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UK

PRA publishes Dear CEO letter containing feedback from recent review work on market conditions facing specialist general insurers

On 31 May 2018, the Prudential Regulation Authority (PRA) published a Dear CEO letter sent by its Director of Insurance Supervision, Anna Sweeney, to the Chief Executives of specialist general insurance firms regulated by the PRA. The letter gives feedback from the PRA's recent review work on the market conditions facing specialist general insurers.

Ms Sweeney says that the conditions in the general insurance market, particularly for specialist risks underwritten within the London Market, remain challenging. There are signs that some of the longer-term prudential risks associated with a soft market, about which the PRA has been warning for a number of years, are now feeding through more demonstrably into firms' reported results. The PRA believes boards of many firms may now benefit from reassessing whether their business models remain sustainable absent further action, and whether controls over underwriting and reserving in specialist lines are adequate in the light of some of the issues highlighted in the letter.

The letter says that over the last year, the PRA has prioritised in-depth review work with relevant insurers to assess the adequacy of firms' oversight of underwriting and associated risks given these market trends. This work has included reviews of underwriting controls, exposure management, reserving, and trends in distribution such as the growth in delegated underwriting arrangements and specifically broker facilities. Further detail on the PRA's review work is provided in appendix 1to the letter, and the high-level feedback from its "Monitoring the Market" survey is covered in appendix 2.

The letter contains nine key findings from the PRA's recent supervisory work which include the following:

- some firms are now reporting underwriting performance consistently below the levels required to achieve sustained profitability. even in years of low natural catastrophe activity;
- some firms are formulating business plans based on loss ratio (and future reserving assumptions) which appear optimistic given current market conditions and firms' historical performance;
- as well as over-optimism in business planning, some firms appear optimistic in the level of assumed future profitability used when calculating their regulatory solvency position;
- in some firms, insufficient use is being made by underwriters of technical pricing models, even for lines of business where such models are generally considered to be more developed and reliable;
- some firms appear to lack management information to allow them to monitor effectively the use or performance of material delegated underwriting arrangements, including broker facilities.

The PRA says that if current market conditions persist, losses arising from weaknesses in underwriting oversight could pose a risk to the viability or sustainability of some insurers' business models, and ultimately to their prudential soundness. Firms therefore would benefit from considering how they intend to adapt their strategies to ongoing market conditions and from reviewing whether their underwriting and reserving assumptions reflect current market realities. The PRA says that firms who continue to exhibit some of the weaknesses outlined in the letter are more likely to find themselves under increasing supervisory scrutiny.

The PRA would like firms to arrange a specific board discussion on the contents of the letter, to ensure that their board is aware of the PRA's feedback, has considered whether the specific issues highlighted might exist within the firm and has assessed whether the firm needs to adjust its strategy or business model further, or strengthen oversight and scrutiny of key underwriting controls.

Firms classified as a Category 1, 2 or 3 firm by the PRA are requested to provide a summary of the firm's response on the issues raised by the PRA and specifically the key findings, by 27 July 2018.

The PRA says that firms should contact their usual supervisor in the first instance if they wish to discuss any aspect of the letter.

The PRA may also wish to discuss firms' response to the issues raised in the letter in its regular meetings with board members and senior executive management.

The PRA is undertaking some further work on reserving, and is planning a follow-up communication later in the summer to feed back its findings in more detail.

FCA publishes FG18/4: The FCA's approach to the review of Part VII insurance business transfers

On 29 May 2018, the Financial Conduct Authority (FCA) published finalised guidance, FG18/4, setting out its approach to reviewing insurance business transfers schemes under Part VII of the Financial Services and Markets Act 2000.

The FCA consulted on the guidance in May 2017 and has updated it in response to the feedback it received. A summary of the feedback received has been published explaining the FCA's amendments.

The FCA says that the guidance is not intended to explain all aspects of the FCA's role in the Part VII process or all issues that firms may need to consider. This is because each transfer has many variations. The FCA will not always insist firms take the approach set out in the guidance on any particular transfer. However, the FCA expects applicants to explain why they have diverged from the guidance where it is relevant to a particular Part VII transfer.

