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Corporate Insurance Newsletter November 2019

UK
- New FCA webpage on IDD general good requirements
- PRA publishes statement on Solvency Capital Requirement
- General insurance distribution chain: FCA publishes FG19/05 for insurance product manufacturers and distributors
- PRA publishes PS25/1 on maintenance of transitional measure on technical provisions
- PRA publishes Dear CEO and Dear Chief Actuary letters to general insurance firms
- House of Commons Treasury Committee inquiries closed
- Financial Services Duty of Care Bill falls
- Insurance age agreement renewed

BREXIT
- EIOPA Brexit insurance recommendations: PRA statement on ACPR response
- Equivalence post-Brexit: government position
- Third-country regimes: FMLC addendum to paper on issues of uncertainty arising in the context of Brexit

INTERNATIONAL
- Commission Delegated Regulation on adapting base euro amounts for PII and financial capacity of intermediaries
- Liquidity risk management: IAIS consultation
- Recovery planning: IAIS application paper
- IAIS supervisory material and ICP 22: feedback on consultation
- Supervision of internationally active insurance groups and mitigation of systemic risk in the insurance sector: IAIS global frameworks

SOLVENCY II
- Implementing Regulation on technical information for Q4 2019 reporting

UK

New FCA webpage on IDD general good requirements

On 27 November 2019, the Financial Conduct Authority (FCA) published a new webpage containing a table setting out the Handbook rules that apply to an incoming firm exercising a passport right under the Insurance Distribution Directive ((EU) 2016/97) ("**IDD**") and so are considered to be general good provisions.

Publication of national legal provisions protecting the general good is required under Article 11 of the IDD.

The FCA includes guidance on how the table should be used, warning that the notes on the application of the Handbook for incoming EEA firms are not a substitute for the detailed application provisions in the Handbook.

The FCA also notes that for an incoming EEA firm that has permission for cross-border services only, many parts of the handbook apply only if the firm carries on regulated activities in the UK. Those parts of the Handbook therefore will not apply if the firm's activities fall within the overseas persons exclusions in article 72 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, or if they would not be regarded as carried on in the UK.

PRA publishes statement on Solvency Capital Requirement

On 20 November 2019, the Prudential Regulation Authority (PRA) published a statement to remind firms that changes made to the Solvency II Delegated Regulation ((EU) 2015/35) by Commission Delegated Regulation (EU) 2019/98 come into effect on 1 January 2020. These changes may impact firms' calculation of the Solvency Capital Requirement (SCR).

The changes relate to the:

- Standard Formula component loss-absorbing capacity of deferred tax (LACDT);
- 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.

Among the changes made to LACDT, there will be a requirement that any increases in deferred tax assets (DTA) after a stress event shall not be included within the calculation of the tax adjustment to the SCR unless firms are able to demonstrate to the PRA's satisfaction that it is probable that future taxable profit will be available against which that increase can be utilised.

The change to LACDT regulations will be relevant to firms that use the Standard Formula for the whole of the SCR and firms that use a Partial Internal Model for the SCR, where LACDT is not included within the scope of that model.

The PRA advises any firm that wishes to include increases in DTA in their LACDT calculation (including where the firm expects to have net deferred tax liabilities (DTL) post-stress, but the DTA component of the net DTL has increased) should speak to their usual supervisory contact at the PRA about how to demonstrate that the inclusion is appropriate.

General insurance distribution chain: FCA publishes FG19/05 for insurance product manufacturers and distributors

On 19 November 2019, the FCA published finalised guidance, FG19/5, setting out its expectations of insurance product manufacturers and distributors in general insurance distribution chains. FG19/5 follows the FCA's guidance consultation in GC19/2 and the FCA also provides a summary of its feedback to this consultation. The FCA says that it has made some revisions to the guidance following the feedback it received.

In publishing the guidance, the FCA aims to provide clarity to firms about its expectations, in particular on the design and distribution of insurance products and the requirement to act in accordance with the customer's best interests.

Read the Hogan Lovells blog article for more information.

