

## INSURANCE OUTLOOK 2018

### January 2018

It would be good for once to be able to say that there were no regulatory developments on the horizon in the year ahead that will affect the insurance sector. Sadly, 2018 is much like any other year in that there are numerous reviews and reports anticipated. In this Outlook briefing we examine some of the key expected developments and comment on what they might hold in store for the insurance industry. No review of the year ahead will of course be complete without at least a passing mention of Brexit and Solvency II.

#### Selected key expected dates

Q1 2018	FCA review of the fair treatment of with-profits customers to start
January 2018	FCA policy statement on its third consultation on implementing the Insurance Distribution Directive
23 February 2018	Deadline for transposition and application of the Insurance Distribution Directive
February 2018	EIOPA due to deliver second set of advice on the review of the Solvency II standard formula
1 October 2018	Proposed revised application date for the Insurance Distribution Directive regime
Autumn 2018	Publication of interim report from the FCA's wholesale insurance broker market study
Q4 2018	Extension of the SM&CR and the Duty of Responsibility to insurers
End of 2018	Commission review of the Solvency II standard formula expected to conclude

## Under regulatory review

### FCA review of the wholesale insurance sector

Historically, the FCA (and the FSA before it) has focussed primarily on areas of potential detriment to individuals and SMEs rather than larger businesses. In its role as a competition regulator it is, however, taking a broader view on the functioning of the markets which it regulates.

In 2018, for example, it intends to carry out a review of the wholesale insurance broking sector. The terms of reference for the market study, published in November, make clear that the FCA will contemplate taking action if it finds that current broking practices are having a detrimental effect on competition. Although the FCA does not specify, this could presumably include introducing new rules regulating the activities of brokers.

The FCA stresses that the primary focus of the market study is not to identify cases where enforcement action may be needed for breaches of existing competition law. It has, however, asked that firms self-report and report on other firms if it emerges during the process of responding to the study that any current conduct is in breach.

The three main topics to be investigated by the market study are:

- whether individual broker firms possess market power - and if so, is this harming competition?
- what conflicts exist in the sector and what is their effect on competition and firm conduct?
- to what extent does broker conduct affect competition in the broker sector?

It will include looking at additional services provided by brokers and the extent to which insurers which do not take up those additional services are disadvantaged. It will also include consideration of the types of remuneration provided to brokers and whether these could give rise to conflicts.

### FCA webpage

### FCA proposed review of the fair treatment of with-profits customers

The FCA published an information request to with-profits firms in June of last year, ahead of an expected review of the fair treatment of with-profits customers. The current expectation is that the review will commence sometime in Q1 2018. The last wide ranging review of the with-profits sector took place in 2010 and resulted in a number of changes to the regulatory regime being made in 2012, including new rules around: writing new business in a with-profits fund; purchase and retention of strategic investments; actions where there is a significant fall in the volume of new contracts being written in the with-profits fund; and governance of with-profits funds.

The FCA has not yet indicated any areas of concern to be addressed in this review - on issuing the information request it said that it would decide on scope once it had received the information from firms. There is a thematic link with the FCA's previous work on the fair treatment of long-standing customers in the life insurance sector, which resulted in guidance published in December 2016. As part of that review the FCA

considered issues around governance, customer communication, calculation of policy values and the ability of customers to change products.

#### FCA webpage

### Implementing the Insurance Distribution Directive

2018 finally sees the commencement of the new regime for insurance distribution under the IDD. Scheduled to come into effect from 23 February 2018, it now looks as though the application date for the new rules will be pushed back to 1 October 2018. The Commission has published a legislative proposal to this effect and confirmation of agreement to the change is awaited from the EU Council and Parliament.

Although the changes brought in by the IDD are less fundamental than those introduced by Solvency II, they cast a wider net as they will affect both insurers and intermediaries distributing insurance products. Like Solvency II, there will also be multiple sources of rules and guidance under the new regime. Some key aspects are highlighted below:

Requirement	Principal source(s)
“Customers best interests” rule including prohibition on conflicting remuneration arrangements	ICOBS, COBS, SYSC Commission Delegated Regulation (EU) 2017/2359 (information requirements and conduct of business rules for insurance-based investment products)
New pre-contract disclosure requirements including an obligation for all insurance intermediaries to disclose the nature and basis of the remuneration received	ICOBS, COBS
Changes to demands and needs requirements	ICOBS, COBS
Changes to suitability rules for insurance based investment products (IBIPs)	COBS Commission Delegated Regulation (EU) 2017/2359 (information requirements and conduct of business rules for insurance-based investment products)
Restrictions on cross-selling	ICOBS, COBS
New category of “ancillary insurance intermediaries”	Amendments to the Regulated Activities Order
New standardised Insurance Product Information Document (IPID) for retail non-life insurance products	ICOBS Commission Implementing Regulation (EU) 2017/1469 - the IPID Technical Standard

Product governance requirements	New Product Intervention and Product Governance Sourcebook (PROD) Commission Delegated Regulation (EU) 2017/2358 (product oversight and governance requirements)
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The IPID only applies to the sale of non-life insurance products because a separate disclosure document is mandated for packaged retail and insurance-based investment products under the Packaged Retail and Insurance Based Investment Products (PRIIPs) Regulation, which came into effect on 1 January 2018.

