

Insurance Sector Regulatory Update

September 2024

A photograph of three business professionals in a meeting. A man in a white shirt and glasses is smiling and looking towards a woman in a light blue shirt. Another man in a grey suit is visible in the background. The scene is set in a bright office with large windows.

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The new UK prudential regime will eventually be known as 'Solvency UK'. The PRA will continue to refer to the regime as Solvency II until such time as all references to Solvency II can be changed across all relevant materials.

Our April 2024 newsletter covered the reforms set out in PS2/24 and PS3/24 which will come into effect on 31 December 2024. Our view is that these changes are non-trivial and it is recommended that firms assess any necessary changes to their reporting process and test in advance of the 2024 year-end.

Some technical background is useful although much will primarily be of interest to reporting software vendors and in-house technology teams. At the end of April, Version 2.0.0 of the Bank of England Insurance Taxonomy was released setting out the technical implementation of these requirements. This package replaces QRT-based reporting submitted using the EIOPA authored Solvency II taxonomy. The PRA has renamed the templates, whilst “keep[ing] familiarity with previous... names” – notably changing the 'S' prefix from EIOPA templates to 'IR' (insurance reporting) and slotting in previous 'NS' (national specific) templates (e.g. S.01.01 maps to IR.01.01).

Helpfully, the PRA have put together a Q&A document and a template and instructions issue log and will update these as required.

Timescales are challenging. The PRA expects to publish the final set of Solvency UK rules including the reporting rules, templates and instructions with updated legal references in Q4 2024 as part of the Policy Statement to CP 5/24. The PRA will publish a revised Reporting Instrument consolidating the changes from PS 3/24 and PS 10/24. The full reporting rules will be available on the Rulebook part of the website at a later date.

Please see “The King's Speech 2024” below for further comment regarding the higher thresholds introduced by PS2/24.

<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/regulatory-reporting/insurance/solvency-ii-regulatory-reporting-reformsroundtableqajuly2024.pdf>

<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/regulatory-reporting/insurance/boe-insurance-known-issues-july-2024.pdf>

<https://www.bankofengland.co.uk/prudential-regulation/publication/2024/april/review-of-solvency-ii-consultation-paper>



Stress Tests

The PRA have published information on both the dynamic general insurance stress test (DyGIST) and the life insurance stress test (LIST) that the PRA intends to run in 2025.

The 2025 LIST will apply to UK life insurers active in the bulk purchase annuity market with the largest annuity portfolios. The test consists of a core scenario (evolving market stresses) and two exploratory scenarios (additional credit downgrades for the most material asset type). The results of the core scenario will be published at an individual firm level.

Building on the PRA's concerns around transfers of annuity portfolios (including counterparty risk, complexities, effectiveness of management actions in stress and sector wide vulnerability), they published a Dear CEO letter, PS13/24 and Supervisory statement SS5/24 (both titled "Funded reinsurance") on 26 July.

DyGIST covers around 80% of the PRA regulated general insurance market, as measured by gross written premium, including LV= and NFU.

<https://www.bankofengland.co.uk/prudential-regulation/publication/2024/july/list-2025>

<https://www.bankofengland.co.uk/prudential-regulation/publication/2024/july/general-insurance-stress-test-2025>



Consumer Duty

Sheldon Mills, executive director of consumers and competition at the FCA, spoke at the FCA's 31 July event "Consumer Duty: 1 year on". He commented that the Duty "has been driving improvements in firm culture, conduct and governance, too, which over time will drive better outcomes still." The conduct regulator will publish a grid of their forward programme of Consumer Duty work, prioritising initiatives where:

- "First, there is a need to act to address harm, or potential harm, to retail customers.
- Second, we want greater understanding of how you're embedding the Duty, the outcomes your customers are getting, and where potential issues are emerging. Where we need more data and information from firms, we'll only ask for what we really need.
- And third, we believe sharing more information on good practice and our expectations will benefit industry and help drive better outcomes."

He added "Ultimately, we are seeking to ensure that value overall is provided – price is one element, but service and understanding are also key components."

