reporting requirements contained in the Non-Financial Reporting Directive (2014/95/EU) (the "NFRD"). *Please refer to our update on ESG in the Insurance Sector: Growth, Opportunities and Risks for more information.*

The CSRD aims to ensure that companies report reliable and comparable sustainability information needed by investors and other stakeholders and that the sustainability reporting standards are consistent with the existing legal framework, the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation.

The proposed CSRD extends the scope of the sustainability reporting requirements to:

- all listed SMEs; and
- all large companies (as defined in the Accounting Directive[1]), whether listed or not and without the previous 500-employee threshold.

The change means the regime will now affect approximately 50,000 companies compared to the 11,000 currently within the scope of the NFRD.

The proposal will require companies to report on how sustainability issues such as climate change affect their business, and the impact of their activities on people and the environment consistent with the current regime under the NFRD.

It is thought that the Commission should be able to adopt the first set of reporting standards under the new legislation by the end of 2022.

Commission Delegated Regulation

On 21 April 2021, the Commission also adopted:

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[1] Large companies are defined as companies that exceed at least two of either (i) a balance sheet total of €20,000,000, (ii) net revenue of €40,000,000, and (iii) average number of employees during the financial year of 250.

- A Delegated Regulation amending the Solvency II Delegated Regulation as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings (C(2021) 2628).

  The Solvency II Delegated Regulation specifies requirements on governance, conflicts of interest and risk management for (re)insurance undertakings. Delegated Regulation C(2021) 2628 requires (re)insurers to reflect sustainability risks in their risk management processes by requiring that (re)insurers' actuarial functions take into account sustainability risks in their assessments of the uncertainty associated with estimates made in the calculation of technical provisions, and by requiring that sustainability risks are taken into account in the implementation of the prudent person principle.

- A Delegated Regulation amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products (C(2021) 2614 final).

  Delegated Regulation C(2021) 2614 final amends these regulations by clarifying that sustainability factors should be considered by insurers in suitability assessments and by integrating sustainability risks into the product oversight and governance requirements and into the rules on conflicts of interest.

Both Delegated Regulations will enter into force 20 days after their publication in the Official Journal and will apply 12 months after publication (expected to be by autumn 2022).

EIOPA Opinion on Supervising Use of Climate Change-Risk Scenarios in ORSA

The European Insurance and Occupational Pensions Authority ("EIOPA") has published an opinion on the supervision of the use of climate change-risk scenarios in insurers' own risk and solvency assessments ("ORSA").

The opinion, which is addressed to national competent authorities ("NCAs"), sets out expectations on the supervision of the integration of climate change-risk scenarios by insurers in their ORSAs.

The opinion follows an information request from EIOPA which revealed that only a small minority of insurers assessed climate change risks in their ORSAs. Moreover, among the few that did, most of them made assessments that took only a short-term perspective. EIOPA notes however, that the (re)insurance industry will be impacted by climate change in both the short and long term, as business strategies are disrupted by rising underwriting risks of undertakings and affected asset values, triggered by rising global temperatures and the associated physical risks.

(Re)insurers are therefore expected to integrate climate change risks in their system of governance, risk-management systems and ORSAs. In the ORSA, (re)insurers should also assess and identify material climate change risk exposures and subject the material exposures to a risk assessment.

Specifically, climate change risks should be assessed not only in the short term but also in the long term as evidence already shows that climate change is affecting (re)insurers with the incidence and severity of natural disasters and extreme weather events.

EIOPA expects NCAs to collect qualitative and quantitative data to perform a supervisory review of the analysis of short and long-term climate change risks in the ORSA, the results of which EIOPA began monitoring in April 2023.

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Please do not hesitate to contact us with any questions.

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