The purpose of the guidance is to help firms identify the areas of difference (from expectations and examples set out in the guidance) early enough in the process so they do not create problems closer to court dates and interfere with timelines. The FCA says that one specific aim of the guidance is to provide some examples of the types of comments that it has made or is likely to make to applicants and independent experts about their submissions on proposed Part VII Transfers. It hopes that this will help applicants draft their proposals in ways that minimise challenge from the FCA and lead to a more efficient review process.

PRA publishes PS10/18: Financial management and planning by insurers

On 17 May 2018, the PRA published a policy statement, PS10/18, which gives feedback to responses to its November 2017 consultation paper, CP23/17, containing proposals for a draft supervisory statement on effective financial management and planning by insurance firms and groups. The policy statement also contains the final version of the supervisory statement, SS4/18, which takes effect on the day of publication, that is, 17 May 2018.

The PRA received seven responses to CP23/17 and says that these responses generally welcomed the clarity the PRA expressed regarding the importance of a robust risk appetite framework in the management and monitoring of key business activities. Respondents also agreed that many of the proposals set out in the proposed supervisory statement were in line with the current financial planning and management of firms, and would reinforce current good practices.

The PRA has made several changes to the supervisory statement consulted on to reflect comments made in the responses. These are listed in paragraph 1.13 of the policy statement and full details are given in chapter 2. They include:

- enabling more proportionality to be applied by insurers in meeting the expectations in the supervisory statement;
- including some specific wording to explain how the expectations in the supervisory statement may be applied by Lloyd's and managing agents;
- noting that most insurers have a policy whereby they review their risk appetite each year in the context of their risk profile, or following some major external event;
- the addition of a paragraph on consistency of an insurer's risk appetite with its external communications;
- noting that management actions, and decisions on capital distributions (including dividends), that are taken in actual stress situations, might differ from those developed from hypothetical scenarios.

FCA publishes GC18/2: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015

On 17 May 2018, the FCA published a guidance consultation, GC18/2, on fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 (CRA).

The proposed guidance relates to all financial services consumer contracts entered into since 1 July 1995. Part 2 of the CRA (the unfair terms aspects) came into force on 1 October 2015 and now implements the Unfair Contract Terms Directive. The CRA revoked the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs). For contracts entered into before 1 October 2015, the FCA has provided references to the relevant provisions in the UTCCRs.

The proposed new guidance, which is set out in annex 2 to the document, reflects current legislation and case law and outlines a number of non-exhaustive areas the FCA believes firms should have regard to when drafting and reviewing variation terms. These include and are not limited to the following:

- the validity of the reason(s) for using the variation term;
- the transparency of the variation term;
- provision for notice in the variation term;
- provision for the freedom to exit the contract should a consumer not wish to accept the variation.

The proposed new guidance outlines factors for firms to consider when seeking to draft variation terms, and also considers a number of reasons that the FCA has observed firms commonly include when drafting variation terms allowing them to alter their consumer contracts.

Annex 1 to the document contains existing material available on the FCA website not included in the consultation and also includes examples of what the FCA sees as good and poor practice in the way that firms review unfair terms issues. In March 2015 the FCA withdrew some unfair contract terms material from its website and further material was withdrawn in May 2016.

Comments are requested by 7 September 2018.

The FCA has also updated its webpages on unfair contract terms (see the links on this webpage) to reflect its powers under the CRA, including the webpage containing examples of unfair terms.

Financial Guidance and Claims Bill receives Royal Assent

On 10 May 2018, the Financial Guidance and Claims Bill received Royal Assent, and became the Financial Guidance and Claims Act 2018.

The first part of the Act establishes the new single financial guidance body which will replace the Money Advice Service, the Pensions Advisory Service and Pension Wise. The new body is likely to be created by the end of 2018.

The second part of the Act amends the Financial Services and Markets Act 2000 to provide for the transfer of the regulation of claims management services from the Ministry of Justice to the Financial Conduct Authority. It also imposes a cap on the fees that claims management companies can charge for their services.

