Client Update

European Insurance Compendium Update, August 2017

INTRODUCTION

Despite Brexit and June's British election causing a lull in regulatory news, there have been continuing developments in the insurance sector. This client update aims to highlight recent key developments.

EIOPA—OPINION ON SUPERVISORY CONVERGENCE IN LIGHT OF THE UNITED KINGDOM WITHDRAWING FROM THE EUROPEAN UNION

11 July 2017—The European Insurance and Occupational Pensions Authority ("EIOPA"), the European insurance regulator, published an opinion focused on the supervisory convergence of European jurisdictions in response to Brexit. EIOPA aims to play an active role in building a common supervisory culture throughout the European Union, though the opinion does not go as far as some other European regulators in mandating an even playing field for regulators seeking to attract United Kingdom firms seeking a foothold in Europe.

The opinion assumes that the UK's withdrawal from the EU includes the UK leaving the European single market, and that, as a result, the UK will become a third-country (non-EU) jurisdiction for the purposes of applying the Solvency II framework. EIOPA notes that once the UK withdraws from the single market, UK insurance and reinsurance companies will lose their right to conduct business across the EU Member States by way of freedom of establishment and freedom to provide services. UK firms may seek to relocate or set up new businesses in Europe to maintain access to the EU single market. EIOPA believes that the challenge caused by Brexit requires a common effort at the EU level to ensure a consistent supervisory approach to the potential undertakings.

The opinion also sets out guidance on the application of the existing legal framework in considering arrangements between European and non-European entities. EIOPA will continue to monitor developments, applying a risk-based approach and using information collected from Members.

EUROPEAN COMMISSION—ADOPTION OF DELEGATED REGULATION AMENDING THE SOLVENCY II DELEGATED REGULATION CONCERNING CAPITAL REQUIREMENTS FOR INFRASTRUCTURE COMPANIES

8 June 2017—The European Commission adopted a Delegated Regulation amending the Delegated Regulation (EU) 2015/35 governing the calculation of regulatory capital requirements for investments by insurance and reinsurance companies in companies holding infrastructure assets, known as infrastructure corporates.

What Are Infrastructure Corporates?

An infrastructure corporate is an entity or corporate group that carries out activities that provide or support essential public services such as energy generation, social housing and healthcare. Loans to infrastructure corporates are usually unsecured, which makes them riskier than other infrastructure investments, such as infrastructure projects.

Before the new regulation, infrastructure corporates were treated like any other company or corporate entity. For equity investments, this meant that their treatment depended on whether (and where) the company was listed. For debt investments, the treatment depended on the ratings and duration of the debt.

How Will the Delegated Regulation Affect Insurance Companies?

Essentially, the Delegated Regulation reduces the capital charges attached to investments by insurance companies in infrastructure corporates. It does this in two key ways: (i) it simplifies the definition for infrastructure corporates and ensures consistency with infrastructure projects; and (ii) it reduces the risk calibration for infrastructure by 25% and treats unrated debt at par with BB-rated debt. By reducing the capital charges for insurance companies, the Delegated Regulation aims to promote growth in infrastructure investment in the EU.

What Does This Mean for Now?

The Council of the EU and the European Parliament still must approve the amending Delegated Regulation before it can be published in the Official Journal of the EU and enter into force.

EIOPA—CONSULTATION ON FIRST SET OF ADVICE TO THE EUROPEAN COMMISSION ON SOLVENCY II REVIEW

4 July 2017—EIOPA issued a consultation paper on its first set of advice to the European Commission on its planned Solvency II review.

In the paper, EIOPA sets out draft advice for the following:

- Simplified calculations.

- Reducing reliance on external credit ratings in the standard formula.
- Treatment of guarantees, exposure guaranteed by a third party and exposures to regional governments and local authorities.
- Risk-mitigation techniques.
- Look-through approach on investment-related vehicles.
- Undertaking specific parameters.
- Loss-absorbing capacity of deferred taxes.

One of EIOPA's key proposals is the extension of the "look-through approach" (which requires insurers to calculate their Solvency Capital Requirement ("SCR") for investments in investment funds (collective investment undertakings) to count the underlying assets) to investments in "related undertakings" (undertakings whose purpose is holding assets on behalf of their parent undertaking). As the look-through approach does not currently extend to investments in related undertakings, this may have an impact on an insurer's calculation of its SCR.

The deadline for responses is 31 August 2017. EIOPA intends to finalise its advice in October 2017.

INSURANCE-LINKED SECURITIES REGULATIONS

20 July 2017—The HM Treasury published the final draft regulations that will implement the new regulatory framework for insurance-linked securities (ILS). It also published the tax regulations relating to ILS. The regulations set out how to establish special vehicles to issue ILS, the legal framework for ILS, and the associated tax treatment. The government aims to have the regime in force by autumn 2017. The announcement further signals the government's intent to make London and the UK a global centre for ILS.

What Are Insurance-Linked Securities?

The broad term "Insurance-Linked Securities" covers a range of financial instruments relating to the insurance market. An ILS is, generally speaking, a financial instrument whose value is determined by an insurance loss event. It is in effect a type of reinsurance: the risk and potential liability of an insurance contract is transferred from the insurers to investors. It also allows insurers and reinsurers to tap into additional and new forms of funding. There are two main types of ILS: catastrophe bonds and mortality bonds, although other forms of ILS do exist.

ILS can be attractive investments as they can be traded on the capital markets and have little or even no correlation with the wider financial market, as their value is linked with non-financial risks. From the perspective of the insurer, ILS can act as a fully-collatorised, multi-year reinsurance contract.

FCA'S REVIEW OF UK ASSET MANAGERS AND FURTHER CONSULTATION

29 June 2017—The United Kingdom Financial Conduct Authority ("FCA") published its final report on the UK's asset management sector.

In relation to insurance companies, the FCA is looking into bringing into the scope of its reform retail investment products sold by insurers in the form of unit-linked or with-profits products (such as personal pensions, investment bonds and endowments). Insurance companies could also be caught under the FCA's governance reforms, such as the strengthened duty to act in the best interests of investors.

In addition to the report, the FCA published a consultation on implementing the proposed remedies. It discusses extending the scope of the proposals to other retail investment products, such as unit-linked or with-profits insurance products. The FCA argues that strengthening requirements for fund managers, but not insurance companies, could lead to unintended consequences for competition between firms offering economically similar products. If the asset managers are incentivised to offer products through a different, less regulated vehicle, it would defeat the objective of the FCA of improving outcomes for investors.

The deadline for responses is 28 September 2017.

IAIS RELEASES ICS VERSION 1.0 FOR EXTENDED FIELD TESTING

21 July 2017—The International Association of Insurance Supervisors ("IAIS"), the global body of insurance regulators, announced the release of the Insurance Capital Standard ("ICS") Version 1.0 for extended field testing.

The risk-based ICS is one component of the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame"). ComFrame is a set of international quantitative and qualitative supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups ("IAIGs").

Extended field testing means that the field testing exercise is extended to all potential IAIGs and other interested groups. Around 50 of the world's largest insurance groups are involved in the extended field testing process. The exercise contains extensive data requests on technical and policy issues that the IAIS will be seeking to resolve for ICS Version 2.0.

Although ICS Version 1.0 is not a formal consultation document, the IAIS welcomes feedback, and will consider any it receives while it develops ICS Version 2.0.

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Please do not hesitate to contact us with any questions.

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