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UK

IPRE loans and internal credit assessments for illiquid, unrated assets: PRA publishes CP23/19

On 27 September 2019, the Prudential Regulation Authority (PRA) published a consultation paper on income producing real estate (IPRE) loans and internal credit assessments for illiquid, unrated assets (CP23/19). The PRA is proposing to amend supervisory statement SS3/17: Solvency II: Matching adjustments – illiquid unrated assets and equity release mortgages. This consultation paper sets out the PRA's expectations in respect of:

- The modelling of IPRE loans within the Solvency II internal models; and
- The use of internal credit assessments for assigning fundamental spreads for illiquid, unrated assets.

The consultation closes on 27 December 2019. The changes should come into force on 31 March 2020.

Equity release mortgages: PRA publishes PS19/19

On 27 September 2019, the PRA published PS 19/19 Solvency II: equity release mortgages – Part 2 which contains feedback to responses given to CP 7/19 Solvency II – equity release mortgages Part 2 and also contains the final version of supervisory statement SS3/17: Matching adjustment – illiquid, unrated assets and equity release mortgages.

CP 7/19 contained proposals in these areas:

- Reviewing and updating the minimum deferment rate and volatility parameters in the Effective Value Test (EVT)
- The treatment of assets other than ERM loans held by the SPV used to structure ERM loans
- The frequency with which the EVT would be assessed
- The treatment of ERM loans where the amount of principal and/or accrued interest at a given future date is uncertain; and
- Principles for assessing the ERM risks in internal model SCRs.

Having received generally supportive responses to the consultation, the PRA has made some changes to SS3/17 to provide clarification and detail.

The updated SS3/17 will come into effect on 31 December 2019 and will supersede the version published in December 2018 which was due to come into force on 31 December 2019.

Unit-linked funds' governance review: FCA publishes findings and next steps

A follow up action arising from the Financial Conduct Authority's (FCA) Asset Management Market Study in 2018 was for the FCA to review firms' governance practices covering the value provided by unit-linked funds. On 24 September 2019, the FCA published a webpage on which it details its findings following the review.

The FCA has found that insurance firms' fund governance for unit-linked funds often does not include considerations that it believes are likely to be important in assessing whether unit-linked funds provide good value for their investors.

The FCA's findings included the following:

- How firms think about value is sometimes too limited. Some firms only consider performance net of fees and charges, with limited assessment of how active the manager of a unit-linked fund had been in achieving the net performance.

- Firms typically do not compare the fees and charges of different funds within their unit-linked fund ranges, even where funds have similar mandates.

- Firms share scale economies with funds only to a limited extent.

- Firms were unable to show the FCA how product features other than asset management were good value.

- The impact of independent governance bodies on unit-linked funds has been positive but limited.

The FCA will assess the findings from the review alongside those from its continuing work on non-workplace pensions, the governance of unit-linked mirror funds, and the effectiveness and scope of independent governance committees. It will then decide whether further remedies are needed.

Prudent person principle: PRA publishes CP22/19

On 18 September 2019, the PRA published a consultation paper, CP22/19, setting out, in a draft supervisory statement, its proposed expectations for investment by firms in accordance with the prudent person principle (PPP). The PPP is set out in Chapters 2 to 5 of the Investments part of the PRA Rulebook (which transpose Article 132 of the Solvency II Directive (Solvency II)).

The PRA has produced the supervisory statement after observing inconsistencies in the way that different firms understand and apply the PPP. The supervisory statement is also intended to address the PRA's concerns about issues arising from recent changes to the insurance sector, such as life insurers with annuity books increasing their exposures to assets not admitted to trading on a regulated market.

The consultation period ends on 18 December 2019. The PRA proposes that the expectations in the supervisory statement will apply from the date on which the final version of the statement is published. The PRA has assessed that the proposals will be affected in the event that the UK leaves the EU with no implementation period in place. The draft SS attached should be read in conjunction with SS1/19 "Non-binding PRA materials: The PRA's approach after the UK’s withdrawal from the EU".