Slightly unusually, there was a lengthy comment on smaller firms and he flagged the "Call for Input" to explore simplifying requirements on firms dealing with retail customers.

The speech followed on from the FCA's June publication setting out the key findings from their review of larger insurance firms' approaches to outcomes monitoring under the Duty. They set out examples of good and poor practice. The regulator found "many firms need to make improvements in their monitoring to enable them to determine whether they are delivering good outcomes for retail customers."

The FCA reiterated that firm's subject to PROD 4 could use any monitoring or reviews already carried out in line with PROD 4, under which the Duty's products and services outcome and the price and value outcome will already be being met.

Subsequently, on 21 August, the FCA published their assessment of insurance manufacturers and distributors' product oversight and governance arrangements against what is required under PROD 4. The FCA found "Many firms were not fully meeting the requirements under PROD 4 and could not ensure and evidence that their products are delivering fair value."

The report provides examples of good and bad practices and illustrates the regulator's expectations alongside the formal rules. There is an example specifically in relation to the target market for income protection, PMI and motor insurance products where the FCA flag the absence of details on any cover provided by an employer. This is an essential element of an income protection product which should be suitably covered in processes, including, we expect, key data inputs in both initial application forms and later change of employer forms to cover a "reasonable foreseeable period" as a policyholder. This serves as an obvious check for insurers to perform and document accordingly. Otherwise, the regulator found that most of the issues applied broadly, rather than to individual products, and existed across both general insurance (GI) and pure protection (PP) products. These also present an obvious check when the principles are applied to the insurer's own products and governance framework.

Manufacturers must take into account distribution arrangements. However, the FCA found that only a few firms had data for monitoring distributors' remuneration to ensure it was consistent with providing fair value to customers. Interestingly, the regulator questions whether consideration has been given to setting a cap on the amount of remuneration or setting a risk tolerance limit.

The report emphasises the governing body is responsible for the product oversight and governance policy. They must be able to adequately evidence how and why they can conclude that products offer fair value and give their customers good outcomes. The statement accompanying the report was unequivocal "Where we see failings have caused significant harm to customers, we will seek to make sure firms and their senior managers are held accountable for these failings and remediate the harm."

All manufacturers and distributors of GI and PP products should consider the contents urgently, assess relevance, and act promptly and appropriately where shortcomings are identified.

The thematic review was quickly followed, on 28 August 2024, by the FCA announcing the intention to launch a market study into how pure protection insurance products are sold following concerns that competition is not working well in the market.

Linking to their wider work on Consumer Duty, the FCA will focus primarily on the sale of four specific types of products:

- term assurance,
- critical illness cover,
- income protection insurance and
- whole of life insurance including policies for over 50s that offer guaranteed acceptance.

The regulator is particularly concerned that commission arrangements may not result in fair value, some pure protection products may not provide fair value to customers (this appears to be specifically in respect of the over 50s insurance) and whether market competition is weakening to the detriment of customers.

In terms of commission, we think it will be important for insurers to show that they've considered all payments to intermediaries within fair value assessments, perhaps investigated, considered and acted on harmful behaviours related to commission arrangements and are satisfied with any variations from "standard" commission terms (including the FCA's reference to "loaded premiums").

The Duty came into force on 31 July 2023 for products and services open for sale and has been in force since 31 July 2024 for products and services that were closed to sale or renewal on 31 July 2023.

<https://www.fca.org.uk/news/speeches/taking-leap-consumer-duty>

<https://www.fca.org.uk/publications/multi-firm-reviews/insurance-multi-firm-review-outcomes-monitoring-under-consumer-duty>

<https://www.fca.org.uk/publications/thematic-reviews/tr24-2-general-insurance-pure-protection-product-governance>

<https://www.fca.org.uk/publications/market-studies/ms24-1-1-market-distribution-pure-protection>



The King's Speech 2024

The speech outlined the new Labour Government's legislative programme. The Draft Audit Reform and Corporate Governance Bill "will also support long-term investment in UK companies, reduce the harm that financial reporting errors can do to businesses and communities up and down the country, and help ensure quality audit for all businesses that need it." The draft bill will replace the Financial Reporting Council with a new regulator – the Audit, Reporting and Governance Authority. Given there is a direct link between the definition of Public Interest Entities (PIEs) and the Solvency II Directive we noted that "This statutory regulator will form a platform for other important changes... removing unnecessary rules on smaller Public Interest Entities, making life easier for important smaller businesses by cutting requirements that are disproportionate."

