Financial Markets Law Committee ("FMLC")

FINANCIAL MARKETS LAW COMMITTEE

Insurance and Pensions Scoping Forum: *Ad hoc* meeting to discuss HM Treasury's Call for Evidence on Solvency II

Date: Wednesday 2 December 2020

Time: 2.00pm to 3.00pm

Virtual meeting

Attendees:

Victoria Sander (Moderator)	Latham & Watkins LLP
Pollyanna Deane	Fox Williams LLP
Beth Dobson	Slaughter and May
Hilary Evenett	Clifford Chance LLP
Ben Lyon	Debevoise & Plimpton LLP
Chris Sage	TransRe
Jonathan Teacher	Swiss Re Management Ltd
Michael Wainwright	Dentons UK and Middle East LLP
Venessa Parekh	FMLC Secretariat
Chhavi Sinha	FMLC Secretariat
Katja Trela-Larsen	FMLC Secretariat

Regrets:

George Belcher	Skadden, Arps, Meagher & Flom LLP
Peter Bloxham	
Charlotte Heiss	Royal & Sun Alliance Insurance Group plc
Adam Levitt	Ashurst LLP
Thomas Lockley	CMS Cameron McKenna Nabarro Olswang LLP
Alison Matthews	Herbert Smith Freehills LLP
Steven McEwan	Hogan Lovells LLP
James Middleton	AIG Europe Limited
Clare Swirski	Debevoise & Plimpton LLP
Kees van der Klugt	Lloyd's Market Association

Minutes

1. Introductions

1.1. Ms Sander opened the meeting.

2. Solvency II Call for Evidence (Victoria Sander)

2.1. Ms Sander noted that the deadline to respond to HM Treasury's Solvency II Call for Evidence (the "**Call for Evidence**") had been pushed back to February.[1] She explained that the Call for Evidence seeks views on reforming the prudential regulation of the U.K.'s insurance sector. While Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (the "**Solvency II Directive**"), on which the U.K.'s regime is based, is also being reviewed in Europe,[2] this meeting would solely focus on the U.K review. The stated main aim of the Call for Evidence is to ensure that the U.K.'s prudential regulatory regime for the insurance sector is "better tailored to support the unique features of the sector and the U.K. regulatory approach". Ms Sander noted that the deadline for comments on HM Government's Future Regulatory Framework Review—which covers the future allocation of regulatory responsibilities between Parliament, HM Treasury and the financial services regulators— has also been extended to February.[3] Members agreed that the U.K's regulatory direction post-Brexit and any changes in the broader regulatory framework for the U.K. would be an interesting topic for discussion and would add perspective to any changes made in the insurance sector. They also agreed that HM Government's future policy aims, for instance whether equivalence with the E.U. is sought, will likely impact U.K. reforms to prudential regulation of the insurance sector. Ms Sander suggested that members run through the different chapters of questions in the Call for Evidence so members could consider which points to recommend for further analysis by the FMLC.

2.2. Members agreed that questions on the Risk Margin—chapter two of the Call for Evidence—would likely receive a number of responses from actuaries. Members agreed that the questions were technical and economic rather than legal issues. A member

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1 HM Treasury, Review of Solvency II: Call for Evidence (19 October 2020), available at https://www.gov.uk/government/publications/solvency-ii-review-call-for-evidence

2 European Commission, Solvency II Review (1 July 2020) https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12461-Review-of-measures-on-taking-up-and-pursuit-of-the-insurance-and-reinsurance-business-Solvency-II-

3 HM Treasury, Future Regulatory Framework Review (1 October 2020), available at: https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation

commented it might be worth highlighting variations in the way different offshore reinsurance structures operate.

2.3. Ms Sander moved on to seek members' views on the matching adjustment, covered in chapter three of the Call for Evidence. She highlighted that the Call for Evidence seeks views on the role the matching adjustment could play in supporting delivery of HM Government's climate and long-term investment objectives, and specifically addresses the eligibility of assets for the matching adjustment. A member remarked that encouraging investment in this manner could come at the expense of policy-holders. Members discussed the technical way securitisations are used to conform to Solvency II Directive requirements, querying whether it delivered the desired economic protection. Members suggested that an expert in structured finance would be best placed to analyse this question.

2.4. Members took the view that the questions on the calculation of the Solvency Capital Requirements ("**SCR**") and the calculation of the transitional measure on technical provisions—chapter four, five and six of the Call for Evidence—fell within the expertise of actuaries. The Forum moved on to discuss the reporting requirements—chapter seven of the Call for Evidence. The Call for Evidence states that the proportionality of Solvency II Directive reporting is enhanced by the reporting waiver framework which the Prudential Regulation Authority ("**PRA**") has used to waive quarterly reporting for smaller firms. Members raised concerns about the practice of relying on waivers to ease the burden of reporting requirements, saying that it might achieve a somewhat haphazard result, given the lack of firm guidance as to how waivers would be used. They commented that a lack of clarity on this policy could generate uncertainty. Members observed that the possibility of the U.K. streamlining the reporting requirements in the Solvency II Directive depended on whether HM Government wishes to retain alignment with and/or achieve a positive equivalence decision from the E.U.

2.5. Moving on to branch capital requirements for foreign insurance firms—chapter eight of the Call for Evidence—members noted there could be a number of insolvency-related and local law issues under this area. A member remarked that, in this chapter, the Call for Evidence's focus on the SCR and Minimum Capital Requirement ("**MCR**") for branches to hold does not take into account a full picture. They suggested additional aspects, such as intergroup transactions, should be considered. In respect of thresholds for regulation by the PRA under the Solvency II Directive—chapter nine of the Call for

Evidence—a member suggested that the regulators could utilise a regulatory sandbox to assist newcomers to the market.

2.6. Members went on to discuss Risk-Free Rates and the transition from the London Inter-bank Offered Rate ("**LIBOR**")—chapter eleven of the Call for Evidence. Ms Sander highlighted that the Call for Evidence specifically addresses the use by insurance firms of discount curves based on LIBOR to value their liabilities in several currencies. A member commented that it would be helpful for firms if views coalesced as to what the replacement for LIBOR will be, emphasising that timing is an important factor.

2.7. Ms Sander stated that the final chapter of the Call for Evidence asks a general question as to which areas of the Solvency II Directive not covered elsewhere in the Call for Evidence should be considered for review, opening the floor to members on this question. Members raised a number of points, including:

- the complexities in the legal structure of long-term assets from a Solvency II Directive perspective, as mentioned earlier in the meeting
- surrender rights and control
- what the PRA's approach to ancillary owned funds will be
- the position on circumstances in which a holding company will be outside the scope of Solvency II Directive group consolidation through use of "other measures" under Article 262 Solvency II Directive.
- the meaning of "consent" under Article 214(2)(c) of the Solvency II Directive in relation to substitutions of collateral.
- whether credit insurance or guarantees can allow an asset to benefit from the rating of the credit insurer/guarantor for purposes of the market risk module, notwithstanding Article 5 and Article 215 of the Solvency II Directive.

3. Any other business

3.1. No further business was raised at the meeting.