

Client Update

UK and European Insurance Regulatory Developments, Autumn 2016

LONDON

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INTRODUCTION

The last few months of 2016 have been notable for significant developments in the UK insurance industry. Here, we highlight the key regulatory and legislative items, including the recently published reforms to Insurance Linked Securities (“ILS”) and Insurance Special Purpose Vehicles (“ISPVs”) proposed by HM Treasury, the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”). We also examine the latest guidance and consultations on Solvency II.

HM TREASURY – INSURANCE LINKED SECURITIES

The [Autumn Statement Policy Paper](#), delivered by the United Kingdom’s Chancellor of the Exchequer on 23 November 2016, set out the government’s plan to make London a global centre for ILS, the process by which insurance risk is transferred to the capital markets through debt or equity securities.

HM Treasury has launched a [consultation](#) on its Risk Transformation Regulations 2017 (the “Regulations”) and the Risk Transformation (Tax) Regulations 2017 (the “Tax Regulations”), building on a [previous consultation](#) on ILS in March 2016. This regulatory package is intended to attract ILS business away from offshore jurisdictions into the United Kingdom. HM Treasury is focusing on areas such as tax, corporate governance and authorisation in order to simplify the United Kingdom’s current comparatively complex system. The aim is to allow greater competition with the major ILS markets, such as Bermuda, Guernsey and Gibraltar.

Transforming London into an international ILS hub will not be without its challenges. The major ILS locations have cultivated their prominence in the market through minimal regulatory interference and very low taxation, and it remains to be seen to what extent the United Kingdom will be able to replicate such ILS-friendly conditions.

The draft Regulations will operate as a separate legislative regime to the Companies Act 2006 and will apply to ISPVs, which can either be the new protected cell companies (“PCCs”) or single transaction special purpose vehicles.

The consultation on the Regulations and the Tax Regulations closes on 18 January 2017.

FCA/PRA – INSURANCE SPECIAL PURPOSE VEHICLES

Alongside the Treasury consultation noted above, the PRA and the FCA have published a [joint consultation paper](#) on the authorisation and supervision of ISPVs. The consultation is intended to gain industry insight into a draft PRA/FCA statement, “Authorisation and Supervision of Insurance Special Purpose Vehicles”.

The statements detail the regulators' outlook and requirements with regard to ISPV and PCC applications, and the need for future compliance with regulatory requirements following authorisation. The statements include notification details and draft application forms to be used in the authorisation process and ongoing supervision of ISPVs and new cells.

The significant cover that ILS can deliver through ISPVs makes it an effective tool in risk mitigation, and this is recognised by the Solvency II directive. In order to remain in line with Solvency II, ISPVs will be required to conform to certain requirements relating to funding, corporate governance, investor rights subordination and the actual transfer of risk.

The joint PRA/FCA consultation closes on 23 February 2017.

TREASURY SELECT COMMITTEE SOLVENCY II INQUIRY: ABI RESPONDS

The Association of British Insurers (“ABI”) has published an [overview response](#) to the House of Commons Treasury Select Committee’s investigation into the regulatory framework under Solvency II.

The ABI has generally backed the suitability of Solvency II for the United Kingdom market. Given the referendum decision to withdraw from the European Union, there remains uncertainty as to what relationship the United Kingdom will have with Solvency II post-Brexit.

The ABI has confirmed that, given the extensive contribution the United Kingdom made in the crafting and development of Solvency II and the net benefits it has for the industry, it feels the focus should be on how to make the regime work best for the United Kingdom, rather than repealing or replacing it.

Furthermore, given the emphasis on preserving passporting rights and gaining equivalence, maintaining input into the development of Solvency II would be desirable for British (re)insurers.

Certain areas have been identified by the ABI as requiring attention and reform, including; risk margin, reporting requirements and removing barriers to long-term investments.

PRA PUBLISHES STATEMENT ON MODEL DRIFT UNDER SOLVENCY II

On 25 October 2016, the PRA published a [supervisory statement](#) on its plans for monitoring model drift and reporting of the Standard Formula solvency capital requirements for Solvency II firms. This follows a consultation on this statement in May 2016. Model drift remains a key concern for the PRA, as their supervisory role is crucial under Solvency II rules.

In response to the consultation feedback, the PRA has clarified particular areas regarding the Standard Formula calculation, how ratios will be rebased, the extent of external auditing and the timings around quantitative reporting templates.

This supervisory statement should help crystallise expectations for Solvency II firms when dealing with model drift and regulatory reporting requirements.

A statement was also published on 10 October 2016 which clarified and updated the reporting instructions for firms outside Solvency II.

SOLVENCY II AND DIRECTORS' LETTERS

A [policy statement](#) from the PRA on Directors' letters under Solvency II was published on 25 November 2016. The statement is a response to the May 2016 consultation on the matter and there have been amendments to the supervisory text. The PRA has now published supervisory statements which include guidance on internal models, longevity risk transfers, counterparty credit risk and the recognition of deferred taxation.

The Directors' letters, upon which the PRA based their supervisory statements, will be archived.

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Please do not hesitate to contact us with any questions.