PRA applications to recalculate TMTP

On 16 September 2019, the PRA updated its webpage on Solvency II to state that, if the current market conditions persist, it would be willing to accept applications from Solvency II firms to recalculate the transitional measure on technical provisions (TMTP) as at 30 September 2019.

In line with Supervisory Statement 6/16 "Maintenance of the 'transitional measure on technical provisions' under Solvency II", the PRA has been monitoring market conditions since the previous biennial TMTP recalculation (as at 31 December 2017), and also has considered whether changes in market conditions since the end of June can reasonably be considered to have been sustained. The PRA concludes that if the current market conditions persist, it will be willing to accept applications from firms to recalculate TMTP as at 30 September 2019.

In their applications, firms should demonstrate that a material change in risk profile has occurred. This is relevant to all firms with current TMTP approval. In order to expedite the application process, the PRA expects applications to use firms' existing TMTP calculation methodology.

Applications received should be in addition to the expected biennial TMTP recalculation as at Tuesday 31 December 2019.

PRA publishes PS18/19 and SS5/19 on liquidity risk management for insurers

On 14 September 2019, the PRA published a policy statement, PS18/19, and a supervisory statement (SS) on liquidity risk management for insurers, SS5/19. PS18/19 sets out feedback received to the PRA's March 2019 consultation paper, CP4/19, which sought views on a draft version of the SS.

Respondents to the consultation generally welcomed the PRA's proposals, and made a number of observations and requests for clarification. Therefore, after considering the responses, the PRA has made some changes to the draft policy. The most significant amendments involve clarifying the PRA's expectations on the definition of risk limits within an insurer's liquidity risk appetite framework and the role of the board in managing liquidity risk. In addition, the function and characteristics of the liquidity buffer have been clarified. The PRA has also made a number of editorial amendments to improve the clarity of the SS; these are not explicitly addressed in PS18/19.

The expectations set out in SS5/19 and the withdrawal of SS2/13, "Collateral upgrade transactions and asset encumbrance: expectations in relation to firms' risk management practices" have immediate effect.

Fair treatment of vulnerable customers: FCA delays response to GC19/3

On 4 September 2019, the FCA updated its webpage on guidance consultation 19/3 (GC19/3), which seeks views on proposed guidance for firms on the fair treatment of vulnerable customers. The consultation closes on 4 October 2019 and the FCA was due to issue a response in autumn 2019. However, an update to the GC19/3 webpage indicates that this response will be postponed until 2020.

Authorisation and supervision of insurance SPVs: PRA publishes CP19/19

On 3 September 2019, the PRA published a consultation paper (CP19/19) on insurance special purpose vehicles (ISPVs) and updates to authorisation and supervision. The consultation is relevant to parties who want to apply for, or have obtained authorisation as, an ISPV. It is also relevant to insurers and reinsurers seeking to enter into arrangements with UK ISPVs as a form of risk mitigation.

In its consultation, the PRA sets out proposed amendments to the ISPV Part of the PRA Rulebook. The proposals aim to provide further clarity and elaborate on certain additional aspects of the PRA's approach and expectations regarding the authorisation and supervision of ISPVs.

The consultation closes on 3 December 2019.

Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations 2019

The Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations 2019 (SI 2019/1233) have been published, together with an explanatory memorandum. This statutory instrument (SI) ensures that Solvency II and related legislation will continue to operate effectively once the UK has left the EU. The SI amends:

- the Risk Transformation Regulations 2017;
- the Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018;
- the Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019;
- the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019; and
- retained direct EU legislation: Commission Delegated Regulation (EU) 2015/35.

The SI came into force on 6 September 2019. Regulations 3 and 4 come into force immediately before exit day, and the remaining regulations come into force on exit day.

