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Corporate Insurance Newsletter February 2018

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UK

The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018: draft regulations published by HMRC

On 28 February 2018, HM Revenue & Customs (HMRC) published for consultation a draft version of the Insurance Companies (Taxation of Re-insurance Business) Regulations 2018, together with a related tax information and impact note.

The Finance Act 2012 introduced a new regime for taxing basic life assurance and general annuity business (BLAGAB) of life insurance companies. Specific anti-avoidance rules are required for re-insurance arrangements of BLAGAB to ensure the tax on investment returns from assets backing life insurance policies remains within the special tax regime. Regulations define the scope of the charge and provide the method for calculating investment returns.

These new regulations replace the previous regulations, the Insurance Companies (Taxation of Reinsurance Business) Regulations 1995, with rules that reflect modern commercial practice.

Comments are requested by 28 March 2018.

LMA publishes guidance for UK coverholders on IDD

On 28 February 2018, the Lloyd's Market Association (LMA) published guidance for UK coverholders on the Insurance Distribution Directive (IDD).

The guidance covers various aspects of the IDD including product oversight and governance, manufacturer responsibilities and insurance product information documents. The LMA has also published an accompanying model binding authority endorsement (LMA5312) which is attached as an appendix to the guidance.

Speech by Sam Woods, PRA on looking out for the policyholder

On 27 February 2018, the Bank of England published the text of a speech given by its Deputy Governor for Prudential Regulation and CEO of the Prudential Regulation Authority (PRA), Sam Woods, at the Association of British Insurers Annual Conference 2018.

Among other things, Mr Woods considered the role of the policyholder and reform of the Solvency II Directive. He also referred to the House of Commons Treasury Select Committee's report on the impact of Solvency II. The PRA published its response to this report on 27 February 2018, see item below.

PRA publishes final response to House of Commons Treasury Select Committee report on Solvency II

On 27 February 2018, the PRA published its final response to the House of Commons Treasury Select Committee's October 2017 report on the Solvency II Directive and its impact on the UK insurance industry. The PRA had published its interim response to the report in January 2018.

The final response is split into four parts:

- part 1 gives an overview of the UK insurance industry and sets out the rationale for the prudential regulation of insurers;
- part 2 discusses the design of Solvency II, how it differs from the previous prudential regime for insurers in the UK, and the impact Solvency II has had on insurers since it came into force on 1 January 2016;

- part 3 discusses the Select Committee's recommendation in respect of the PRA's secondary competition objective, and the points raised by the Select Committee about the PRA's engagement with industry and its skills and experience in insurance;
- part 4 responds to the specific policy recommendations made in the Select Committee's report and provides an update on further developments on other policy issues raised by the Association of British Insurers during the Select Committee's inquiry. The PRA says that it will provide a further update in due course on any outstanding issues, including the risk margin.

FCA statement on proposals to introduce a public register

On 26 February 2018, the FCA published a statement giving the information that it will consult on proposals to make information available on a wider range of individuals at authorised firms.

The FCA and the PRA currently maintain a public financial services register, the "FS Register", of the firms they regulate and the individuals they have approved. Under the FCA's July 2017 proposals to extend the senior managers and certification regime to almost all regulated firms, the FCA will only approve the most senior individuals within firms. This means that only senior managers will appear on the FS Register.

In response to these proposals, the FCA received substantial feedback on the public value of it maintaining a central public record of certification employees and other important individuals in firms regulated by the FCA who will no longer appear on the FS Register. This includes non-executive directors, financial advisers, traders and portfolio managers.

The FCA says that it has listened to this feedback and will consult by summer 2018 on policy proposals to address it. In addition, the FCA plans to issue an update shortly on its work to improve the usability of the FS Register, which incorporates feedback from the Work and Pensions Select Committee.

PRA updates PS31/17 to prepare for delay in application date of IDD

On 22 February 2018, the PRA published an update to its December 2017 policy statement, PS31/17, which contained final policy as part of changes to the PRA Rulebook as outlined in chapters 7 and 8 of the PRA's Occasional Consultation Paper, CP18/17. The policy statement provided the majority of final rules and form changes associated with the MiFID II Directive and the Insurance Distribution Directive (IDD).