ABI and BIBA publish guiding principles and action points on general insurance pricing

On 8 May 2018, the Association of British Insurers (ABI) and the British Insurance Brokers' Association (BIBA) published a set of guiding principles and action points with the aim of addressing some of the issues in the current market that can lead to excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.

The guiding principles and action points apply to personal lines general insurance products with contract terms of ten months or longer, except pet and private health insurance products, where different market conditions mean they are not applicable.

Action points include the following:

- ABI and BIBA members should make clear in written, online or verbal customer communications that the new customer premium only applies for that year and subsequent renewal premiums may be higher;
- ABI and BIBA members who impact the final premium paid by customers should review their pricing approach for customers who have been with them longer than five years and assess whether this approach delivers a fair outcome;
- ABI members will actively review their customers' tendency to shop around in line with the existing ABI and BIBA code for potentially vulnerable customers at renewal, to ensure outcomes for these customers are carefully considered against the guiding principles;

the ABI and BIBA will publish a report, in no more than two years' time, which will demonstrate how ABI and BIBA members have sought to tackle excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.

Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 published

Along with an explanatory memorandum and a transposition table, the Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 (IDO) was published on 1 May 2018.

The IDO makes amendments to some of the key financial services legislation – including the Financial Services and Markets Act 2000 (FSMA) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (FSMA RAO) – in order to implement the Insurance Distribution Directive (IDD). These amendments include:

- Introducing a new article 33B of the FSMA RAO, setting out an exclusion from the article 25 regulated activities (*arranging deals in investments*). This exclusion relates to the provision of specified information where no other steps are taken by the insurance intermediary to conclude the contract.
- Revising the criteria for the exclusion for connected contracts of insurance in article 72B of the FSMA RAO.
- Amending section 137R of FSMA to allow the FCA to make financial promotion rules in accordance with Article 17 of the IDD (which contains general principles on marketing communications).
- Inserting a new Part 13A of FSMA, and amending Part 13, to allow an appropriate regulator to exercise its powers of intervention in relation to EEA firms passporting into the UK under the IDD and to allow for enhanced supervision under Article 7 of the IDD.
- Amending Part 26 of FSMA to require the publication of information relating to sanctions imposed in accordance with the IDD.
- Amending Schedule 3 of FSMA and the Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 to make provisions concerning passporting under the IDD by UK and EEA firms.

The IDO will come into force on 1 October 2018 (save the provisions which enable the FCA to make financial promotion rules which will come into force on 23 May 2018).

INTERNATIONAL

Sustainable finance: European Commission package of reforms

On 24 May 2018, the European Commission announced the publication of a package of reforms relating to sustainable finance. Full details of the many documents published are given on this Commission webpage and a set of frequently asked questions has also been published.

The Commission is proposing measures to:

- provide clarity on what sustainable investments are by creating an EU-wide classification system or taxonomy to provide businesses and investors with a common language to identify what degree economic activities can be considered environmentally-sustainable;
- ensure that asset managers, institutional investors, insurance distributors and investment advisors include economic, social and governance factors in their investment decisions and advisory processes as part of their duty to act in the best interest of investors or beneficiaries. Asset managers and institutional investors who claim to pursue sustainability objectives would have to disclose how their investments are aligned with those objectives;
- create a new benchmark category for low-carbon and positive-carbon impact benchmarks, fostering a generally accepted market standard to measure a company's footprint and, in consequence, an investment portfolio's carbon footprint;
- ensure that investment firms and insurance distributors integrate sustainability preferences into their suitability tests when offering advice to investors and that the products offered meet their clients' needs.

EIOPA publishes results of a study on modelling of market and credit risk

On 22 May 2018, the European Insurance and Occupational Pensions Authority (EIOPA) published its first comparative study on market and credit risk modelling.

EIOPA says that market and credit risk contribute significantly to the solvency capital requirement of insurance undertakings and is also important for the majority of internal model undertakings. In 2016/17 EIOPA and several national competent authorities started a European-wide comparative study of market and credit risk in internal models based on year-end 2015 data, aimed at the development of tools and to foster common supervisory practices. The study focused on EUR denominated instruments and consisted of 14 participants from seven different Member States covering 95% of the Euro investments (excluding unit-linked assets) held by all undertakings with an approved internal model covering market and credit risk in the EEA.