PRA publishes PS25/1 on maintenance of transitional measure on technical provisions

Following its consultation on the subject in CP11/19, the PRA published on 14 November 2019, its feedback in a policy statement, PS25/19, on the maintenance of the transitional measure on technical provisions (TMTPs) under the Solvency II Directive. PS25/19 also contains the PRA's final supervisory statement, SS6/16, "Maintenance of the 'transitional measure on technical provisions' under Solvency II".

The PRA's policy intends to provide:

- further clarity on the consistency of Solvency I and Solvency II methodologies; and
- additional guidance for firms seeking to simplify the recalculation methodology of the TMTPs.

After considering the responses to its consultation, the PRA has made some changes to its draft policy, including:

- new text to acknowledge that the distinction between a methodology and assumption change may rely on judgement (paragraph 3.2 of SS6/16); and
- a new paragraph providing additional clarity of the PRA's expectations for firms using a simplified methodology for TMTP recalculation (paragraph 4.18E of SS6/16).

The expectations set out in the amended SS6/16 came into effect on 14 November 2019.

PRA publishes Dear CEO and Dear Chief Actuary letters to general insurance firms

On 5 November 2019, the PRA published a Dear CEO letter, sent to the CEOs of general insurance firms, setting out the PRA's priorities for the general insurance sector in the months ahead and giving some feedback from supervisory activity across the sector over the last year.

The PRA states that its priority areas of focus for general insurance firms over the coming year are:

- reserve adequacy and associated reserving governance and controls, particularly in the light of emerging risk developments, including in the US;
- the extent to which firms are demonstrating discipline in underwriting strategies remediation activity and controls, notwithstanding recent rate rises in some specialty lines;
- emerging risk trends and experience in firms' exposure management practices, including both natural catastrophe and man-made accumulations;
- understanding UK retail general insurers' responses to the FCA's pricing practices review, once this review is finalised;
- ensuring firms develop and maintain a culture where staff feel able to speak up and raise concerns, with effective mechanisms in place to support them in doing so (including mechanisms to ensure access for control functions to non-executive board members).

The above issues are considered in more detail in the Dear CEO letter.

In addition, the PRA has written a separate Dear Chief Actuary to chief actuaries of general insurance firms, flagging a number of key issues that have emerged from the PRA's recent actuarial work. These include bias in reserve assessment, weakening in the case reserving basis, inadequate claims inflation allowance, attritional loss deterioration, and transparency over key judgements and assumptions in management information. The PRA also sets out other relevant areas of uncertainty that it expects firms to consider actively as part of their year-end reserving. Firms should expect challenge by the PRA in the areas covered in the letter, where the PRA assesses weaknesses within firms or inadequate justification.

The PRA expects firms to bring the Dear Chief Actuary letter to the attention of their audit or reserving committees. It also expects firms to explicitly refer to how they have considered the review findings in their 2019 year-end reserving exercises and associated actuarial reports.

The PRA encourages firms to assess the issues identified in both these letters and consider whether there are relevant issues that need addressing. Firms should expect the PRA to discuss these issues with them in its supervisory interactions with firms over the coming months.

House of Commons Treasury Committee inquiries closed

The House of Commons Treasury Committee has updated a number of its inquiry webpages to announce that the inquiries are now closed due to the general election on 12 December 2019. This includes, for example, the inquiry on the future of the UK's financial services.

Following the dissolution of Parliament on 6 November, all Select Committees ceased to exist until after the general election. The Treasury Committee indicates that, if an inquiry on a particular subject is held in the future, the Committee may refer to the evidence already gathered as part of the inquiry.

Financial Services Duty of Care Bill falls

Parliament has updated its webpage on the Financial Services Duty of Care Bill 2019-20 to indicate that the Bill will make no further progress as the 2017-19 Parliament has been dissolved. The Bill had had its first reading in the House of Lords having been introduced as a private members' bill by Lord Sharkey. The Bill required the FCA to make rules for authorised persons to owe a duty of care to consumers in their regulated activities.

Insurance age agreement renewed

The British Insurance Brokers' Association announced on 5 November 2019, that it, the Association of British Insurers and the UK government have renewed their "signposting" agreement on age and insurance. The agreement, originally in force in 2012, helps older people find the essential cover they need.

