Neha Bora
Prudential Regulation Authority
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By email: CP17_21@bankofengland.co.uk

6 December 2021

Dear Ms Bora,

PRA consultation paper CP17/21 – Solvency II: Definition of an insurance holding company

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.

On 6 September 2021, the Prudential Regulation Authority ("**PRA**") published a Consultation Paper setting out its proposed approach to interpreting and applying the definition of an insurance holding company for the purposes of the Group Supervision Part of the PRA Rulebook.[1] The purpose of these proposals is to set out the PRA's approach to distinguishing an insurance holding company from a mixed-activity insurance holding company. The Committee welcomes the opportunity to comment on legal uncertainties which may arise in the context of the proposals.

Regulation 2(1) of the Solvency 2 Regulations 2015 (the "**Regulations**") sets out the definition of an insurance holding company. The definition is based on whether the main business of the holding company in question is to acquire and hold participations in subsidiary undertakings that are "exclusively or mainly" insurance or reinsurance undertakings, or Third Country insurance or reinsurance undertakings (collectively referred to here as "insurance or reinsurance subsidiaries"). The definition of insurance holding company in the Glossary of the PRA Rulebook uses the same formulation. The term "mainly" is not currently defined for these purposes in the Regulations or the PRA Rulebook.

Mainly

The FMLC welcomes PRA's proposal to clarify the interpretation of the term "mainly". Market participants have tended to rely on guidance that was issued by the Financial Services Authority ("**FSA**") alongside implementation of the E.U.'s Insurance Groups Directive in 2002.[2] It is understood that the withdrawal of this guidance some years ago occurred as part of the FSA's initiative to reduce the size of its rulebook, rather than because it was no longer relevant. The position has not, however, been clarified since that time and only those who have practised in this area for some years may be aware of the earlier guidance. The PRA proposes to define "mainly" by reference to the value of a group's assets, revenues or to its capital requirements.[3]

Given the above position, the proposed new definition is broadly consistent with current practice. The application of a 50% threshold and the need to satisfy two out of the three thresholds does, however, introduce greater certainty and is helpful.

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Ancillary insurance services undertaking

The proposed new definition of an "insurance holding company" will take into account "ancillary insurance services undertakings" for the first time. The Committee understands that this change is designed to ensure that a parent company cannot avoid the full force of group supervision (by being treated as a mixed-activity insurance holding company instead of an insurance holding company) simply by means of using one or more service companies. The change should ensure that groups with broadly comparable businesses are treated in the same way.

While the objective behind this change appears to be sensible, the definition of "ancillary insurance services undertaking" gives rise to some questions. For example, the definition only covers a group company if (1) its principal activity consists of owning or managing property; managing data-processing services; providing health and care services; or *any other similar activity*; and (2) that activity is ancillary to the principal activity of one or more (re)insurers (italics added).

Given the lack of similarity between the first three types of activity, it is not clear what type of activity should be regarded as a "similar activity" to those specified. If the intention is that the activity is "similar to any of the others" rather than "similar to all of the others", that may reduce the uncertainty, although there remains room for doubt based on the wording (see comments below). This could, in practice, mean that a decision as to what is a "similar activity" will depend on the PRA's discretion alone, causing uncertainty amongst market participants in the course of their own assessments and preparation. The definition would benefit from additional clarification.

The Committee is aware that this terminology is used in other contexts, suggesting that the intention may be to introduce uniformity in terminology across financial sectors. However, in April 2021 (echoing views expressed on several previous occasions) the European Banking Authority ("**EBA**") recognised the need for additional clarification of the definition of "ancillary services undertaking" as used in the Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (the "**Capital Requirements Regulation**" or "**CRR**"), noting that it was "prone to inconsistent interpretation across the E.U.". More recently, the European Commission proposed amendments to the CRR definition of "ancillary services undertaking" to introduce the following:[4]

> (18) 'ancillary services undertaking' means an undertaking the principal activity of which, whether provided to undertakings inside the group or to clients outside the group, the competent authority considers to be any of the following: (a) a direct extension of banking; (b) operational leasing, factoring, the management of unit trusts, the ownership or management of property, the provision of data processing services or any other activity that is ancillary to banking; (c) any other activity considered similar by EBA to those mentioned in points (a) and (b).

