

UK and European Insurance Regulatory Update

9 December 2019

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

International Association of Insurance Supervisors

In November, the International Association of Insurance Supervisors (the “IAIS”), in a step towards the establishment of a global standard for insurance regulation, adopted a global supervision framework, consisting of three parts:

- the Common Framework (the “ComFrame”), which establishes supervisory minimum standards and guidance for the group-wide supervision of Internationally Active Insurance Groups (“IAIGs”);
- the Insurance Capital Standard Version 2.0 (the “ICS”), which will be part of ComFrame and apply to IAIGs; and
- the Holistic Framework for the Assessment and Mitigation of Systemic Risk in the Insurance Sector.

The most contentious element, the ICS, aims to establish a group-wide capital standard that will enable supervisors to evaluate the health of insurance groups across jurisdictions on a comparable basis. The implementation of the ICS will begin in January 2020 with a five-year monitoring period, including confidential reporting by insurance groups to their supervisors. Although the IAIS encouraged IAIGs to participate, according to guidance published by the National Association of Insurance Commissioners, which follows concerns in the U.S. market, U.S. IAIGs will not be required to participate in the monitoring period with respect to the ICS.

Further discussion of the global supervision framework is available in our Debevoise Update that can be found [here](#).

Part VII Transfers

The Prudential Assurance Company Limited (“Prudential”) proposed to transfer £12.9 billion of annuity liabilities to Rothesay Life plc (“Rothesay”) under Part VII of the Financial Services and Markets Act (“FSMA”). In August, the High Court of England and Wales used its discretion under FSMA to refuse to sanction the transfer. The decision by the Court casts doubt on the industry assumption that the Court will sanction transfers that have the approval of both the independent expert and the regulators.

The Court’s key considerations in the decision to refuse to sanction the scheme were:

- the unique characteristics of annuities as compared to general insurance products, which encouraged the Court to consider non-actuarial and non-regulatory factors;
- the perception that the Prudential group would be more likely to fund the obligations of the annuities in the event of the annuity provider’s insolvency; and
- the importance placed on the established reputation and history of the Prudential group as a rational motivation for choosing an annuity provider by policyholders.

In September, an appeal to the Court of Appeal was filed by Prudential and Rothesay on the basis of an error of law. The appeal is expected to be heard in Spring 2020.

Further discussion of the decision is available in our Debevoise Update that can be found [here](#).

EIOPA Solvency II

In October, EIOPA published a [consultation paper](#) which set out technical advice as part of the 2020 European Commission’s (the “Commission”) review of Solvency II. EIOPA’s final advice to the Commission is expected to be published in June 2020. The paper is split into three parts:

- the review of the long-term guarantee measures;
- the potential introduction of new regulatory tools; and
- revisions to the existing Solvency II framework.

EIOPA is of the view that the Solvency II directive is generally functioning well overall. However, EIOPA's proposals suggest that it is willing to address problematic aspects of the Solvency II framework. In particular, EIOPA proposed measures designed to incorporate the macro-prudential perspective into the prudential framework. In addition, EIOPA revisited its previous advice to the Commission on the calibration of the interest rate risk module and challenged the Commission's approach to long-term equity investments, although EIOPA stopped short of making express recommendations on this issue.

Further discussion of the consultation paper is available in our Debevoise Update that can be found [here](#).

PRA Updates

Liquidity Risk Management

In September, the Prudential Regulation Authority (the "PRA") published a [policy statement](#) and [supervisory statement](#) on liquidity risk management for insurers. The most significant changes to the draft policy that were identified in the policy statement were:

- clarification of the PRA's expectations on the definition of the risk limits within an insurer's liquidity risk appetite framework;
- the role of the board in managing liquidity risk; and
- the function and characteristics of the liquidity buffer.

These changes were reflected in the accompanying supervisory statement.

Prudent Person Principle

In September, the PRA published a [consultation paper](#) on a draft supervisory statement to clarify the role of the Prudent Person Principle ("PPP") under Solvency II. The PRA has previously observed inconsistencies in the understanding and application of the PPP. The paper identifies the following areas where particular attention should be paid:

- investment strategy development and maintenance;
- the management of risks arising out of the investment function;

- investment in non-traded assets; and
- intra-group loans and participations.

Solvency Capital Requirements

In November, the PRA published a [statement](#) reminding insurers that there would be incoming changes on 1 January 2020 that could impact insurers' Solvency Capital Requirements ("SCR") under Solvency II. There are a number of changes being made, the most discussed of which is the change to the loss-absorbing capacity of deferred tax assets for those using the standard model or a partial internal model for the SCR calculation. Other changes that may affect the calculation of SCR relate to:

- segmentation of non-life insurance and reinsurance obligations;
- standard deviations for the non-life premium and reserve-risk sub-module;
- segmentation of Not Similar to Life Techniques ("NSLT") health insurance and reinsurance obligations; and
- standard deviations for the NSLT health premium and reserve risk sub-module.

Reserving Review

In November, the PRA published a "Dear Chief Actuary" [letter](#) addressed to the chief actuaries of general insurance firms regulated in the UK. The letter outlined the main areas of weakness and inadequate justifications that the PRA had seen in their recent actuarial work. These were:

- bias in reserve assessment;
- weakening of case-reserving basis;
- inadequate claims-inflation allowance;
- attritional loss deterioration; and
- transparency over key judgments and assumptions in management information.

Lloyd's Developments

Lloyd's and the Monetary Authority of Singapore (the "MAS") established, as a temporary measure while the Lloyd's Asia platform was being established, a scheme designed to enable Lloyd's underwriters to write Singaporean-domiciled risk from outside of Singapore.

The MAS has informed Lloyd's that the scheme will be repealed in November 2022 following a three-year transition period. This means that from 1 November 2022, Lloyd's underwriters based outside of Singapore will be able to write Singaporean-domiciled business on a cross-border basis in the following ways:

- Reinsurance business;
- Insurance business written via a Singapore intermediary which has obtained specific authorisation from the MAS; or
- Insurance business written without the involvement of a Singapore intermediary, i.e. directly from the insured.

The Lloyd's Asia Scheme Regulations permit Lloyd's underwriters to establish a service company on the Lloyd's Asia Platform and contain a positive list of permitted classes of business. However, there are a number of classes that are not "permitted", for example, Property General Liability and Accident and Health. Lloyd's has stated that it continues to discuss allowing Lloyd's underwriters on the Lloyd's Asia Platform to provide more specialist insurance products with the MAS.

Lloyd's has [encouraged](#) managing agents to engage with Lloyd's Asia as soon as possible to ensure that business can be retained.

Brexit Developments

In November, the Autorité de Contrôle Prudentiel et de Résolution (the "ACPR") published a [statement](#) saying that they would not comply with a recommendation by EIOPA for treatment of specific insurance policies in the event of a no-deal Brexit. The objection was to one of the nine recommendations published by EIOPA in February for the treatment of UK insurance undertakings and distributors should the UK leave the EU without a deal. The ACPR's objection relates to treatment of policies sold to policyholders who were in the UK at the time of sale but who are now resident or established in France. As a result, insurers must consider if they would be required to

make use of the French Run-Off Ordinance and, consequently, whether they will require the appropriate passports to continue to carry out business in France upon the UK's exit from the EU. The PRA has also released a [statement](#) advising insurers with relevant policies to seek legal advice and appropriate passports.

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Please do not hesitate to contact us with any questions.

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