Under the agreement, if an insurer or insurance broker is unable to offer cover to an older motorist or traveller because their age is above any upper age limits they have, then they automatically refer the customer to an alternative provider who can meet their needs or to a dedicated signposting service.

The agreement applies to motor and travel insurance contracts entered into on or after 5 November 2019 that are private, voluntary and separate from an employment relationship.

BREXIT

EIOPA Brexit insurance recommendations: PRA statement on ACPR response

On 31 October 2019, the European Insurance and Occupational Pensions Authority (EIOPA) published member state responses to its February 2019 "Recommendations for the insurance sector in light of the United Kingdom withdrawing from the European Union".

In its response, the French regulator, Autorité de contrôle prudentiel et de résolution (ACPR), indicated that it does not intend to comply with EIOPA's Recommendation 6, relating to insurance policies originally sold in the UK by UK insurers to policyholders now resident or established in France. On 8 November 2019, ACPR published a further statement on its website regarding affected policyholders.

On 12 November 2019, the PRA published a statement indicating that, as per the ACPR statement, to make use of the French run-off ordinance, UK insurers must have appropriate passports in place to carry out business in France on exit day.

The PRA and the FCA encourage firms to seek legal advice and consider any risk arising from the ACPR approach to affected policyholders as soon as possible.

Equivalence post-Brexit: government position

In October 2019 the House of Commons European Scrutiny Committee asked the Economic Secretary to the Treasury to clarify, by 31 October 2019, if the government is considering seeking equivalence under EU law post-Brexit and, if so, which EU legislation is being prioritised. The Committee has now published a letter dated 31 October 2019, from John Glen, Economic Secretary to the Treasury, to Sir William Cash, the Committee Chair, responding to these questions.

Mr Glen confirms that the government is seeking equivalence under EU law post-Brexit as part of a deep and comprehensive future relationship with the EU. He states that the UK and the EU have committed to start assessing equivalence with respect to each other under existing frameworks as soon as possible after the UK's exit from the EU. The aim is to conclude the assessments by the end of June 2020. However, Mr Glen does not identify which pieces of EU legislation the government will prioritise for equivalence applications.

Third-country regimes: FMLC addendum to paper on issues of uncertainty arising in the context of Brexit

On 5 November 2019, the Financial Markets Law Committee (FMLC) published an addendum to its July 2017 report, "Issues of Legal Uncertainty Arising in the Context of the Withdrawal of the U.K. from the E.U.–the Provision and Application of Third Country Regimes in E.U. Legislation".

The 2017 report focused on issues of legal uncertainty specific to the application of EU legislation to UK-based financial services providers in the event that the UK withdraws from the EU without retaining access to the single market under any other legal provision.

The paper newly published is an addendum to the 2017 report and sets out some key updates to the 2017 report since its publication. The key updates are in respect of the specified examples of financial industry sectors, which were given by way of illustration in the 2017 report.

INTERNATIONAL

Commission Delegated Regulation on adapting base euro amounts for PII and financial capacity of intermediaries

Commission Delegated Regulation (EU) 2019/1935 amending the Insurance Distribution Directive (IDD) with regard to RTS adapting the base euro amounts for professional indemnity insurance (PII) and for financial capacity of insurance and reinsurance intermediaries was published in the Official Journal of the EU on 22 November 2019. The Delegated Regulation adapts the base amounts in euros referred to in Article 10(4) and (6) of the IDD by the percentage change in the European index of consumer prices to reflect a 4.03% increase of the index.

The Delegated Regulation enters into force on 12 December 2019 and will apply from 12 June 2020.

Liquidity risk management: IAIS consultation

On 19 November 2019, the IAIS published for consultation a draft application paper on liquidity risk management. The paper gives guidance and examples on:

- applying liquidity risk management measures proportionately and the ways that supervisors may tailor requirements;
- detailed components of the four elements for "more detailed risk management processes" contained in ICP standard 16.9:
    - o liquidity stress testing;
    - o maintenance of a portfolio of unencumbered highly liquid assets;
    - o a contingency funding plan; and
    - o the submission of a liquidity risk management report to the supervisor; and
- integration of liquidity risk into insurers' enterprise risk management frameworks as described in the ICP Standard 16.8, including recommendations for governance.

