HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

The Lord Tunnicliffe CBE
House of Lords
London
SW1A OPW

28th February 2019

Dear Denis,

FOLLOW UP FROM THE DEBATE ON 11 FEBRUARY 2019 CONCERNING THE SOLVENCY 2 (AMENDMENT ETC) (EU EXIT) REGULATIONS 2019, INSURANCE DISTRIBUTION (AMENDMENT) (EU EXIT) REGULATIONS 2019; AND FINANCIAL CONGLOMERATES AND OTHER FINANCIAL GROUPS (AMENDMENT) (EU EXIT) REGULATIONS 2019

With respect to the Solvency 2 SI, Insurance Distribution SI and, the Financial Conglomerates and Other Financial Groups SI, I shall address here the outstanding questions I committed to answering during the debate.

You asked about the transitional power referred to in the Explanatory Memorandum to the Solvency II regulations. The details of the temporary transitional power (TTP) are contained in the statutory instrument that corrects inoperable provisions in the Financial Services and Markets Act 2000 which was debated in the House of Commons on 25 February 2019.

The TTP is a broad power which will enable regulators to phase in any requirement which changes as a result of the legislation to correct inoperable provision in Solvency 2 and other financial services legislation. The power has been designed to prevent or mitigate any extreme, and possibly unforeseen, impact on any activity arising from the legislation. The TTP can be used, for example, to address the impact of removing

preferential capital treatment for EU27 assets held by insurance undertakings but its use extends beyond this issue.

Additionally, you asked whether too much power has been transferred to the Prudential Regulation Authority (PRA). In the longer term we will need to review the regulatory framework in the UK, including the role of regulators and how far they should be accountable. I should highlight that the Government continually keeps the regulatory framework for financial services under review, and updates this as necessary.

I would also like to take this opportunity to note that the UK is a full service financial centre, with strengths across all the major sectors – including banking, and asset management, as well as associated professional services (accounting, legal, and consultancy). The insurance sector is at the heart of this ecosystem, making a vital contribution to the UK economy, attracting global capital, serving the needs of consumers, and generating UK exports. It plays a fundamental role in assessing and managing risk – whether strengthening the resilience of local communities, sustaining regional growth, or underpinning global trade. The Government is, therefore, committed to making the UK one of the most competitive places in the world for insurance.

In relation to the powers of regulators specifically, I would note that a core purpose of the regulatory and supervisory regimes will always be ensuring financial stability and protecting taxpayers. But resilience goes beyond regulation, and the Government is determined to maintain and enhance the long-term competitive position of UK financial services. The Government has already taken action to ensure the regulators act in a proportionate manner that takes into account the competitiveness of the sector:

For instance, the regulators are required by the Financial Services and Markets Act (2000) to take into account the eight principles of good regulation. One of these principles is proportionality: the principle that any burden or restriction that the regulators impose on a person, firm or activity is proportionate to the benefits they expect as a result.

In addition, the regulators have also been brought into the scope of the Government's Better Regulation Framework. The Enterprise Act 2016 requires the Financial Conduct Authority (FCA) to measure and publish the impact of their regulations on industry.

Finally, 'competitiveness' was listed as an aspect of government economic policy to which the regulators should have regard in Remit Letters issued by the Chancellor at Spring Budget 2017.

On a separate point, the noble Baroness, Lady Bowles, asked whether there is a figure for UK insurance undertakings' holdings of EU assets compared to the rest of the world. To the best of our knowledge, there is no reliable data on UK insurance undertakings' holdings of EU assets; however, analysis by the regulators suggests that the capital impact of this change should not be significant.

I now turn to the Insurance Distribution (Amendment) (EU Exit) Regulations 2019. The Earl of Kinnoull requested that the Government consider a review of insurance regulation with the objective of identifying rules that were overly burdensome on insurance brokers. As was noted during the debate, the core of the UK's rules relating to insurance distribution is relatively new. For example, The Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 only came into force on 01 October 2018. These regulations, and the FCA's associated rules, were opened up for feedback through consultation and the Government is grateful for the range of submissions that were received from the breadth of the UK's world leading insurance industry.

Given the relatively recent introduction of the UK's existing regulatory framework for insurance distribution and the points I noted in my response to the request for a review of Solvency II, in relation to the Government's commitment to maintaining the long-term competitiveness of the UK's financial services industry, it would not be appropriate for a review of insurance distribution regulatory regime to be undertaken at this time.

On the Financial Conglomerates and Other Financial Groups (Amendment) (EU Exit) Regulations 2019, the Baroness Bowles asked if the EU Financial Conglomerates Directive (FICOD), being a relatively "old" example of financial services legislation, had achieved its aim of addressing some of the risks inherent in the bancassurance business model.

FICOD was the first legal instrument to recognise the importance of supervising complex financial groups that operated across the banking and insurance sectors—the "bancassurance" model—and to establish a set of expectations for supervisory cooperation for banking and insurance regulators. In doing so, it facilitated effective supervisory cooperation which has been important in addressing issues that arise at the level of a group, including double gearing.

With the entry into force of the Capital Requirements Regulation (CRR) and Directive (CRD) (soon to be revised by CRR II and CRD V), Bank Recovery and Resolution Directive (BRRD) and Solvency 2, FICOD plays a less central role than it did on its introduction, the legislation continues to be used by supervisors overseeing large financial groups. For example, in their supervision of investment firms, the FCA apply FICOD to ensure that capital used for the purposes of the investment firm is separate from the capital used within the insurance firm at the consolidated level.

Whether FICOD continues to be fit for purpose at a pan-European level is an ongoing debate of which I am sure you are aware. In 2017, the European Commission noted

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that following the introduction of more recent prudential legislation on banks and insurers, there could be greater coherence of the financial conglomerates regime. In particular, different definitions of groups apply between FICOD, CRR, BRRD and Solvency II, and additional clarity could improve the application of prudential requirements for firms subject to these regimes.

I appreciate the expertise and attention that those present brought to the debate and I hope that you find this response useful. I am copying this letter to the Baroness Bowles and the Earl of Kinnoull whose points I also addressed here. A copy will also be deposited in the Library.

With all good wishes,

Michael

The Rt Hon. the Lord Bates
Lords Spokesperson for HM Treasury