BREXIT

FCA updates Brexit temporary transitional directions

On 26 September 2019, the FCA published a press release announcing the publication of updated versions of the draft directions that it intends to make using its no-deal Brexit temporary transitional powers.

It has published revised draft versions of the main FCA transitional direction (together with revised versions of Annex A and Annex B), the FCA prudential transitional direction and the explanatory note to the directions.

Brexit preparations: FCA speech

On 16 September 2019, the FCA published a speech by Andrew Bailey, Chief Executive of the Financial Conduct Authority (FCA), on the state of play of preparations for Brexit in the financial services sector. Mr Bailey discusses the progress the FCA has made to date for a no-deal Brexit. He reaffirms the FCA's commitment to preserve open markets, subject to maintaining the overall integrity of markets.

FCA efforts to ensure firms are getting ready for a no-deal Brexit

The FCA is stepping up its efforts to ensure firms are aware of what they need to do to prepare for the potential of a no-deal Brexit. It urges all firms to consider the implications of a no-deal exit and finalise their preparations.

To help firms prepare, the FCA will run a series of digital adverts signposting to the FCA Brexit webpages, and has set up a dedicated telephone line (0800 048 4255).

In relation to UK firms losing their passport into the EEA, the FCA warns that whether firms need regulatory permissions to continue to do business in an EEA country will depend on the activity they are carrying on, the local law and the approach of the local authorities in that jurisdiction. It advises that firms should make themselves aware of any transitional regimes, with deadlines or registration requirements.

The FCA has made available a list of EEA regimes on its website. However, it highlights that, under the Luxembourg transitional regime for existing contracts, firms must register by 15 September 2019. Firms should also consider regulatory changes that could apply in the event of no-deal. For example:

- MiFID II transaction reporting will change;
- there will be a number of other changes to the FCA Handbook;
- the Temporary Permissions Regime will come into force; and
- the FCA will become responsible for credit ratings agencies and trade repositories.

Bank of England updates Brexit analysis

The House of Commons Treasury Committee has published a letter (dated 3 September 2019) received from Mark Carney, Bank of England (BoE) Governor, on the BoE's economic analysis of Brexit. The BoE was responding to a letter (dated 17 July 2019) from the Committee asking whether previous BoE economic analysis, produced in November 2018, remained "fully relevant".

The BoE explains the context of its previously produced EU withdrawal scenarios. In summary, it states that advancements in preparations for a no-deal exit mean that the BoE's assessment of a no-deal exit is now less severe compared with previously. However, the BoE's assessment of scenarios where there is a withdrawal agreement followed by a transition to a WTO (World Trade Organisation) trading relationship or by a transition to a new economic partnership, remains the same.

INTERNATIONAL

Proposed Regulation on sustainability disclosures: trade associations call for delay

On 20 September 2019, Insurance Europe published a letter, sent jointly by it and seven other trade associations to the European Commission, on the timings for the application of the proposed Regulation on disclosures relating to sustainable investments and sustainability risks.

While the signatories support the European Commission's objectives of financing a more sustainable economy, they are concerned that the proposed Regulation is likely to become applicable before the necessary level 2 legislative measures are adopted. This will create significant compliance challenges and liability risks for market players, as well as confusion for investors.

The trade associations urge the Commission to take immediate action to ensure there is "realistic time" for implementation. They suggest that the application date of the Regulation should be changed to 12 months after all the regulatory technical standards (RTS) have been published in the Official Journal of the EU.

Cyber risk: EIOPA publishes report on challenges and opportunities for insurers

On 17 September 2019, the European Insurance and Occupational Pensions Authority (EIOPA) published a report on the challenges and opportunities for insurers arising from cyber risk. EIOPA recognises that insurers are susceptible to cyber threats directly themselves and through the cover they offer for cyber risk through their underwriting activities. This report analyses cyber risk from both angles and is based on responses from 41 large (re)insurance groups across 12 European countries, with the aim to further enhance the level of understanding of cyber risk for the European insurance sector.

