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UK INSURERS: PREPARING FOR THE 2023/4 REGULATORY PIPELINE

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The sixth edition of the Regulatory Initiatives Grid (the "Grid") was published at the end of February 2023. The Grid provides an overview of upcoming initiatives and their timelines to help UK insurers plan and prepare for compliance. This article highlights key regulatory initiatives for UK insurers taken from the 'Insurance' and 'Multi-sector' categories used in the Grid, along with the steps insurers should take in preparation for the mentioned reforms.

Some of the key initiatives outlined in the Grid include the evaluation of General Insurance (GI) pricing rules, implementation of Solvency UK reforms, and enhancement insurance resolution measures. The Grid also highlights changes to insolvency arrangements, as well as incoming requirements for operational resilience and the Consumer Duty.

The Grid shows that Environmental, Social and Governance (ESG) matters remain high on the regulatory agenda, with several initiatives underway that will impact the insurance sector in 2023. Most ESG work for insurers will continue to be focused on disclosures, but recent trends suggest that regulators will place greater emphasis on insurers incorporating ESG factors into investment decision-making and risk management practices.

The Grid is available here.

Background

The Grid is compiled by the Financial Services Regulatory Initiatives Forum, which is made up of representatives of several UK regulatory bodies, including the Bank of England, the Financial Conduct Authority (FCA), and the Prudential Regulation Authority (PRA).

The Grid was scheduled to be released in November 2022 but was postponed so that Forum members could consider the potential effects of the Government's Edinburgh Reforms. The introduction of "Solvency UK" and the repeal and replacement of retained EU law are both included in this significant package of legislative amendments. The latest Grid includes references to these initiatives.

Insurance

- **Evaluation of GI Pricing**
  The FCA intends to conduct an impact assessment of the GI Pricing Practices rules, which took effect in 2021/22. The rules, which apply to insurers and insurance distributors offering home or motor insurance, aim to ensure that policyholders get fair value for their insurance. New rules included a ban on price-walking (where

Key points

- An FCA evaluation of GI Pricing Practices rules is underway with possible rule amendments to address any deficiencies.
- The FCA plans to extend its 'Customers in financial difficulty' to all customers, these are additional expectation on top of the Consumer Duty.
- Targeted amendments to insurer insolvency arrangements expected, with further Court powers to reduce the value of an insurer's contracts.
- A new UK insurance resolution regime in line with international standards and best practices is now the subject of government consultation.
- The PRA has concerns around risk transfer to reinsurers, including how UK annuity providers transfer longevity and investment risks to them.
- The PRA is conducting a BPA thematic review and could issue further guidance or regulatory change in this area.
- Further PRA consultations for 'Solvency UK' are expected later this year, leading to a new PRA Rulebook.
- Workplace diversity and inclusion regulatory proposals to be published.
- Mandatory climate-related financial disclosures could be extended to all UK insurers.
- A review of the SM&CR expected, insurers should be ready to feedback on whether the regime has improved governance and 'fit & proper 'arrangements.
- Insurers have until 31 March 2025 to demonstrate compliance with operational resilience requirements.
- Insurers should be prepared for compliance with the Consumer Duty by July 2023 for new and renewal insurance products.
- The Financial Services and Markets Bill will be enacted soon, and insurers need to be aware that significant regulatory changes will be implemented.

loyal customers are charged higher premiums on renewal) and rules on facilitating the cancellation of auto-renewing policies. In-scope firms were required to revisit their product governance and update their policies and procedures to ensure they complied with the rules.

The FCA has indicated that it plans to contact in-scope insurers in Q1 2023 regarding a data request, with the actual data collection taking place in 2024. The FCA's study is projected to be finished by 2024–2025, at which point the FCA may amend the rules to address any issues it identifies with current practice.

- **Customers in financial difficulty**
  As part of its consultation paper (CP23/1) published at the beginning of this year, the FCA sought feedback on its proposal to replace previous insurance guidance for customers experiencing financial difficulties due to COVID-19 with new insurance guidance that would apply to all customers. The proposed guidance sets out broad expectations for insurers regarding customer support initiatives. These are intended to assist a firm meet its obligations under PRIN 12 (the new Consumer Duty) and ICOBS 2.5.1R (the Customer's Best Interests rule).

Insurers should engage with the guidance since it adds additional expectations over and above those under the Consumer Duty.The consultation closes on 11 March 2023, with the guidance, if made, to take effect on 31 July 2023.

- **Insolvency Arrangements**
  In May 2021, HM Treasury published the consultation document 'Amendments to the Insolvency Arrangements for Insurers' which proposed a series of targeted amendments to the current insurer insolvency arrangements.

