FINANCIAL MARKETS LAW COMMITTEE

27 May 2016

Abi Caldwell
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20 Moorgate
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Dear Ms Caldwell

Discussion Paper on Equity Release Mortgages[1]

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

A Discussion Paper ("DP") on Equity Release Mortgages ("ERM") was published by the Prudential Regulation Authority (the "PRA") on 31 March 2016. The DP sought views on ERM valuation, capital treatment, risk management and associated matters. Whilst the FMLC has not had the opportunity to consider the proposals in detail, the DP has caused stakeholders to raise with the FMLC the question whether a (re)insurer may originate an ERM exposure in the first instance. This in turn has precipitated the question whether an insurer can originate any lending activity, which the FMLC considers to be an issue of persistent legal uncertainty.

Insurers are required to limit their commercial business to insurance business and activities directly relating to that business. This is a long-standing rule—set out both in EU and UK law—but has always been a source of uncertainty. It is generally accepted that insurers can invest in loans made by others, or make one-off loans from time to time, but it is less clear whether they can actively seek out opportunities to engage in lending activity (*ie,* whether by originating the loans directly or purchasing loans systematically from a closely related originator).

The provisions of Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance (the "Solvency II Directive") are relevant here. The Solvency II Directive, whilst carrying over the basic prohibition on non-insurance activities from earlier regulation,[2] also introduces the "prudent person" principle.[3] Although this, on the face of it, appears to widen the scope of "admissible" assets beyond the PRA's previously prescriptive list, it is subject to a number of qualifications. Chief among these is, that (re)insurers

1 Sonya Branch, Stephen Parker and Sean Martin took no part in the preparation or discussion of this letter and it should not be taken to represent the views of the Bank of England, HM Treasury or the Financial Conduct Authority.

2 See Article 18(1)(a) of Solvency II Directive.

3 See Article 132 of Solvency II Directive.

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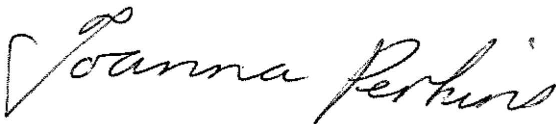
shall only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report.

Taking all this together, the FMLC notes that it is unclear what the appropriate level of expertise (or, in the words of the Solvency II Directive, "monitoring and control") is required of an insurer if it is to engage in lending activity and whether this varies from one lending type to another. This is particularly the case for those medium-sized insurers that may not have the expertise or infrastructure of a larger insurer. Furthermore, the FMLC observes that it is unclear whether an insurer may undertake these activities directly, or should do so only *via* a specialised lending subsidiary within its group.

The Committee considers that guidance at the juncture would be helpful. It is appropriate, in the view of the FMLC, that this guidance should be sought at the national level, as opposed to the supranational, EU level. Whilst the Solvency II Directive is a maximum harmonisation measure, the "prudent person" principle would appear to allow a degree of variation from insurer to insurer and Member State to Member State. Indeed, it would appear that in certain other EU jurisdictions lending is expressly permitted.[4]

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,



Joanna Perkins

FMLC Chief Executive

[4] The FMLC understands that in Germany and France direct lending by insurers is permitted and Italy has recently introduced legislation to allow direct lending to a certain extent.