The results of the study show significant variations in asset model outputs, partially resulting from model specificities, which indicates the need for further supervisory actions. EIOPA says the study is a first step in an ongoing process of monitoring and comparing internal market and credit risk models. It has decided to perform regular studies on the market and credit risk modelling in internal models starting from year-end 2017. The year-end 2017 version of the study will again focus on risk charges for benchmark portfolios under the combined market and credit risk.

Brexit: EIOPA opinion on the solvency position of insurers in light of the UK's withdrawal from the EU

On 18 May 2018, EIOPA published an opinion on the solvency position of insurance and reinsurance undertakings in light of the withdrawal of the UK from the EU.

The opinion calls upon national supervisory authorities to ensure that the insurance and reinsurance undertakings under their supervision identify, measure, monitor, manage and report the risks arising from the UK becoming a third country and include them in their own risk and solvency assessment. National supervisory authorities should also assess the risks affecting their national markets and, where necessary, take preventive supervisory actions.

EIOPA says that the withdrawal of the UK from the EU may have an impact on the solvency position of insurers. Technical provisions, own funds and capital requirements of insurance and reinsurance undertakings in Member States other than the UK can change when the UK becomes a third country due to changed regulatory requirements. In particular, the Solvency II Directive distinguishes between activities in and outside of the EU.

The opinion sets out 14 areas where the determination of the solvency position of insurers will change. The areas include the risk-mitigating impact of derivatives, the recognition of ratings from UK rating agencies and the regulatory treatment of credit risk exposures situated in the UK. Not all of the changes may affect each insurance company.

EIOPA, together with national supervisory authorities, will monitor the risks to the solvency position of insurance and reinsurance undertakings.

EIOPA launches fourth EU-wide stress test

On 14 May 2018, EIOPA announced the launch of its fourth stress test for the European insurance sector. An EIOPA webpage on the stress test has also been published. Among other things, this contains specifications, templates and a set of frequently asked questions and answers.

For each stress test, EIOPA tailors the scope and scenarios according to developments in market conditions and their potential negative implications for insurers. The 2018 scenarios encompass a combination of market and insurance specific risks, including a natural catastrophe scenario.

The deadline for submission of results to the national competent authorities is 16 August 2018. EIOPA says that it will regularly publish questions and answers addressing queries from the participating groups. The publication of the stress test results is planned in January 2019.

SOLVENCY II

Solvency II's impact on long-term insurance and reinsurance activities: European Commission request for information from EIOPA

On 17 May 2018, the European Commission published the text of a letter and a request for information that it has sent to EIOPA on the impact of the Solvency II Directive on long-term insurance and reinsurance activities. Both documents are dated 27 April 2018.

The request for information says that the Solvency II Directive sets out two review clauses for 2020, one on the standard formula for capital requirements and the other on the long-term guarantee measures. These review clauses set out specific objectives related to the availability of long-term guarantees (LTGs) in insurance products, the behaviour of insurance as long-term investors and, more generally, financial stability.

EIOPA submitted annual reports on the LGT measures in 2016 and 2017. However, in addition to the information provided in these reports, the Commission has identified the areas listed in section 3 of the request for information, information on which it says should help in assessing the appropriateness of the current framework by 2020.

EIOPA is invited to provide the information by 16 December 2019. The Commission asks EIOPA to share its timetable for the work. The Commission will follow up with a call for advice closer to the 1 January 2021 deadline for the review.

Commission Implementing Regulation published in the Official Journal

On 18 May 2018, the text of Commission Implementing Regulation (EU) 2018/730 of 4 May 2018 laying down technical information for the calculation of technical provisions and basic own funds for reporting with reference dates from 31 March 2018 until 29 June 2018 in accordance with the Solvency II Directive was published in the Official Journal of the European Union.

The Implementing Regulation entered into force on the day following that of its publication in the Official Journal. It applies from 31 March 2018.