THE FINANCIAL SERVICES AND MARKETS BILL - WHAT DOES IT MEAN FOR INSURERS?

The Financial Services and Markets Bill was introduced to Parliament on 22 July 2022 and proposes important changes to the UK's regulatory framework for financial services, including paving the way for Solvency II reforms.

Our briefing "UK Financial Services and Markets Bill: enacting the future regulatory framework" explains the key features and what this would mean for the UK financial services sector in general. This note focuses on the provisions which will impact the UK insurance market.

If passed, the Bill would revoke all 'EU-derived legislation' relating to financial services and markets, including regulations relating to Solvency II, insurance distribution, motor vehicle insurance and occupational pensions. The box at the end of this note sets out 'EU-derived legislation' relevant to the UK insurance sector.

The government has indicated that this process would take several years, and that 'EU-derived legislation' would continue to be treated as retained EU law until it is revoked. Retained EU law comprises onshored EU regulations, technical standards and decisions and domestic legislation and rules implementing EU law, all as amended by 'exit instruments' under the European Union (Withdrawal) Act 2018. Retained EU law would remain in force during a transitional period until it is revoked and replaced by new or modified legislation.

Framework for Solvency UK

The Bill provides the framework for the government's Solvency II reforms to create a "Solvency UK", which aims to increase flexibility and unlock capital for investment by insurers.

The Bill (once enacted) will allow HM Treasury to implement the Solvency UK reforms by revoking Solvency II and transferring that responsibility to the PRA so that the PRA can replace it with the appropriate regulatory requirements in its rulebook. This also allows the possibility for the PRA to make further rules, modifications, or amendments as part of its general rule-making powers.

Revoking, replacing, and revising EU-derived legislation is a demanding process for government, regulators, and market participants. There will be extensive consultation with stakeholders, with consultations by HM Treasury and the PRA currently underway on the specific details of what Solvency UK will look like.

Secondary Growth and Competitiveness objective

When HM Treasury launched Phase II of its future regulatory framework review in October 2020, we encouraged firms to consider whether they agreed with the government's approach, in particular, the government's then plan not to introduce a new statutory objective to support the competitiveness of the UK financial sector. During the Phase II review, HM Treasury considered the benefits of a new competitiveness objective but sided with the PRA's position that it could distract from, or dilute, the key stability, market integrity and consumer protection objectives.

Following market feedback during Phase II, HM Treasury were persuaded of the need to ensure that the regulators' objectives reflect the importance of the financial services sector as an engine of growth for the wider economy, and the need to support the future strength and viability of the UK as a global finance centre. In a subsequent consultation in November 2021, HM Treasury introduced new secondary objectives for the PRA and the FCA to provide for a greater focus on growth and international competitiveness and this is included in the Bill. Whilst this secondary objective has been welcomed in the insurance industry, concerns remain as to whether a secondary objective is a strong enough mechanism to achieve meaningful change.

On a positive note, we have already seen indications that the regulators are mindful of the UK's competitiveness in the international markets. Recently, for example, the PRA has announced the introduction of a "green channel" for certain ISPV applications in response to the perception that the UK market is uncompetitive. We hope that introduction of a secondary objective on competitiveness and growth would encourage the regulators to consider other areas under their scope, balanced against the primary objectives of financial stability and consumer protection. That said there is likely to be ongoing tension in this area.

Insurance Practitioner Panel

The Bill also proposes to put the existing PRA Practitioner Panel's insurance sub-committee on a statutory footing with a new Insurance Practitioner Panel.

The insurance sub-committee currently feeds into the Practitioner Panel and is currently maintained by the regulators voluntarily. A standalone Insurance Practitioner Panel would mean the industry would be represented separately, with members officially appointed by the PRA, and a Chair appointed by HM Treasury.

Insurers in Financial Difficulties

Not specifically addressed in the regulatory framework review consultation, the Bill includes a new regime for insurers in financial difficulties. The Bill will make changes to write-down orders and introduces restrictions on policyholders' surrender rights and switching rights and provides specific rules relevant to the Financial Services Compensation Scheme whereby a scheme manager must take specified measures for safeguarding policyholders affected by write-down orders.

We will be producing a separate analysis of the detail of those provisions in due course.

Designated Activities Regime

The Bill introduces a new designated activities regime ("**DAR**") that will mirror the regulated activities regime and under which persons would be prohibited from carrying on "designated activities" unless they are exempted or carry on those activities in accordance with the DAR. The DAR would allow the relevant regulator to make rules relating to the designated activity, but the regulator would be subject to a more limited rulemaking power as it would not be able to make rules relating to unrelated activities of the firm.