The consultation period closes on 20 January 2020.

Recovery planning: IAIS application paper

On 18 November 2019, the IAIS published an application paper on recovery planning. The paper aims to provide:

- recommendations and guidance to supervisors regarding recovery planning, and co-operation and co-ordination between supervisors;
- additional information for insurers about recovery planning; and
- examples to illustrate the application of principles, standards and guidance relevant to recovery planning.

It contains guidance about supervisory material related to the ICPs on recovery planning, particularly revised material in ICP 16.15 and ComFrame 16.15b (enterprise risk management for solvency purposes), as well as material in ICP 23 and ICP 25 on group-wide supervisors and supervisory co-operation and co-ordination.

IAIS supervisory material and ICP 22: feedback on consultation

The International Association of Insurance Supervisors (IAIS) has published documents that set out the main comments received on its consultations on revisions to the IAIS supervisory material and on ICP 22 (the insurance core principle on anti-money laundering and combating the financing of terrorism), together with its feedback to those comments.

The IAIS adopted the finalised holistic framework on 14 November 2019, which incorporates an enhanced set of supervisory material including a revised ICP 22. In publishing feedback, the IAIS aims to provide background to the final version of the supervisory material and ICP 22 that it has adopted.

Supervision of internationally active insurance groups and mitigation of systemic risk in the insurance sector: IAIS global frameworks

On 14 November 2019, IAIS adopted a comprehensive set of reforms that will enable effective cross-border supervision of insurance groups and contribute to global financial stability. It also published on 20 November 2019, its response to the main comments received on its consultation on revisions to the Holistic Framework for systemic risk in the insurance sector and its response to its consultation on version 2.0 of its risk-based global insurance capital standard.

The adopted reforms include:

- a **Common Framework (ComFrame)** establishing supervisory standards and guidance focused on the effective group-wide supervision of internationally active insurance groups (IAIGs). The ComFrame is a comprehensive and outcomes-focused framework that provides supervisory minimum requirements tailored to the international activity and size of IAIGs. ComFrame builds on the revised set of Insurance Core Principles (ICPs), that are applicable to the supervision of all insurers;

- version 2.0 of the **Insurance Capital Standard (ICS)** being implemented in two phases, the first being a five-year monitoring period, starting in January 2020. During the monitoring period, ICS Version 2.0 will not trigger any supervisory action but will be used for confidential reporting and discussion in supervisory colleges to provide feedback to the IAIS on the ICS design and performance. The IAIS has agreed to a detailed plan for the operation of the monitoring period, including a workplan and timeline for the period 2020-2024 and a collective effort to make participation by IAIGs in the monitoring period as large as possible across different jurisdictions and business models. The IAIS says that feedback from supervisors, ongoing data analysis, public consultations and an economic impact assessment during the monitoring period will aid the further refinement of the ICS prior to its implementation, in phase two, as a group-wide prescribed capital requirement (PCR);
- a definition of comparable outcomes and an overarching approach for the development of assessment criteria to assess whether other jurisdictions have **comparable outcomes** to the ICS; and
- the **Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector**, for implementation from the beginning of 2020. The Holistic Framework consists of an enhanced set of supervisory policy measures and powers of intervention, an annual IAIS global monitoring exercise and collective discussion on the outcomes and appropriate supervisory responses, and a robust implementation assessment.

In recognition of the fact that the Holistic Framework, consistently implemented, provides an enhanced approach to assessing and mitigating systemic risk in the global insurance sector, the FSB has decided to suspend the identification of global systemically important insurers (G-SIIs) from 2020. The FSB will review the need to either discontinue or re-establish an annual identification of G-SIIs in November 2022.

SOLVENCY II

Implementing Regulation on technical information for Q4 2019 reporting

Commission Implementing Regulation (EU) 2019/1902 laying down technical information for the calculation of technical provisions and basic own funds for reporting with reference dates from 30 September 2019 until 30 December 2019 under the Solvency II Directive was published in the Official Journal of the EU (OJ) on 14 November 2019.

The Commission adopted the Implementing Regulation on 7 November 2019. It entered into force on 15 November 2019 and says, in Article 2, that it applied from 30 September 2019.

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