In relation to cyber risk as an element of the insurer's own operational risk profile, EIOPA concludes that:

- having clear, comprehensive and common requirements on governance of cybersecurity as part of operational resilience would help ensure the safe provision of insurance services;
- the most common cyber incidents affecting insurers are phishing mail, malware infections (ransomware), data exfiltration and denial of service attacks. The main consequences suffered by insurers following these cyber incidents are business interruption and material costs for policyholders and third parties;
- industry is generally aware of the potential cyber threats and have incorporated cyber risk explicitly in their risk management frameworks; and
- further actions to strengthen the resilience of the insurance sector against cyber vulnerabilities are essential, including streamlining cyber incident reporting frameworks across the insurance and financial sector.

In relation to the cyber insurance market, EIOPA concludes that:

- although still small in size, the European cyber insurance industry is growing rapidly;
- non-affirmative cyber exposures (instances where cyber exposure is not explicitly included or excluded in an insurance policy) remain a source of concern. While common efforts to assess and address non-affirmative cyber risks are under way, the lack of quantitative approaches, explicit cyber exclusions and action plans to address non-affirmative cyber exposures suggest insurers are currently not fully aware of the potential exposures to cyber risk;
- some groups have adopted a "wait-and-see" approach to address non-affirmative cyber risk, where the implementation of actions plans to address non-affirmative exposure depends on the materialisation of future events. This approach in dealing with cyber risks can be

particularly problematic, as insurers may suffer substantial unforeseen losses in traditional polices if a cyber incident materialises;

- further effort is needed to properly tackle non-affirmative cyber exposures to address the issue of potential accumulation risk and provide clarity to policyholders;
- the industry should further improve its assessments and data collection, so that cyber risks can be adequately measured, monitored and managed. To this end, creating a European-wide cyber incident reporting database, based on a common taxonomy, could be considered.

Big data analytics in insurance: IAIS publishes a consultation

On 2 September 2019, the International Association of Insurance Supervisors (IAIS) published for consultation a draft issues paper on the use of big data analytics in insurance. The paper builds on the IAIS Issues Paper on Increasing Digitalisation in Insurance and its Potential Impact on Consumer Outcomes (November 2018) by focusing more specifically on issues relating to the use of personal and other data by insurers as a result of digitalisation. The scope of the paper focuses on the use of algorithms and advanced analytics capabilities by insurers to make decisions based on patterns, trends and linkages and the availability to insurers of new alternative data sources, collectively referred to as "big data analytics" (BDA).

To help understand the potential benefits and risks to consumers associated with the use of BDA by insurers, the IAIS considers the manner in which insurers are now able to collect, process and use data across various stages of the insurance product lifecycle, namely product design, marketing, sales and distribution, pricing and underwriting and claims handling. In the draft paper, the IAIS also makes certain observations about the potential implications for supervisors as a result of the use of BDA in insurance.

The consultation closes on 16 October 2019.

SOLVENCY II

Solvency II review: Sustainability

On 30 September 2019, EIOPA published its Opinion on sustainability within Solvency II. The European Commission is due to review the Solvency II Directive in 2020 and in August 2018 it asked EIOPA to provide an opinion on sustainability. This is in addition to the technical advice EIOPA provided in May 2019 on integrating sustainability risks and factors in the delegated regulations under Solvency II and the Insurance Distribution Directive.

The Commission asked EIOPA for it opinion on the integration of sustainability, in particular climate related developments, into the Solvency II framework for:

- the valuation of assets and liabilities
- investment and underwriting practices
- calibration of market and natural catastrophe risks
- use of internal models
- integration of sustainability risks across the three Solvency II Pillars

The European Commission will take into account EIOPA's opinion as part of its review of the Directive. The Commission is due to deliver it report of the Solvency II review by 1 January 2021.

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