As noted above, in the UK most of the IDD requirements will be transposed into the FCA Handbook. The FCA has published three consultations and three policy statements on implementing the IDD (the most recent of which was only published this month). The FCA timetable has been driven to an extent by delays in the publication of the delegated regulations. In view of these delays, a postponement of the application date for the new rules to October will no doubt be welcomed by the industry.

### Insurance Linked Securities

The Risk Transformation Regulations and the Risk Transformation (Tax) Regulations came into effect in December 2017, providing the architecture for the new Insurance Linked Securities regime in the UK.

Following industry push back on the initial regulatory approval regime, a stream lined process to establish an ISPV and subsequently add additional cells to take on risk was agreed by the PRA. Exactly what appetite there will be to use the regime and the extent to which UK-established vehicles will be able to compete with their overseas counterparts remains untested - although specialist reinsurer Neon has already obtained authorisation for a risk transformation vehicle, NCM Re, and launched an ILS transaction on 1<sup>st</sup> January.

### Preparing for Brexit

#### Domestication of financial services law

The devil, they say, is in the detail - and thousands of pages of it are expected over the coming months supplementing the Withdrawal Bill to domesticate EU law. It is as yet unclear the extent to which and in what form there will be an opportunity for industry and its advisers to comment on statutory instruments affecting the insurance sector. Where there is consultation, the likely volume of material suggests that coordination through representative trade associations or other fora would be a desirable approach.

A letter dated 12 December 2017 from the Economic Secretary to the Treasury, Stephen Barclay, to its Chair, Nicky Morgan set out the proposed approach to the domestication of financial services legislation. The letter suggests that the regulators will have responsibility for making detailed rules which apply to firms; however, it also states that Level 2 legislation other than technical standards will become the responsibility of ministers and Parliament (presumably by enacting statutory instruments). It is not clear from this how the Solvency II Delegated Regulation will be domesticated, although the working assumption is that it will be dealt with by way of SI.

Points of interest in the domestication process will include:

- any changes to the European regime which go beyond what is strictly necessary for domestication

- treatment of EU Member States in the domesticated legislation - for example, will exposures to EU central banks continue to receive a favourable treatment in SCR calculations?
- how will the current process under which EIOPA provides technical information for various aspects of the Solvency II capital regime be replicated?
- what changes will be made to FSMA to reflect Brexit, including in Part VII dealing with insurance business transfers?

### International insurance groups

Much of the focus in the first half of 2016 was on the plans of UK insurance groups to address policies written into other EU jurisdictions. The PRA wrote to firms in April 2017 asking for information about their contingency plans and many UK insurers have started the process of transferring blocks of insurance business to prepare for Brexit.

More recently, the position of EU insurers doing business in the UK using their passporting rights has been under scrutiny. The government has (somewhat late in the day) clearly indicated that it will take steps, if necessary, to allow for continuity after Brexit of insurance contracts written into the UK by EU firms. Separately, the PRA has published a consultation on an updated supervisory statement regarding the treatment of international insurers (CP30/17) and a 'Dear CEO' letter addressing this issue. Importantly, firms have been invited to submit applications for third country branch or new subsidiary applications from **January 2018**. Firms which will need a new authorisation post-Brexit should therefore be taking steps now to start to put arrangements in place, if they have not already done so. We commented on these publications in our December briefing note on [Brexit and EEA insurers](#).

The PRA has indicated that EU jurisdictions are likely to be considered as sufficiently "equivalent" to allow branch authorisations. There are some limitations, however - the PRA suggests that firms with liabilities of £200 million or above covered by the FSCS are likely to need to set up a subsidiary rather than a branch.

EIOPA has also called on both UK and EU insurers to take action to secure continuity of cross-border contracts, referring explicitly to the protection of policyholders as the main objective of supervision. It published an opinion on 21 December with the aim:

*"to remind supervisory authorities and insurance undertakings to take the necessary steps in order to prevent insurance activities without authorisation and ensure service continuity with regard to insurance contracts concluded before the Withdrawal date by way of freedom of establishment or freedom to provide services so that these contracts will be fulfilled also after the withdrawal of the UK from the European Union."*

There remains no sign at present of a co-ordinated approach by the EU27 to preserve continuity of contracts written by UK insurers into the EU.

### CP30/17

#### Dear CEO letter

## Solvency II - on the horizon

The regime is now fairly well embedded but adjustments continue to be made, at both European and domestic level. The Commission is due to carry out a review of the standard formula by the end of 2018 - EIOPA submitted a first set of advice on this in October 2017 and is due to submit further advice by the end of February.

Domestically, this month the PRA published the third of its consultations on improvements to the regime, arising out of the Treasury Committee enquiry into insurance regulation. The CP covered reporting obligations and followed on from the earlier two consultations on (i) the matching adjustment and (ii) internal models. The consultation periods for the initial two supervisory statements run until 31 January and 20 March respectively and the consultation period for the final CP ends on 13 April.

The PRA has also been asked by the Committee to report back by the end of March on the steps it is taking to improve the regime - further 'improvements' could in theory therefore follow, although the PRA seems to have indicated that it does not intend to do anything else at this stage.



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