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UK

PRA publishes a Dear CEO letter on existing or planned exposure to crypto-assets

On 28 June 2018, the Prudential Regulations Authority (PRA) published a Dear CEO letter sent by its CEO, Sam Woods, to the CEOs of banks, insurance companies and designated investment firms to remind them of the relevant obligations under PRA rules, and to communicate the PRA's expectations regarding firms' exposure to crypto-assets.

The letter says that the PRA acknowledges that firms may have taken limited exposure to crypto-assets to date and hopes that the letter is helpful to firms in considering any existing exposures and/or plans for the future.

The letter reminds firms of their responsibilities under the PRA's Fundamental Rules 3 (to act in a prudent manner), 5 (to have effective risk strategies and risk management systems) and 7 (to deal with regulators in an open and co-operative way, and disclose appropriately anything relating to their firm of which the PRA would reasonably expect notice).

The letter outlines the risk strategies and risk management systems that the PRA considers most appropriate to crypto-assets, which include:

- recognition by firms that crypto-assets represent a new, evolving asset class with risks which should be considered fully by the board and highest levels of executive management. In particular, an individual approved by the PRA to perform an appropriate Senior (Insurance) Management Function should be involved actively in reviewing and signing off on the risk assessment framework for any planned business direct exposure to crypto-assets and/or entities heavily exposed to crypto-assets. Firms should make their usual supervisory contacts aware of the responsible individual;
- firms' remuneration policies and practices should ensure that the incentives provided for engaging in this activity do not encourage excessive risk-taking;
- firms ensuring that their risk management approach is commensurate to the risks of crypto-assets. Given the technical complexity of crypto-assets, firms should ensure that they have access to appropriate, relevant expertise to assess any risks stemming from their exposure to these assets. Firms should conduct extensive due diligence before taking on any crypto-exposure and maintain appropriate safeguards against all the related risks. This includes not only financial risks, but also operational (including cyber) and reputational risks.

The letter also says that where relevant, firms should set out their consideration of risks relating to crypto-exposures in their internal capital adequacy assessment process or own risk and solvency assessment.

The PRA expects firms to inform their usual supervisory contact of any planned crypto-asset exposure or activity on an ad hoc basis, together with an assessment of the risks associated with the intended exposure.

The PRA says that it will communicate any supervisory or policy updates on the prudential treatment of crypto-assets, including through Pillar 2 for banks if deemed necessary, in due course.

European Union (Withdrawal) Act 2018: HM Treasury's approach to financial services legislation under the Act

On 26 June 2018, the European Union (Withdrawal) Act 2018 (Withdrawal Act) received Royal Assent and on 27 June 2018, HM Treasury published its approach to financial services legislation under the Withdrawal Act.

The approach document contains sections on:

- the implementation period (see paragraphs 1.2 to 1.7);
- the Withdrawal Act and financial services contingency preparations: this section gives examples of "deficiencies " in financial services legislation which will arise when the UK leaves the EU and existing EU law is transferred to UK law. HM Treasury is drafting statutory instruments (SIs) to fix these deficiencies and will begin laying these under the Withdrawal Act (see paragraphs 1.8 to 1.16). HM Treasury says that firms should continue to plan on the assumption that an implementation period will be in place from 29 March 2019 and, therefore, that they will be able to trade on the same terms that they do now until December 2020. They will need to comply with any new EU legislation that becomes applicable during this period;
- HM Treasury's approach to fixing deficiencies outlined in the previous section of the document: HM Treasury confirms that it will introduce a temporary permissions regime and that it intends to introduce further specific transitional regimes for entities operating cross-border and outside of the passporting framework (see paragraphs 1.17 to 1.23);
- the split of responsibilities between HM Treasury and the financial services regulators (see paragraphs 1.24 to 1.29).

HM Treasury intends to lay the first financial services onshoring SIs soon. Among the first SIs laid will be the SIs delivering the temporary permissions regime, the temporary recognition regime for central counterparties and the SI sub-delegating the power to fix deficiencies in binding technical standards and regulator rulebooks to the financial services regulators.