The proposed designated activities include, *inter alia*, offering securities to the public, applying for, securing or maintaining the admission of securities to trading on a securities market, acting as an originator, sponsor, original lender or securitisation special purpose entity on a securitisation, issuing an instrument which references a benchmark, measuring the performance of an investment fund through a benchmark, determining the amount payable under an instrument or financial contract by reference to a benchmark, and contributing to a benchmark.

This may therefore be relevant to insurers in relation to their capital raising and management activities, and to those involved in insurance-linked securities depending on the eventual scope of the regime.

What should firms do now?

The enactment of the Bill will trigger an extensive programme of consultation on proposed changes to the retained EU laws that will be revoked. Given the statements in the Chancellor's recent Mansion House speech about the proposed new freedoms for insurers we expect that the Solvency UK proposals would be part of the first suite of changes, and firms should continue to monitor these consultations in parallel with consultation on the Bill; inevitably, the devil will be in the detail of the new proposals, particularly in light of the clear tension between the desire of certain parts of the industry and the government to give greater freedom for insurers, and the desire of regulators to focus on ensuring the ongoing financial soundness of the industry.

What's next?

The first reading of the Bill took place on 20 July and the second reading is timetabled for 7 September 2022 after the summer recess. Once the second reading is complete, the Bill will proceed to the committee stage where each clause (part) and any amendments (proposals for change) to the Bill may be debated. If the Bill follows a similar timescale to the Financial Services Bill 2019-21, we expect that it to take at least six months from introduction to receive the Royal Assent, with the Act to come into force by the end of January 2023 at the earliest.

EU-derived legislation relevant to the UK insurance sector.

Solvency II

- Solvency II: Solvency 2 Regulations 2015 (S.I. 2015/575)
- the Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 (S.I. 2019/407)
- Reinsurance Directive Regulations 2007 (S.I. 2007/3253)
- Electronic Commerce and Solvency 2 (Amendment etc.) (EU Exit) Regulations 2019 (S.I. 2019/1361)
- Solvency 2 (Credit Risk Adjustment) Regulations 2021 (S.I. 2021/463)
- Solvency 2 (Group Supervision) (Amendment) Regulations 2021 (S.I.2021/1408)

Insurance Distribution

- Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 (S.I. 2018/546)
- Insurance Distribution (Amendment) (EU Exit) Regulations 2019 (S.I.2019/663)
- Insurance Mediation Directive (Miscellaneous Amendments) Regulations 2003 (S.I. 2003/1473)
- Packaged Retail and Insurance-based Investment Products Regulations 2017 (S.I 2017/1127)
- Packaged Retail and Insurance-based Investment Products (Amendment) (EU Exit) Regulations 2019 (S.I 2019/403)
- Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products

Lloyd's

- Insurers (Reorganisation and Winding Up) (Lloyd‘s) Regulations 2005 (S.I. 2005/1998)
- Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 (S.I. 2008/1950)

ILS

- Risk Transformation Regulations 2017 (S.I. 2017/1212)
- Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations 2019 (S.I. 2019/1233)

Friendly societies

- Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008 (S.I. 2008/1140)
- Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2008 (S.I. 2008/1144)
- The Financial Services and Markets Act 2000 (Amendment of section 323) Regulations 2008 (S.I. 2008/1469) Friendly Societies (Amendment) (EU Exit) Regulations 2018 (S.I. 2018/ 1039)

Insolvency

- Insurers (Reorganisation and Winding Up) Regulations 2004 (S.I. 2004/353)

Motor

- Financial Services and Markets Act 2000 (Fourth Motor Insurance Directive) Regulations 2002 (S.I. 2002/2706)

Any provisions made under EU directives

- including under Solvency II (2009/138)
- insurance distribution (2016/97)
- motor vehicle insurance (2009/103)
- institutions for occupational pension provision (2016/2341)
- financial groups directive (2002/87)

CONTACTS

Ashley Prebble
Partner

T +44 207006 3058
E ashley.prebble@cliffordchance.com

Cheng Li Yow
Partner

T +44 207006 8940
E chengli.yow@cliffordchance.com

Imogen Ainsworth
Partner

T +44 207006 2184
E imogen.ainsworth@cliffordchance.com

Hilary Evenett
Senior Director

T +44 207006 1424
E hilary.evenett@cliffordchance.com

AUTHORS

Amera Dooley
Knowledge Director

T +44 207006 6402
E amera.dooley@cliffordchance.com

Nancy Li
Senior Associate

T +44 207006 6047
E nancy.li@cliffordchance.com