If this drafting is accepted, it would provide explicitly that the decision whether or not a firm should be regarded an "ancillary services undertaking" is one for the relevant supervisory authority. The new definition suggests that a "similar activity" would need to be similar to activities falling within both (a) and (b). While this will not provide firms with certainty, it may at least be helpful in setting expectations.

Inconsistency between PRA rules and legislation

The PRA's proposals will result in the definition of an "insurance holding company" in the PRA's rulebook being different from that applying under the Solvency 2 Regulations 2015. The Consultation Paper states that the intention is to clarify the PRA's approach to the term "mainly". This could be taken to mean that the PRA is not changing the definition itself,

merely clarifying how it applies. This is difficult to reconcile, however, with the fact that ancillary insurance services undertakings are being brought into the definition for the first time. If the PRA rulebook definition of an "insurance holding company" is to be changed, the same change should be made to relevant legislation.

Changes are not retrospective

Notably, the proposed changes are not intended to be retrospective. They will only apply, therefore, to future determinations of insurance holding company status, which will include assessments of existing groups on the occasion of a "trigger event". The term "trigger event" is not defined in the Consultation Paper but the PRA expects it to include the acquisition or disposal of a company within a group. Whether any acquisition or disposal, however small, will constitute a trigger event is unclear. Uncertainty around the scope of a "trigger event" (and therefore whether the more onerous implications of being an "insurance holding company" are likely to result from a transaction) means the legal effect in practice of the changes proposed is less clear than it should be, which will give rise to concern amongst market participants. Therefore, it would be helpful if the PRA could clarify the meaning of a "trigger event" for these purposes.

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 should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Brian Gray
FMLC Chief Executive[5]

1 PRA, *Consultation Paper: CP17/21 Solvency II: Definition of an insurance holding company* (September 2021); available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/september/cp1721.pdf?la=en&hash=C3A476A91A1101ED946B6B84C000648A04CD4026

2 Directive 2002/92/EC on insurance mediation; available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32002L0092&rid=9

3 The PRA proposes to define "mainly" in the following manner (new text is underlined and deleted text is struck through):

> **Insurance Holding Company**
>
> means a parent undertaking, other than a UK Solvency II firm and a mixed financial holding company, the main business of which is to acquire and hold participations in subsidiary undertakings and which fulfils the following conditions:
>
> (1) its subsidiary undertakings are either exclusively or mainly UK Solvency II firms, third country insurance undertakings ~~or~~, third country reinsurance undertakings or ancillary insurance services undertakings: the subsidiary undertakings of a parent undertaking are mainly UK Solvency II firms, third country insurance undertakings, third country reinsurance undertakings or ancillary insurance services undertakings where more than 50% of two or more of:
>
> (a) the parent undertaking's consolidated assets;
>
> (b) the parent undertaking's consolidated revenues;
>
> (c) the group SCR (as if calculated at the level of the parent undertaking),
>
> are derived from subsidiaries that are UK Solvency II firms, third country insurance undertakings, third country reinsurance undertakings or ancillary insurance services undertakings; and
>
> (2) at least one of those subsidiary undertakings is a UK Solvency II firm.

4 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013, see page 44

The FMLC is not aware whether the European Insurance and Occupational Pensions Authority has expressed similar concern about inconsistent interpretations of the definition of "ancillary services undertaking" in the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance ("Solvency II" or "Solvency II Delegated Regulation") (from which the PRA's definition is derived), nor whether any further clarification by the European Commission is to be anticipated. However, the point made by the EBA appears to be equally applicable in an insurance context.

5 The FMLC is grateful to Geoffrey Maddock (Herbert Smith Freehills LLP) for his help in drafting this letter.