Further SIs fixing deficiencies in EU legislation will be laid over the autumn of 2018 into early 2019. HM Treasury plans to lay these SIs in groups, with some of the first to be laid in autumn 2018 covering significant files relating to prudential regulation and capital markets. HM Treasury plans to publish drafts of these SIs and accompanying explanatory information over summer 2018, ahead of laying, to give stakeholders an opportunity to engage and familiarise themselves with the draft provisions.

The Bank of England's approach to financial services under the European Union (Withdrawal) Act 2018

On 27 June 2018, the Bank of England also published a statement on its approach to financial services under the Withdrawal Act.

In the statement, the Bank says that it intends to consult, in co-ordination with the Financial Conduct Authority (FCA) when appropriate, on proposed changes to onshored binding technical standards and rules in autumn 2018. It plans to do this following HM Treasury's publication in draft, or laying before Parliament, of statutory instruments relating to most of its regulatory remits. The changes would largely only come into force on 29 March 2019 in the eventuality that the implementation period is not put in place.

The Bank does not expect firms providing services within the UK's regulatory remit to have to prepare now to implement these changes. HM Treasury has set out that it intends to provide regulators with powers to grant transitional relief, where appropriate, to ensure that, in a scenario in which an implementation period is not in place, firms and financial market infrastructures have sufficient time to comply with the changes.

The FCA's role in preparing for Brexit: FCA statement

On 27 June 2018, the FCA published a statement on its role in preparing for Brexit. The FCA says that further to HM Treasury's paper on its approach to amending financial services legislation under the European Union (Withdrawal) Act 2018 (Withdrawal Act), the statement provides stakeholders with an update on how it is preparing for the UK leaving the EU.

The FCA says that it continues to prepare for a range of scenarios, including one in which the UK leaves the EU on 29 March 2019 without a withdrawal agreement and implementation period having been ratified between the UK Government and the EU.

The Withdrawal Act will transfer and convert existing EU law at the point of exit into UK law. It also gives powers to ministers to make secondary legislation to amend this legislation to ensure it functions effectively when the UK leaves the EU. As part of this HM Treasury intends to task the FCA with amending and maintaining EU binding technical standards.

The FCA will also be amending its Handbook to ensure it is consistent with changes the Government is making to EU law and that it functions effectively when the UK leaves the EU. In the run up to March 2019, it will limit Handbook changes unrelated to Brexit to those identified as core priorities in its 2018/19 Business Plan as well as other essential items. It will continue to progress important initiatives, such as the high-cost credit review, the implementation of the senior managers and certification regime and next steps from its asset management market study. It will delay its rule making for some initiatives, such as the work on illiquid assets or the remit of independent governance committees.

The FCA is planning to consult on these changes in autumn 2018, subject to HM Treasury's timelines for statutory instruments. It also plans to consult on the rules which will apply to firms in the temporary permissions regime.

The FCA says that with regard to EU entities that currently access or do business in the UK through means other than an EU passport, it will set out separate details for those entities and activities in due course.

FCA publishes FS18/1: Call for input on access to insurance

On 25 June 2018, the FCA published a feedback statement, FS18/1, on its June 2017 call for input on access to insurance.

The FCA published the call for input to gather more evidence and decide how best to address concerns about people with pre-existing medical conditions obtaining affordable travel insurance. The FCA says that the call for input prompted a high level of interest. Most stakeholders felt that it could be difficult for consumers who have, or have had, pre-existing medical conditions to find affordable travel insurance.

A number of themes emerged from the responses including:

- there is a lack of quality information on alternative options available to consumers after they had received a high quote or had been refused cover, which can cause consumers to assume that they are uninsurable;
- a general lack of understanding amongst consumers and firms around insurance terms and the risk factors that are considered by providers when calculating the premium;
- the lack of transparency around pricing, the risk factors which drive quotes and how premiums are calculated which limits consumers' awareness about their options and can mean that they have difficulties in finding competitive insurance that is appropriate for their medical condition.