  The amendments include clarifications and enhancements to the court's existing (but seldom, if ever, used) power, under section 377 of the Financial Services and Markets Act 2000 (FSMA), to order a reduction of the value of an insurer's contracts (a 'write-down'). They also introduce new provisions to help mitigate business disruption and losses for insurers in distress including a write-down manager to oversee the process, a statutory moratorium on certain termination/suspension rights and a change to the protection provided by the Financial Services Compensation Scheme (FSCS) in the event of a write-down under section 377 FSMA. For further information on the consultation, please see our note HM Treasury Consultation: Insolvency Arrangements for Insurers.

The enhanced insolvency arrangements represent a significant development for insurers, their policyholders, and many of their counterparties. Insurers should examine the amendments to understand what new powers the courts will have, what liabilities can be written down, and how a moratorium would operate.

The government has confirmed that it will introduce amendments in the Financial Services and Markets Bill 2022.

- **Insurer Resolution Regime**
  A UK insurance resolution regime (IRR) that is in line with generally accepted standards and best practices is now the subject of government consultation. The plans would provide the UK authorities with new tools and powers to handle the failure of an insurer, with the Bank of England serving as the resolution authority (RA).

  The IRR sets a high threshold for the application of new resolution powers because it requires the fulfilment of four cumulative resolution conditions before an insurer may be placed in resolution. In summary, a UK insurer may be resolved if (i) they are failing or likely to fail, (ii) corrective action is unlikely, (iii) resolution is required to achieve the resolution objectives and (iv) resolution is in the public interest. The RA would have new power to transfer the insurer or its business to a purchaser, a bridge institution or temporary public ownership or to reduce (or convert into equity) the claims of unsecured creditors. Safeguards would apply to ensure that creditors are no worse off than in liquidation.

  Currently, there is a lack of clarity about the interaction between the resolution proposals and the Insolvency Arrangements as they appear to be separate write-down processes. It is expected that once the UK confirms the IRR, the interaction between these two processes will be clarified.

  Insurers should consider the potential impact of IRR on their business including the possible impact on their debt issuance, financial and supply contracts and insurance and reinsurance terms or pricing and whether they are likely to be within the scope of the proposed additional pre-resolution planning obligations. Insurance groups that are issuers in public markets will also need to consider how to address the proposals in risk factors in their offering documents. Insurers may also wish to respond to the consultation proposals to seek to ensure that the IRR is proportionate to the risks presented by the insurance sector.

  For further information on the IRR, please see our briefing: HM Treasury consults on new UK Insurer Resolution Regime.

- **Annuity reinsurance concentration**
  A growing concern for the PRA is how insurers transfer their risks to reinsurers, including how UK annuity providers transfer longevity and investment risks to them. Charlotte Gerken, executive director for insurance supervision at the PRA, discussed the high levels of longevity reinsurance and the emergence of "funded reinsurance" in a speech at the Bank of America CEO Conference in September 2022. She also raised concerns about the exposure of primary insurers to "concentrated risk".

  Increasing reliance on longevity reinsurance in offshoring risk to US and Bermuda reinsurers could be explained by the popularity of bulk purchase annuity (BPA) deals, The PRA has also been concerned about portfolio regulatory arbitrage and offshore revenues. Bermuda's more relaxed capital approach may also have contributed to the emergence of more complex 'funded reinsurance'. There will likely be interest in how the PRA concerns affect the UK insurance-linked securities (ILS) market, as one way to onshore the risk is to amend the UK regime so it has a similar offering to Bermuda.

Concentration risk was also flagged as an issue in the PRA Insurance supervision: 2023 priorities letter published in January 2023. Here, the PRA warns that a mass 'recapture event' (e.g., where a reinsurer defaults) could result in large concentrations to a few counterparties. As collateral terms are not standardised and are sometimes opaque, recaptured assets may also not be Solvency II-compliant.

The PRA is also currently conducting a BPA thematic review which has taken the UK market by surprise. Firms that have been approached by the PRA should demonstrate how they are responding to PRA expectations for risk management, including Solvency II requirements. In addition, they should be ready to explain the steps they are taking to address any PRA concerns. The PRA will decide whether further guidance or regulatory change is needed in this area in due course.

- **Solvency UK reforms**
  For the delivery of 'Solvency UK', the Grid indicates that secondary legislation will follow the passage of the Financial Services and Markets Bill 2022. The PRA will consult on new rules, with one consultation expected in Q2 of this year. Given that most of the Solvency II onshored requirements are anticipated to reside in the PRA Rulebook, more PRA consultations are also anticipated; however, this approach is contingent upon new legislation resulting from the Bill.

  For further information on Solvency UK reforms, please refer to our article: Transitioning to Solvency UK - the Edinburgh Reforms and the Solvency II Review: Response.

