**EXPLANATORY MEMORANDUM TO**

**THE CIVIL LIABILITY (INFORMATION REQUIREMENTS) AND RISK TRANSFORMATION (AMENDMENT) REGULATIONS 2020**

**2020 No. [XXXX]**

## 1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury ("the Treasury") and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

## 2. Purpose of the instrument

*The Civil Liability Act 2018*

2.1 The Civil Liability (Information Requirements) and Risk Transformation (Amendment) Regulations 2020 ("the Regulations") contain provisions made under section 11 of the Civil Liability Act 2018 ("the 2018 Act") setting out the requirement on insurers in scope of the Regulations to provide information to the Financial Conduct Authority ("the FCA") in respect of private motor insurance policies sold to customers domiciled in England and Wales.

2.2 The Regulations set out what kind of information is required and the level of authentication required, as well as how and when it should be provided to the FCA. The purpose of these provisions is to allow the Government to assess whether cost savings made by insurers from the reforms under the 2018 Act have been passed onto consumers.

*The Risk Transformation Regulations 2017*

2.3 In addition, this instrument amends the Risk Transformation Regulations 2017 (S.I. 2017/1212, 'the RTR'). The RTR implements a competitive UK regime for Insurance Linked Securities (ILS) business, in line with the requirements of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance ("Solvency 2"). The RTR introduced a new UK corporate form for use in ILS transactions: the protected cell company (PCC). A PCC is a single legal entity comprising a core and cells. It enables many separate ILS deals to be managed by one company, with the cell structure ensuring that the assets and liabilities of each deal remain strictly segregated.

2.4 When a PCC takes on insurance risk in an ILS transaction, it issues securities to raise capital to cover that risk. As ILS are highly complex investments they should not be offered to retail investors. The policy intention of the RTR was, therefore, to facilitate the marketing of ILS by PCCs to only 'qualified' investors, following the definition of qualified investor set out in the EU's Markets in Financial Instruments Directive (2014/65/EU). The then Economic Secretary to the Treasury made this clear in the House of Commons debate on the RTR in November 2017: "The regulations ensure that only sophisticated or institutional investors can be offered insurance-linked securities in the UK" (HC Deb 29 November 2017, vol 632, cols 1-8).

2.5 To this end, regulation 157 of the RTR prohibits PCCs from making public offers of their securities. However, regulation 157, when read together with regulation 11, and relevant case law, could be read as requiring PCCs to scrutinise and select specific qualified investors before an offer of securities is made to them. This is considered too onerous. The amendment in regulation 8 of this instrument therefore ensures that PCCs may make public offers of securities to qualified investors without preselection, provided that the securities are not offered or made available to retail investors. This is in line with the policy intention for the UK's ILS regime as set out in the consultation and policy documents published by HM Treasury prior to the RTR.

2.6 The instrument achieves this by introducing the concept of "qualified investor" into regulation 158. This brings coherence to the restrictions applied in regulation 11 and regulation 157. The amendment in regulation 8 (2)(a) and (b) will mean that regulation 158(3)(b), (4) and (5) of the RTR will become redundant and are therefore deleted. The purpose of regulation 158(3)(b) was to allow an offer to be made as a "private concern", meaning that an offer could be made to someone who is already connected with the PCC. However, the policy intention is to allow all offers to be made to qualified investors, regardless of whether they are connected with the PCC or not.

## 3. Matters of special interest to Parliament

***Matters of special interest to the Joint Committee on Statutory Instruments***

3.1 Part 1 of the Regulations specifies that Part 2 comes into force on 1st April 2020, to ensure that Part 2 comes into effect no later than the starting date of the report period specified in the 2018 Act. Given the busy Parliamentary timetable, this may mean that these regulations come into force less than 21 days after the day on which these Regulations are made.

3.2 HM Treasury is confident that the length of time between the making of the instrument and its coming into force will not cause issues for those affected by the Regulations. Stakeholders have been consulted extensively throughout the development of section 11 of the 2018 Act and the implementing Regulations, on a formal and informal basis and with ongoing input from the FCA and the Association of British Insurers ("ABI"). The industry is accordingly well-informed and is prepared to meet the instrument's regulatory requirements. Further, insurers are required to submit their data to the FCA on a one-time basis only and not until after 1st April 2023, so a shorter period between laying and coming into force is likely to have minimal practical impact.

***Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)***

3.3 The territorial application of this instrument varies between provisions. Parts 1 and 3 of this instrument apply to the United Kingdom. Disregarding any minor or consequential effects, Part 2 applies to England and Wales only.