On 21 December 2017, the PRA updated the policy statement to include the MiFID II Passporting Amendment Instrument 2017, PRA 2017/43, which includes consequential IDD-related changes to the Branch Notification and Cross Border Services Notification forms.

Since the MiFID II and IDD Consequential Amendments Instrument 2017 was published on 15 December 2017, the European Commission has announced a proposal to postpone the application date of the IDD from 23 February 2018 to 1 October 2018. As a result, the PRA has published a new instrument, the PRA Rulebook: CRR Firms, Non CRR Firms, Solvency II Firms, Non Solvency II Firms: MIFID II Passporting and IDD Consequential Amendments Instrument 2018, PRA 2018/2 and updated the policy statement. The new instrument makes the necessary change to the PRA Rulebook to delay implementation of the IDD to 1 October 2018. This delay was consulted on in the PRA's February 2018 consultation paper, CP4/18. The PRA says there is no change in policy.

PRA publishes PS1/18: Strengthening accountability in banking and insurance: optimisations to the SIMR, and changes to SMR forms

On 7 February 2018, the PRA published a policy statement, PS1/18, which provides feedback to responses to chapters 2 and 3 of its June 2017 consultation paper, CP8/17, on strengthening individual accountability in banking and insurance: optimisations to the Senior Insurance Managers Regime (SIMR).

The policy statement also provides:

- the final rules amending the SIMR, the PRA Rulebook: Solvency II Firms, Non-Solvency II Firms: Senior Insurance Managers Regime (Amendment) Instrument 2018, PRA 2018/1. Part of this instrument comes into force on 9 April 2018 and the rest comes into force on 10 December 2018 (see appendix 1); and
- an updated Supervisory Statement (SS) 35/15 on strengthening individual accountability in insurance. This is effective from 10 December 2018 (see appendix 2).

The PRA says that the final rules relating to the implementation of the amendments to the SIMR do not differ significantly from those proposed in CP8/17. Most respondents supported the relevant proposals in CP8/17 and feedback to a number of specific comments has been addressed via clarifications in SS35/15.

In response to consultation feedback, the PRA has made one slight modification to the final rules relating to the new Head of Large Business Area function (SIMF6) proposed in CP8/17. The definition of this function has been revised so that the proposed quantitative criterion that the business area has gross total assets of £10 billion or more, has been amended to a criterion that either the value of assets, or the amount of technical provisions, relating to that business area are £10 billion or more.

The PRA has also updated SS35/15 to clarify its expectations on the implementation of the amendments to the SIMR, including the new Chief Operations function (SIMF24) and the new prescribed responsibility for the oversight of outsourced operational functions and activities.

The updated SS35/15 also incorporates the changes that were proposed in the PRA's July 2017 consultation paper, CP14/17, to remove gender-based language and terminology from SS35/15, as none of the respondents included comments on those proposals.

PRA publishes CP4/18: Insurance Distribution Directive: change to commencement date

On 5 February 2018, the PRA published a consultation paper, CP4/18, containing proposals to amend the effective dates of PRA rules related to the Insurance Distribution Directive (IDD) following a proposal by the European Commission to postpone the application date of the IDD.

In chapter 7 of its October 2017 Occasional Consultation Paper, CP18/17, the PRA consulted on proposals to update the necessary forms and parts of the PRA Rulebook to take account of the changes to requirements brought about by the IDD. The final rules for these proposals were contained in the PRA's December 2017 policy statement, PS31/17.

After publication of the final rules, the European Commission announced a proposal to postpone the application date of the IDD from 23 February 2018 to 1 October 2018. The proposal will need to be agreed by the European Parliament and the Council of the European Union in an accelerated legislative procedure. As a result the PRA is proposing to update the IDD-related rules made in PS31/17 to be effective from the updated application date of 1 October 2018. Minor, non-IDD-related editorial changes will still be made on 23 February 2018.

The PRA also proposes to include the criminal records check question found in 5.05.4 of Short Form A for insurers and 5.05.3 in Long Form A for relevant authorised persons. This amendment is identical to the change consulted on by the PRA in Chapter 8 of CP18/17. The PRA is also using this opportunity to consult on the inclusion of four additional questions in the Passporting Forms: Branch Notification Form; and Cross-Border Notification Form. The changes to the passporting forms are intended to align these forms with the Financial Conduct Authority (FCA) forms which were finalised by the FCA in its January 2018 policy statement, PS18/1.