The FCA is following up on these three main themes and will be holding industry stakeholder roundtables to encourage industry-led signposting reforms. Its aim is to help consumers with more serious pre-existing medical conditions to find specialist travel insurance providers. The signposting service will also provide links to coordinated consumer education/information. The FCA believes this will improve product awareness in this market, so that consumers can make more informed choices. It will continue work on pricing practices in retail general insurance and will publish more details of the scope of this work shortly. It plans to feed the findings of the call for input work into the debate part of this work. This will help it assess whether it needs to act to ensure future insurance pricing practices support a market that works well for its consumers.

Brexit contract continuity clause published by the IUA

On 22 June 2018, the International Underwriting Association (IUA) announced the publication of a Brexit contract continuity clause to help insurance companies manage insurance contracts as the UK leaves the EU.

The policy clause (reference number IUA 09-077), which can be found on the IUA clauses website, is designed to manage the insured risk as and when the UK leaves the EU and working on the assumption there will be no equivalent passporting rights for UK insurers. There is also an accompanying commentary which explains the key technical considerations and issues arising in the drafting process.

Insurance contract law: Law Commissions' updated draft Bill on insurable interest

On 20 June 2018, the Law Commission and the Scottish Law Commission published an updated insurable interest draft Bill, together with accompanying notes. The draft Bill focusses on life insurance and other insurances which relate to human life, such as accident and health cover. This Law Commission webpage gives full details of the background to the publication of the updated draft Bill.

Insurable interest is the requirement where someone taking out insurance must be at risk of suffering a loss or disadvantage if the insured event occurs. Without insurable interest, an insurance contract is void. The draft Bill suggests broadening the concept of insurable interest for life-related insurance in the following ways:

- providing that individuals have an automatic insurable interest in cohabitants, not just spouses or civil partners;
- extending insurable interest to cover children and grandchildren, so that they could lawfully be covered under travel or health policies;
- confirming in law that pension trustees and other administrators of group schemes have an insurable interest in the lives of members of the group. This would ensure that employers' life and health policies have the full support of the law;
- allowing for trustees of private trusts to purchase life insurance bonds if the settlor of the trust would have had the necessary insurable interest to do so.

Comments are requested by 14 September 2018.

Continuity of cross-border financial contracts post-Brexit: TheCityUK paper

On 20 June 2018, TheCityUK published a paper on the continuity of cross-border financial contracts post-Brexit.

The paper says that when the UK leaves the EU, UK-based providers will no longer be able to rely on passports and the right of establishment to service existing cross-border financial contracts throughout the EEA. There will also be an identical impact on EEA providers who will be unable to service existing financial contracts with UK-based parties. This will, for example, impact general insurance, long-term life insurance, pension schemes, medium and long-dated derivatives contracts, revolving credit facilities, and may also affect general customer terms of business, prime brokerage and custody arrangements. The extent of this issue is significant and will affect both UK and EEA consumers.

In order to remedy the difficulties for UK and EEA providers, TheCityUK says that a co-ordinated solution which takes into consideration key timeframes, agreed between the UK and the EU, is required. The solution must grandfather affected cross-border contracts either for a time-limited period or potentially until maturity. This could be achieved through:

- a bilateral agreement between the UK and EU, supported by regulatory co-operation;

- separate regulatory action or legislation in each jurisdiction, consistent with the approach agreed between the UK and EU;
- inclusion in the EU Withdrawal Agreement alongside appropriate regulatory backing for such a political agreement. Until such legislation has been passed, regulatory backing will be needed to provide certainty for providers and customers.

The paper also says that there are certain situations where such official grandfathering is the only available solution, even in the long term, such as:

- contracts relating to assets and liabilities that cannot be separated into UK and EU27 components, for example, pan-European directors' and officers' liability;
- claims that arise many years after a policy has expired but relate to a period that was covered, for example, insurance claims for asbestos exposure;
- instances where a small number of contracts are affected, and it is simply not commercially viable to establish a new subsidiary in a different country to service a small number of contracts.

The paper says that firms are already taking steps to mitigate the impact on customers and clients, however market participants cannot fully address this issue without regulatory support by March 2019. This is because the scale of the task and the need for third party co-operation will make it extremely challenging and operationally complex to complete in the limited time remaining before the UK leaves the EU.