## 4. Extent and Territorial Application

4.1 The extent of Parts 1 and 3 of this instrument is the United Kingdom.

4.2 The extent of Part 2 of this instrument is England and Wales.

4.3 The territorial application of Parts 1 and 3 of this instrument is the United Kingdom.

4.4 The territorial application of Part 2 of this instrument is England and Wales, with only minor and consequential effect in the rest of the United Kingdom.

## 5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury, John Glen, has made the following statement regarding Human Rights:

"In my view the provisions of the Civil Liability (Information Requirements) and Risk Transformation (Amendment) Regulations 2020 are compatible with the Convention rights."

## 6. Legislative Context

*The Civil Liability Act 2018*

6.1 The Civil Liability Act 2018 received Royal Assent on 20 December 2018.

6.2 Section 11 of the 2018 Act provides for regulations to be made by HM Treasury which may require an insurer to provide information to the FCA about the effects of Parts 1 and 2 of the 2018 Act. These are the reforms relating to compensation for soft tissue (whiplash) injuries and the Personal Injury Discount Rate (PIDR), which aims to moderate the compensation paid for long-term injuries so that claimants do not end up severely over- or under-compensated and unable to meet their long-term needs.

6.3 Section 11 is to be implemented by way of regulations, made under the affirmative procedure and debated in both Houses of Parliament, which may further set out what the reporting requirements are, which insurers are affected and any methodology to be used. The regulations may also make provision for audit requirements.

6.4 Part 2 of these Regulations give effect to section 11 of the 2018 Act and set out in detail the requirements on insurers.

*The Risk Transformation Regulations 2017*

6.5 The Solvency II Directive (the "S2 Directive") and directly applicable legislation made under it set out the overarching regulatory framework for insurance and reinsurance business in the European Union and has applied from 1 January 2016. The Directive recognises ILS cover provided by special purpose vehicles as a risk mitigation technique available to insurance and reinsurance firms.

6.6 The RTR created the regulatory and supervisory regime for Insurance Linked Securities (ILS) in the UK. ILS are an alternative form of risk mitigation for insurance and reinsurance firms. They offer insurance and reinsurance firms a means of transferring risk to a special purpose vehicle which issues securities to raise sufficient capital to cover the insurance risk it has taken on. The RTR created a new regulated activity under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 – insurance risk transformation – and introduced a new form of body corporate called a "protected cell company" to act as a special purpose vehicle in ILS transactions.

## 7. Policy background

***What is being done and why?***

*Provisions under the Civil Liability Act 2018*

7.1 The Civil Liability Act 2018 reformed the compensation system for whiplash injuries and changed the way the Personal Injury Discount Rate (PIDR) is calculated. These reforms were expected to generate savings for motor insurers. The motor insurance market is highly competitive and the Government expected that firms would pass savings onto consumers to remain competitive on price. In addition, in March 2018, members of the ABI signed a letter publicly committing to passing on these savings to their customers. The signatories to this letter comprised 86% of motor and liability insurance underwritten by ABI members.

7.2 During the passage of the 2018 Act, Parliamentarians expressed concerns about whether the Government would be able to hold insurers to account for this commitment. The Government made an amendment to the Bill which is now section 11 of the 2018 Act, providing for regulations to be made under that Act to set out the detail of the requirements on insurers.

7.3 Part 2 of these Regulations contains provisions made using this power. The objective is to allow HM Treasury to assess whether savings resulting from the 2018 Act have been passed onto purchasers of private motor insurance.

7.4 In order to provide HM Treasury with sufficient information to make that assessment, firms must provide a set of figures to the FCA on their actual (audited) premiums, as well as the total (audited) value of all claims where the final payment of that claim is made during the report year, for each year of a three-year reporting period, as set out in regulation 4.

7.5 Regulation 5 provides that firms must also calculate a set of figures showing what their costs and premium prices would be if the 2018 Act had not been passed. For this calculation, firms must use the same methodology as for the audited figures and must also use a baseline PIDR of CPI minus 0.75%. This is the discount rate set by the prior legislation which existed at the time the 2018 Act was passed. HM Treasury appreciates that this counterfactual information will be more difficult to audit. An auditor will therefore be required to provide an assurance, rather than a full audit, that the information has been calculated in accordance with the requirements in regulation 5.

7.6 Regulation 6 provides that insurers must state whether they have passed on any benefits to customers other than by way of a reduction in premiums. They may provide additional information, which is relevant to the aim of assessing whether they have passed on savings to consumers, to demonstrate how other factors have influenced their costs of claims and premium prices. For example, they may wish to provide information on reinsurance or intermediary costs, or other factors that may have impacted insurers' reserving or pricing practices.

