

UK and European Insurance Regulatory Developments, Q2 2018

July 11, 2018

In this client update we highlight some recent insurance regulatory developments, both in the United Kingdom (the “UK”) and the European Union (the “EU”) in Q2 2018.¹

Solvency II

**Debevoise
& Plimpton**

On 17 April 2018, the European Commission (the “Commission”) published the draft [delegated regulation](#) to amend the securitisation calculations under Solvency II. The draft is intended to align the calculations with the simple, transparent and standardised securitisation (“STS”) regulation² so that insurers would not be subject to different sets of requirements. The regulation also provides for an adapted charge for Solvency II for different tranches of STS securitisations, which will be welcomed by the industry.

On 17 May 2018, the Commission [requested information](#) from the European Insurance and Occupational Pensions Authority (“EIOPA”) on the impact of Solvency II on long-term insurance and reinsurance activities. EIOPA should respond to the Commission’s request by 16 December 2019 and will follow up with a call for advice closer to the 1 January 2021 statutory review deadline.

EIOPA Supervision

On 24 April 2018, EIOPA published its [supervisory convergence work plan](#), which identified certain priority areas, including practical implementation of the common supervisory culture and supervision of emerging risks.

On 14 May 2018, EIOPA [announced](#) the launch of the 2018 EU-wide stress test for the insurance sector. Each stress test is tailored to recent developments in market conditions and the scenarios encompass both market- and insurance-specific risks.

¹ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014

² Regulation (EU) 2017/2402 of 12 December 2017

The stress test targets 42 European insurance groups (representing around 78% of European market coverage). The full list of the participating insurance groups can be found [here](#). These were selected according to their size, market coverage and relevance for financial stability. Results should be submitted by 16 August 2018 and the results will be published in January 2019.

Brexit Developments

Brexit clauses

Lloyd's published the [binding authority sunset endorsement](#), which prohibits the binding of business with an EEA regulatory risk location after 31 December 2018, in line with recent Lloyd's [guidance](#). The model clause may be used on any binding authority agreement terminating after 31 December 2018 that encompasses EEA business. Lloyd's drafted the model clause to manage the transition of binding authority business to its Brussels subsidiary.

The International Underwriting Association also published a [Brexit contract continuity clause](#) that enables risk to be placed with both a UK-domiciled insurer and a contingent EU-based insurer. This is designed to allow the contingent insurer to step in and fulfil any policy obligations of the original carrier if a "Brexit event" occurs.

EIOPA Brexit opinion

On 18 May 2018, EIOPA published an [opinion](#) on the solvency position of insurance and reinsurance undertakings in the EU27 member states after Brexit, in particular the impact of the UK becoming a third country. The opinion focuses on risks arising under Solvency II (which distinguishes between risks arising inside and outside the EU). The opinion sets out Brexit-related changes that may occur including:

- **Derivatives:** Derivatives can be recognised in the calculation of the Solvency Capital Requirement ("SCR"), subject to certain conditions, including that the transfer of risk is effective in all relevant jurisdictions. After Brexit, UK banks will lose their Markets in Financial Instruments Directive ("MiFID") passport, threatening whether UK banks' derivatives can be recognised as effectively transferring risk.
- **Credit Ratings:** The calculation of a firm's SCR for various types of risk is based in part on the ratings of the assets that the firm holds. Undertakings may use an external credit rating if it has been issued by an external credit assessment institution. When UK credit rating agencies ("CRA") are deregistered after Brexit they will not qualify as an external credit assessment institution.

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- Continuity of service: Where measures are not taken to ensure continuity of service, undertakings may not be authorised to service contracts.
 - Government bonds: The SCR Charge for UK government bonds may increase, as these will no longer fall within the zero-risk charge for member states' government bonds. Depending on the credit quality step of UK government bonds, the SCR Charge for these exposures may increase.

EIOPA notes that the impact of some of the changes can be mitigated by measures including the relocation of UK exposures or UK CRAs to the remaining member states.

The Senior Managers and Certification Regime ("SM&CR")

In July, the [Financial Conduct Authority](#) (the "FCA") and [Prudential Regulation Authority](#) (the "PRA") published policy statements and near-final rules on the extension of the SM&CR to insurers, which will take effect from 10 December 2018. The final rules do not differ significantly from those proposed in the consultations launched last July by the [FCA](#) and [PRA](#) (see [here](#) for further details). These will not come into effect until HM Treasury has made the relevant amendments to the Financial Services and Markets Act 2000 and the rules may be amended accordingly.

The PRA's "Dear CEO" Letters

On 12 April 2018, the PRA published a "Dear CEO" [letter](#) on capital extractions by insurance firms in run-off. The PRA believes that the quality of the information submitted by insurance firms in run-off in requests for capital extraction has been inadequate, particularly in relation to stress tests and reserving. The PRA's SS4/14 sets out its expectations on the required information.

In a subsequent "Dear CEO" [letter](#), the PRA set out the market conditions facing specialist general insurers and the key findings from its recent supervisory work, which indicate that some firms are reporting underwriting performance consistently below the levels required to achieve sustained profitability and that underwriters are making insufficient use of technical pricing models. The PRA noted that firms who continue to show some of the weaknesses outlined in the letter are more likely to find themselves under regulatory scrutiny. The PRA asks for a summary of the responses by category 1, 2 and 3 firms by 27 July 2018.

Part VII Transfers

The FCA published [finalised guidance](#) on 29 May 2018, which sets out the FCA's approach to reviewing insurance business transfers (also known as Part VII transfers). In particular, the FCA emphasised its right to be consulted on applications for a Part VII transfer. The FCA also emphasised its right to review the choice and report of the independent expert. The FCA will also review the Scheme Document, looking for clarity on the business and liabilities being transferred (including any changes) and continuity of proceedings against the transferor.

Supervision of Insurance and Reinsurance Undertakings within a Group

In April the Commission published a [report](#) on the supervision of insurance undertakings within a group. EIOPA [reported](#) to the Commission certain concerns with the definition of a group, especially for non-EEA structures. The Commission also recognised that due to divergences among member states, EIOPA requires enhanced powers to bring about greater convergence in relation to group internal models.

Sustainable Investing

The International Association of Insurance Supervisors ("IAIS") published a [draft issues paper](#) on climate change risks to the insurance sector. IAIS notes it is likely that all insurance businesses will be exposed to climate risks in the future and that all insurers must achieve the necessary resilience. In addition, supervisory bodies will need to evaluate insurers' underwriting and investment activities to achieve climate resilience.

In May 2018, the Commission published legislative proposals on sustainable finance reforms, including disclosure requirements on sustainable investing and sustainability risks. The European Parliament and Council of the EU will consider these proposals.

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Please do not hesitate to contact us with any questions.

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