Comments were requested by 12 February 2018.

PRA publishes Dear Chief Actuary letter on general insurance actuarial function reports

On 5 February 2018, the PRA published the text of a "Dear Chief Actuary letter on general insurance actuarial function reports (AFRs).

The purpose of the letter is to provide comments following the PRA's review of AFRs and to:

- set out the areas where it thinks that Solvency II requirements are not always being met;
- share its findings on emerging good practice in AFRs;
- share its observations on how firms' actuarial functions can be more engaged with the firm's board and the firm's risk management.

The key messages of the letter are that firms' actuarial functions can enhance the contribution they are making to their firm's systems of governance. The PRA makes the following particular observations from its review:

- some AFRs have not clearly stated an opinion where required by Solvency II and have focused instead on process, or stating what has been reviewed. The better AFRs provide clear and informative opinions, with appropriate criteria for assessment, and recommendations have a clear rationale;
- it is not always clear how much reliance the board can place on conclusions within the AFR. For example, many reports have not clearly explained the level of independence in the work or any conflicts of interest; also in some AFRs there is insufficient information on how conclusions have been reached and the alternative approaches and recommendations considered by the actuarial function;
- recommendations and deficiencies are not always highlighted clearly for the board. It is a requirement of Solvency II to highlight deficiencies, with recommendations for remediation. The PRA says that it views this as an important part of a firm's governance process;
- there was a wide variety in the length of AFRs the PRA reviewed. Reports should consider the audience, ensure key messages are clear from the executive summary, and contain sufficient supporting analysis;
- the PRA has seen a number of reports that do not cover the role the actuarial function plays in risk management, including both the capital calculations and the own risk and solvency assessment.

The letter also comments on the content of AFRs reviewed relating to technical provisions, opinions on the overall underwriting policy and the adequacy of reinsurance arrangements.

The PRA says that the letter is intended to be part of an ongoing dialogue between it and the chief actuary community. It encourages chief actuaries to share the letter with their boards and welcomes thoughts and feedback.

HM Treasury delays Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018

On 2 February 2018, HM Treasury updated its webpage on the transposition of the Insurance Distribution Directive (IDD) to give the information that it will delay making the Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 until the outcome of the European Commission's proposal to delay the application date of IDD to 1 October 2018 has been confirmed. This is expected to be after 23 February 2018, the original application date of the IDD.

As previously reported, HM Treasury published a revised draft of the Order on 15 January 2018, with the aim that the Order would come into force on 23 February 2018.

HM Treasury says that when the Order comes into force, the FCA will be able to finalise its rules, which were published in near-final form on 19 January 2018 in FCA policy statement, PS18/1. Firms will then be required to comply with those rules from whatever date is ultimately agreed as the application date of the IDD. Under the current proposal from the Commission this date may be 1 October 2018. A further update will be provided following confirmation of the outcome of the EU's legislative processes.

The FCA has also announced that it will take this approach.

INTERNATIONAL

IDD: European Parliament not to object to European Commission proposal to delay application date

On 8 February 2018, the European Parliament published the text of a resolution it has adopted confirming its decision to raise no objections to the European Commission's proposed Commission Delegated Regulation to delay the application of two Delegated Regulations (Delegated Regulation (EU) 2017/2358 and Delegated Regulation (EU) 2017/2359) supplementing the Insurance Distribution Directive (IDD).

The Parliament instructs that its decision be forwarded to the Council of the European Union and the Commission. If the Council does not object to the Commission's proposed Delegated Regulation, it will enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

IDD: EIOPA consults on draft RTS adapting the base euro amounts for professional indemnity insurance and financial capacity of intermediaries

On 1 February 2018, the European Insurance and Occupational Pensions Authority (EIOPA) published a consultation paper on draft regulatory technical standards (RTS) adapting the base euro amounts for professional indemnity insurance (PII) and for financial capacity of intermediaries under the Insurance Distribution Directive (IDD).