7.7 Firms must provide this information to the FCA by 1st October 2023, six months after the end of the three-year reporting period. The FCA will aggregate and deliver the data to HM Treasury, for HM Treasury to compile a report assessing whether the Act's reforms have resulted in savings for insurers and consumers.

7.8 The Regulations are intended to hold firms to account without placing undue burden. Where a component of these calculations was previously set by legislation, such as the PIDR, this pre-existing legislation must be taken into account as the baseline value. Where there is not a prescribed component, such as the methodology, this has been left to the firms to maintain consistency with their own usual accounting and actuarial practices and to reduce the cost burden.

7.9 Firms are required to provide the FCA with relevant information on costs and premium prices for each year that they issue 100,000 or more private motor insurance policies where the period of cover begins in that year. The ABI estimates that the information reporting requirements will capture the vast majority of the market underwritten by ABI members.

7.10 There are no penalties set out in the Regulations, however, section 11 of the 2018 Act amends the Financial Services and Markets Act 2000 to empower the FCA to use its full suite of existing supervisory and enforcement powers over insurers to monitor breaches and ensure compliance with the Regulations.

7.11 A Memorandum of Understanding between HM Treasury and the FCA has been prepared and sets out the information-sharing arrangements between the parties.

*Amendments to the Risk Transformation Regulations 2017*

7.12 Part 3 of the Regulations is intended to repair a defect in the Risk Transformation Regulations 2017 which inadvertently inhibits access to the markets for certain investors.

## 8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

## 9. Consolidation

9.1 There are no plans to consolidate the legislation.

## 10. Consultation outcome

10.1 The Government consulted on Parts 1 and 2 of the proposed Regulations from 21 March to 3 May 2019. The consultation sought views on the government's suggested approach to determining the firms in scope, the information required, and the treatment of this information. The consultation received 16 responses from insurers, industry representatives, and representatives from the legal services industry. Based on these responses, several changes were made to the regulations:

- The definition of "relevant insurer" was amended to refer to firms that provide private motor policies and sell 100,000 or more of those policies in at least one of the report years.
- Provisions for firms to provide additional information have been expanded to a non-exhaustive list including market trends, third party costs and "wider economic factors". This replaces specific provisions requiring information about reinsurance and intermediation.
- The methodology used by firms to produce a counterfactual figure should mirror the methodology which produced the audited data, but the process is

otherwise unspecified except for the requirement to use -0.75% as the counterfactual figure for PIDR calculations.

- The requirement for firms to report technical price was deleted to reflect the difficulties of gathering standardised information for this element.
- The data will be adjusted for inflation.

10.2 The Government's official consultation response can be found here: https://www.gov.uk/government/consultations/civil-liability-act-report-on-savings-provision

## 11. Guidance

11.1 No guidance is issued with these Regulations.

11.2 The Treasury has had extensive engagement with industry during the development of the information reporting requirements in Part 2 and will continue to do so as necessary to ensure that firms are able to comply with these requirements.

## 12. Impact

12.1 The direct cost to business of the implementation of this legislation is estimated to be under £5 million. This comprises the data processing, actuarial and audit costs that are necessary in order for firms to submit a data return that complies with the specifications set out in Part 2.

12.2 There is no, or no significant, impact on charities or voluntary bodies.

12.3 There is no, or no significant, impact on the public sector.

12.4 A de minimis Impact Assessment is submitted with this Memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

## 13. Regulating small business

13.1 The regulations apply to activities undertaken by small business.

13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people) in Part 2, the approach taken is to only require insurers who sell 100,000 or more private motor insurance policies per year. This threshold was raised from 10,000 to 100,000 policies issued in line with industry responses to the consultation, to avoid placing a disproportionate regulatory burden on small or specialist insurers.

## 14. Monitoring & review

14.1 The regulation does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 (c.26) the Economic Secretary to the Treasury, John Glen, has made the following statement:

"The Civil Liability (Information Requirements) and Risk Transformation (Amendment) Regulations 2020 do not require a statutory review clause as the requirement shall cease to have effect before the end of the period of 5 years beginning with the commencement date."

## 15. Contact

15.1 Dominic Wheeler at the Treasury, Telephone: 0207 270 5095 or email: dominic.wheeler@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Hannah Malik and Becky Morrison, Deputy Directors for Insurance and Pensions Markets at the Treasury, can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen, Economic Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.