The paper also says that

- it is critical that the UK and EU implement the transitional period that was agreed at a political level at the European Council meeting in March 2018. It is also important for UK and EU regulators to issue commitments about the future treatment of these contracts to act as a regulatory back stop in the event that the transitional period fails to materialise;
- any UK/EU solution should also be underpinned by ongoing supervisory co-operation between UK and EU regulators;
- the early announcement of grandfathering arrangements, either for a time-limited period or potentially until maturity, would allow for contract continuity which will deliver the best results for UK and EEA customers.

PRA letter to House of Commons Treasury Select Committee on the Solvency II risk margin

On 6 June 2018, the PRA published a letter (dated 4 June 2018) sent by its CEO, Sam Woods, to the Chairman of the House of Commons Treasury Select Committee, Nicky Morgan, giving an update on the PRA's work on the Solvency II risk margin. This letter follows a previous letter, dated 27 March 2018, sent to the Select Committee by Mr Woods in which he said he would provide an update on this work.

Among other things, Mr Woods says that the current design of the risk margin is too sensitive to the level of interest rates, and it is therefore too high at current low levels of interest rates, in particular for long-dated insurance contracts such as annuities. For new annuity business firms have responded to the level of risk margin by reinsuring a substantial proportion of the longevity risk offshore. The PRA says that this build-up of the stock of offshore reinsurance is an unintended consequence and, if left unconstrained, would become a significant prudential concern. However, the PRA's reviews of firms' reinsurance activities have not brought to light significant immediate concerns about the way in which that reinsurance is being conducted and it does not appear that Solvency II is having a detrimental impact on policyholders through annuity prices.

As Mr Woods indicated in his previous letter, the PRA has been considering its supervisory approach to the use of future risk mitigation and transfer mechanisms in a number of contexts, including the calculation of the risk margin. However, in light of the ongoing uncertainty about the UK's future relationship with the EU in relation to financial services, the PRA does not yet see a durable way to implement a change with sufficient certainty for firms to be able to rely on it for pricing, capital planning and use of reinsurance. The PRA will keep this position under review and will update the Select Committee as soon as it can see a clear way forward.

FCA publishes CP18/15: Claims management: how the FCA proposes to regulate CMCs

On 1 April 2019, the FCA will become the regulator of claims management companies (CMCs) established or serving customers, in England, Wales and Scotland. At the same time the Financial Ombudsman Service (FOS) will become responsible for resolving disputes about CMCs.

On 5 June 2018, the FCA published a consultation paper, CP18/15, on how it proposes to regulate CMCs when the responsibility for regulating the sector is transferred to it. The consultation paper sets out the draft rules and guidance the FCA proposes to make in relation to claims management. These draft rules set out the standards that the FCA thinks CMCs regulated by it should have to meet.

The FCA also sets out why and how it enforces its rules, and the process for CMCs to become authorised by the FCA. The consultation paper also sets out proposed changes to the compulsory and voluntary jurisdictions of the FOS and is a joint consultation with the FOS on those changes.

The FCA says that all CMCs it regulates will need to follow certain rules so they manage their business effectively and treat their customers fairly. These will include rules based on existing Claims Management Regulator rules as well as new requirements. The FCA proposes to apply the rules which generally apply to all the firms it regulates, such as the Principles for Businesses (PRIN), to CMCs.

It is also proposing to apply rules that are specific to CMCs. These will help address the specific harms identified in the sector and take account of the business models of CMCs. These rules will be contained in a separate section of the FCA Handbook called the Claims Management: Conduct of Business sourcebook.

The FCA also plans to extend the senior managers and certification regime to CMCs although this proposal will be consulted upon separately in autumn 2018.

Comments are requested by 3 August 2018. The FCA intends to publish a policy statement containing final rules in the fourth quarter of 2018.

The House of Commons Library has published a briefing paper on CMCs which outlines the regulatory structure surrounding them and also contains an outline of the new FCA regime as proposed above.