Since the publication of the PRA's policy statement PS2/24 Review of Solvency II: Adapting to the UK insurance market, which amongst other things set out the revised thresholds for being considered a Solvency II firm in the UK, there has been a lot of uncertainty about what this meant for a firms' PIE status.

The PIE status is determined through a series of European directives and rules, many of which have been repealed and replaced by other directives, but which ultimately lead to the Solvency II Directive.

The new minimum thresholds for Solvency UK are defined separately from the Solvency II Directive and as such will no longer be aligned with the PIE threshold. Therefore, any insurers currently treated as a PIE should assume they will continue to be treated as a PIE in 2025 and beyond. That is until either such time that they fall below the thresholds set out in the Solvency II Directive or the point at which the PIE threshold in the UK ceases to be aligned with the Solvency II Directive.

This is disappointing since smaller insurers are unlikely to incur the additional costs of a one-off move to the non-Directive regime if they are unable to offset these against a reduction in ongoing professional fees. We therefore don't expect many to take advantage of the new thresholds when they are implemented at the end of the year and will choose to 'opt' to remain within the Solvency II regime.

Some unanswered questions remain regarding the wider implications for smaller insurers remaining as a PIE. For example, those that 'opt' to remain within Solvency II when they could otherwise have fallen out, would they remain Solvency II indefinitely or could they opt out again at a future date if the PIE threshold changes, for instance?

We intend to push, alongside the AFM, for regulatory bodies to take action to alter the position. The primary focus will be on the Department for Business and Trade which has the capacity to create exemptions to PIE status, and who previously indicated they were minded to consider this further.

<https://www.gov.uk/government/speeches/the-kings-speech-2024>



Climate Change

In July 2024 the Bank published its annual climate-related financial disclosure. The Bank's analysis suggests that its sovereign bond holdings continue to be exposed to material climate-related financial risks and metrics suggest that the holdings are aligned with the 2°C Paris goal, but not with the 1.5°C ambition. The Bank continues to build out its scenario analysis capabilities and their analysis suggests that the value of the Bank's sovereign bond holdings could fall by up to 10% in the most adverse climate scenario. The Bank has previously stated the scenarios have a range of limitations including not capturing the full suite of potential risks, non-linear impacts and no account for effects of tipping points. The Bank is taking various approaches to mitigate the Bank's exposure to transition and physical risks facing owner-occupied and buy-to-let mortgage collateral.

On 6 June 2024, the IFoA published a risk alert on climate change scenario analysis. The alert points to the challenges and limitations that users of scenario analysis should be aware of when interpreting results. In particular, the climate may change more quickly than some models predict.

<https://www.bankofengland.co.uk/climate-change/the-bank-of-englands-climate-related-financial-disclosure-2024>

<https://actuaries.org.uk/media/ue4hdq3l/risk-alert-climate-change-scenario-analysis.pdf>

Healthcare

Income protection policyholders may need medical treatment in order to return to work. Therefore, the capacity of the healthcare systems (public and private) is an important factor in an insurer's ability to manage claims.

The latest Referral to Treatment (RTT) figures for June 2024 (NHS England) show that the waiting list ticked up slightly to stand at 7.6m cases, consisting of approximately 6.4 million individual patients waiting for treatment.

The BMA has previously commented "The extent to which private hospitals will be able to take on NHS waiting list initiatives going forward is unclear given the increased demand in the self-pay market and the backlog of private sector patients."

<https://www.england.nhs.uk/statistics/wp-content/uploads/sites/2/2024/08/RTT-statistical-press-notice-Jun24-PDF-386K-07252.pdf>



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