Multi-sector issues relating to Insurers

- **Transition Plan Taskforce (TPT)**
  The FCA and HM Treasury created the Transition Plan Taskforce (TPT) in April 2022 to tap into industry expertise and define the standard for climate transition plans toward a low Green House Gas (GHG) emissions economy. Following extensive research, the TPT released a Disclosure Framework that emphasises the necessity for firms to create and follow a short-term action plan that brings them closer to net zero. The Framework is supported by Implementation Guidance, which describes how to develop a transition strategy and when and how to disclose it in compliance with Guidance recommendations.

Mandatory climate-related financial disclosures are already required from in-scope publicly listed insurers or major insurers, and, in line with TPT recommendations, could be extended to all UK insurers in the not-too-distant future. Insurers are therefore urged to participate in the TPT work to understand the direction of future requirements.

- **Sustainable change finance**
  The FCA has already opened a discussion with the financial services industry following the publication of DP23/1 "Finance for positive sustainable change: governance, incentives and competence in regulated firms". In the paper, the FCA outlines that a firm's governance, purpose, and culture are central to how it embeds environmental and social considerations into business, risk, and capital allocation decisions for the benefit of consumers.

The FCA's Discussion Paper also offers some helpful information to start the sustainability conversation at the board level. Insurers should also start to assess their current level of preparedness for the proposed regulatory changes, identify any gaps in their current practices, and start developing plans for how to comply with the new requirements. Doing so can help insurers to stay ahead of the curve and avoid potential penalties or reputational damage that could result from non-compliance.

The FCA is seeking views on how it can move effectively beyond disclosure-based initiatives to help and encourage firms as they develop their arrangements for governance, incentives, and competence in sustainability. Insurers should engage with the DP23/1 and offer feedback so that the regulator can better understand the impact of ESG issues, for example, on underwriting policies and investment mandates and how insurers could incorporate measures like ESG investment screening.

- **Diversity in Financial Services**
  The UK regulators plan to publish proposals on promoting diversity and inclusion across the financial services sectors in a consultation paper in the first half of 2023.

  To get ahead of regulatory plans, insurers are encouraged to refer to the joint Discussion Paper DP 21/2 published in July 2021. This paper sets out the regulatory expectations and guidance for financial services firms to promote diversity and inclusion in their workplaces. The paper outlines key actions that firms can, such as setting targets for diversity and inclusion, ensuring that recruitment processes are fair and inclusive, providing training and development opportunities for diverse talent, and establishing effective governance and accountability structures.

Insurers can also engage with industry groups and networks focused on promoting diversity and inclusion, such as the Dive In Festival, which is a global initiative aimed at encouraging diversity and inclusion in the insurance industry. By participating in such initiatives, insurers can stay up to date with best practices, share knowledge and experience, and build networks of diverse talent.

- **Review of the Senior Managers and Certification Regime (SM&CR)**
  The Government and regulators will commence a review of the SM&CR in the next few months. The Government will launch a Call for Evidence and the FCA and PRA will issue a joint Discussion Paper Develop frameworks for diversity data collection and disclosure.

To prepare for the review of the SM&CR, insurers should be ready to feedback on whether the regime has improved governance arrangements, any issues with identifying senior managers and assessing fitness and propriety as well as compliance monitoring procedures. By taking these steps, insurers can ensure that they can fully input into regime improvements.

- **Operational Resilience**
  The PRA's concerns over general market conditions have informed its rules about operational risk and resilience. The PRA currently expects insurers to identify and map key business services and set impact tolerances (see policy statement PS6/21 "Operational resilience: Impact tolerances for important business services").

Insurers have until 31 March 2025 to demonstrate that they will be able to operate in a range of 'severe but plausible' scenarios, including cyber-attacks. This will, of course, extend to arrangements where a firm relies on a third-party outsourced provider.

- **Consumer Duty**
  The FCA's Consumer Duty represents what the FCA terms a "paradigm shift" in its expectations of firms. For insurers, it includes obligations such as providing clear and transparent information about policies, offering fair prices, handling claims efficiently and fairly, and treating customers based on their needs, which is particularly important for vulnerable customers. Overall, the Duty should benefit both the customers and the insurance industry in the long run.

  The final rules and guidance implementing the new Consumer Duty were published in July 2022. The Duty will come into force for products that are open to sale or renewal at the end of July 2023, and for closed products at end of July 2024.

  For further information on the Duty, please see our briefing: How does the Consumer Duty apply to the UK insurance sector.

Next steps

The next Grid will be published towards the end of the year. Before this, the Forum plans to publish a short update after the Royal Assent of Financial Services and Markets Bill. This is due to the significance of the Bill which will shake up how the financial services sector is regulated in the wake of leaving the EU. The Bill is currently going through the House of Lords but is expected to be passed in a few months from now, subject to Parliamentary timing.

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