INTERNATIONAL

EIOPA publishes draft RTS on professional indemnity insurance and financial capacity of intermediaries

On 28 June 2018, the European Insurance and Occupational Pensions Authority (EIOPA) published 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), which it has submitted to the European Commission for endorsement.

EIOPA consulted on the draft RTS in January 2018 and has also published a final report which includes a feedback statement with a summary of the main conclusions of the consultation. The final report also gives background information on PII and the review undertaken by EIOPA, information on the legal requirement of insurance intermediaries to hold PII as laid down in Article 10(4) of the IDD, a description of the calculation method applied by EIOPA to adapt the base amount referred to in Article 10(4) of the IDD, and the draft RTS.

EIOPA publishes an opinion on disclosure of information to consumers about the impact of the UK's withdrawal from the EU

On 28 June 2018, EIOPA published an opinion addressed to national supervisory authorities about the duty of insurance undertakings and insurance intermediaries to inform customers about the possible impact of the withdrawal of the UK from the EU. EIOPA has also published a set of frequently asked questions on the opinion.

National supervisory authorities are required to ensure that insurance undertakings and insurance intermediaries take appropriate contingency measures to ensure the continuity of services for cross-border insurance contracts between the UK and other EU Member States.

EIOPA says that it is important that customers and beneficiaries are made aware in a timely manner of the implications of these measures both for existing and for new contracts concluded before the withdrawal date. Examples of possible impacts are given in the opinion. Customers should be provided with clear and non-misleading information on the contingency measures taken or planned and on their impact on insurance contracts. Also potential new customers should be properly informed about the impact on their contractual rights and on the provision of insurance services that may emerge from the withdrawal of the UK.

National supervisory authorities are also required to monitor whether insurance undertakings and insurance intermediaries fulfil their obligations to inform their customers about the implications of the withdrawal of the UK from the EU for the services provided to their customers.

EIOPA launches InsurTech insight survey

On 27 June 2018, EIOPA launched a survey on InsurTech.

By InsurTech, EIOPA means technology-enabled innovation in insurance that could result in new business models, applications, processes or products with an associated material effect on the provision of insurance products and services.

EIOPA says that InsurTech solutions using big data, algorithms, artificial intelligence, cloud computing, and blockchain technology are changing the insurance industry. They potentially offer a number of benefits to both insurers and consumers, but there are also new risks associated with InsurTech which need to be carefully assessed. EIOPA’s goal is to have a balanced approach to InsurTech, to enable consumers and the industry to harness the benefits arising from InsurTech, but at the same time to ensure adequate level of consumer protection and financial stability in the markets.

In order to develop a better understanding of these developments, EIOPA has set up an InsurTech Taskforce (ITF). One of the tasks of the ITF will be the mapping of supervisory approaches to InsurTech as well as the current state of InsurTech facilitation with the aim to identify and report on best practices and identifying possible regulatory barriers to financial innovation.

EIOPA is collecting the views of the insurance industry and those not directly active in the insurance value chain. The survey focuses in particular on licencing requirements, barriers to InsurTech and InsurTech facilitation. The results will contribute to EIOPA´s work on mapping of supervisory approaches to InsurTech with the aim to identify and report on best practices and identifying possible regulatory barriers to financial innovation.

EIOPA invites stakeholders to participate in a survey by close of business on 12 August 2018.

IAIS publishes an issues paper on index-based insurances

On 19 June 2018, the International Association of Insurance Supervisors (IAIS) published an issues paper on index-based insurances, particularly in inclusive insurance markets.

Index-based insurances are insurance contracts in which a claim is defined with reference to a pre-determined index (sometimes also referred to as parametric insurance). Since index-based insurances are increasingly looked to as a means to manage weather and catastrophic events, support food security and enhance access to insurance, the issues paper provides background on this product, describes practices and actual examples and identifies related regulatory and supervisory issues and challenges. The main focus of the paper is on weather-related or natural catastrophe event risks.