EIOPA is required to develop the draft RTS under the Article 10(7) of the IDD. Based on a review carried out by EIOPA, which takes account of changes in Eurostat's European index of consumer prices, the proposed new amounts are EUR 1 300 370 and EUR 1 924 550 for the PII and EUR 19 510 for the financial capacity.

Comments are requested by 27 April 2018. EIOPA has to submit the draft RTS to the European Commission by 30 June 2018.

EIOPA publishes paper on systemic risk and macroprudential policy in the insurance sector

On 6 February 2018, EIOPA published the first paper in a series of papers with the aim of contributing to the debate on systemic risk and macroprudential policy in the insurance sector.

This paper outlines the lessons learnt from the financial crisis and the banking sector affecting the insurance sector, as well as the current status of debate within the sector. The paper identifies and analyses the sources of systemic risk in insurance outlining three potential sources: entity-based, activity-based and behaviour-based.

The paper also includes a proposal for a macroprudential framework for insurance and defines specific operational objectives based on the previously-identified sources of systemic risk.

SOLVENCY II

EIOPA publishes second set of advice to the European Commission on the specific items in the Solvency II Delegated Regulation

On 28 February 2018, EIOPA announced that it had submitted its second set of advice to the European Commission on the review of specific items in the Solvency II Delegated Regulation not covered by EIOPA's first set of advice to the Commission which it submitted in October 2017.

EIOPA consulted on the second set of advice in November 2017. This consultation focused on the overarching aspects of the solvency capital requirement (SCR) standard formula not covered by the first set of advice. The advice has been modified as a result of the comments received. EIOPA has also published a set of frequently asked questions on the review of the SCR standard formula.

Reflecting developments in the insurance sector and in the wider environment, EIOPA recommends a mixture of revised calibrations, simplifications and, where needed, proposals to achieve greater supervisory convergence. The key elements in the advice are outlined in EIOPA's covering letter to the Commission. EIOPA says that:

- the availability of more recent data allows for revised calibrations in a number of areas such as natural catastrophe risks and assistance and medical expenses;
- with regard to the calculation of interest rate risk, since the current approach does not cater for negative interest rates and is not effective when interest rates are low, EIOPA recommends new calibrations to correct this unintended technical inconsistency;
- the analyses of recent developments do not provide for sufficient reason to change the calibrations for mortality, longevity risks, and the cost-of-capital (which is one of the key elements of the risk margin). Other elements of the risk margin should be assessed in the upcoming overall review of the Solvency II regime due in 2021;
- with regard to the treatment of unrated debt and unlisted equity, EIOPA recommends objective criteria, such as financial ratios, when these important asset classes can be given the same treatment as rated debt and listed equity;
- following-up its analysis of the loss-absorbing capacity of deferred taxes, which showed divergent supervisory practices in respect of about 25% of the loss-absorbing capacity of deferred taxes, EIOPA has developed a set of key principles. These principles intend to strike a reasonable balance between flexibility and greater convergence.

The annexes to the advice cover relevant material. Annex 6 , which covers natural catastrophe risks: zonal calibration, has been published separately.

Commission Implementing Regulation laying down technical information for the calculation of technical provisions and basic own funds for reporting with reference dates from 31 December 2017 until 30 March 2018 published in the Official Journal

On 3 February 2018, the text of Commission Implementing Regulation (EU) 2018/165 of 31 January 2018 laying down technical information for the calculation of technical provisions and basic own funds for reporting with reference dates from 31 December 2017 until 30 March 2018 in accordance with the Solvency II Directive was published in the Official Journal of the European Union.

In order to ensure uniform conditions for the calculation of technical provisions and basic own funds by insurance and reinsurance undertakings, the Solvency II Directive requires that technical information on relevant risk-free interest rate term structures, fundamental spreads for the calculation of the matching adjustment and volatility adjustments must be laid down for every reference date.

Insurance and re-insurance undertakings should use the technical information, which is based on market data related to the end of the last month preceding the first reporting reference date to which this Implementing Regulation applies. On 9 January 2018, the European Insurance and Occupational Pensions Authority provided the European Commission with the technical information related to end of December 2017 market data. That information was published on 9 January 2018, in accordance with Article 77e (1) of the Solvency II Directive.

The Implementing Regulation entered into force on the day following that of its publication in the Official Journal. It applies from 31 December 2017.