The paper addresses various issues typical to index-based products such as:

- the way the product is designed as a micro, meso and macro scheme which affects the role of the policyholder and expectations of the end customer;
- the roles of various stakeholders; in particular, those not usually seen in conventional insurance such as government agencies and, for example, ministries of agriculture, agencies involved in data and statistics and donors and sponsors;
- legal certainty, insurable interest and the nature of the product as insurance; and
- issues relating to consumer protection including the development of the product and importance of proper consideration of basis risk, setting a sound and credible index and the role of subsidies.

EIOPA expects insurance undertakings to avoid instruments banned or restricted by ESMA

On 1 June 2018, EIOPA published a statement on consumer detriment resulting from policyholder exposure to contracts for differences (CFDs) and binary options. Considering potential future risks to policyholders, EIOPA expects insurance undertakings to avoid as possible direct underlyings of insurance-based investment products, instruments for which the European Securities and Markets Authority (ESMA) has issued a ban or restriction. In general, the use of product intervention powers in one sector should never be circumvented by repacking the instruments that have been banned or restricted for offer in another sector.

EIOPA says that at this point, there is no evidence of direct policyholder exposure to CFDs or binary options, whilst the possibility of such policyholder exposure to CFDs or binary options developing seems not very likely. However, EIOPA's experience has been that unexpected and complex risks have increasingly been offered as potential units within unit-linked contract raising supervisory concerns. For this reason, EIOPA remains cautious on the matter.

Within its remit, EIOPA will use the available powers and measures to ensure the integrity, transparency, efficiency, and orderly functioning of financial markets and that customers' interests are adequately protected throughout the EU. Specifically, EIOPA and national competent authorities will continue to monitor the market for insurance-based investment products, including those providing direct exposure to complex and risky underlyings, in case other restrictions or bans are necessary.

SOLVENCY II

EIOPA invited to produce report on group and passporting provisions

On 21 June 2018, EIOPA published the text of a letter received from the European Commission in relation to the group and passporting provisions of the Solvency II Directive.

Article 242(2) of the Solvency II Directive requires the Commission to make an assessment of assess the benefit of enhancing group supervision and capital management under Solvency II by the end of 2018. The Commission wants to identify challenges and diverging practices in group supervision, as well as in the supervision of freedom of establishment and freedom to provide services. EIOPA is invited to provide a report on a list of specific items that the Commission has identified for the scope of this review by 1 November 2018.

The letter is dated 7 June 2018 and is accompanied by an annex listing the issues on which EIOPA is to report. These include:

- practices in centralised group risk management and the functioning of group internal models;
- intragroup transactions and risk concentrations;
- mediation of supervisory disputes;
- barriers to asset transferability;
- the level of protection of policy holders and beneficiaries of the undertakings of the same group, particularly in crisis situations;
- insurance guarantee schemes;
- the scope of group supervision;
- group solvency calculation and group supervision.

European Commission adopts Delegated Regulation amending the Solvency II Delegated Regulation

On 1 June 2018, the European Commission published a Commission Delegated Regulation it has adopted, amending the Solvency II Delegated Regulation (EU) 2015/35 as regards the calculation of regulatory capital requirements for securitisations and simple, transparent and standardised (STS) securitisations held by insurers and reinsurers.

The Solvency II Delegated Regulation contains detailed implementing rules for the Solvency II Directive, including rules on risk calibrations for the calculation of capital charges for specific asset categories. The Solvency II Delegated Regulation includes a detailed list of criteria to identify certain securitisations (so-called type 1 securitisations), which benefit from significantly lower capital requirements for insurers investing in senior tranches compared to other securitisation positions.

The Commission says that the current low interest rate environment is increasing pressure on insurers to search for higher yields on their investments to fill the gap between promised and current real-world interest rates. Stimulating insurers' investment in new asset classes may help them to diversify and increase the yield of their investment portfolios. STS securitisation, accompanied by robust risk management safeguards, can be designated as a new asset class.

The STS Regulation entered into force on 17 January 2018 and will apply as from January 2019. It will be addressed to insurers and will amend the Solvency II Directive. This requires a number of changes to the Solvency II Delegated Act to ensure alignment and consistency.

The adopted Delegated Regulation will enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

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