EXPLANATORY MEMORANDUM TO

THE INSURANCE AND REINSURANCE UNDERTAKINGS (PRUDENTIAL REQUIREMENTS) (AMENDMENT AND MISCELLANEOUS PROVISIONS) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Tulip Siddiq MP, the Economic Secretary to the Treasury and City Minister at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Emma Kavanagh, Deputy Director for the Insurance and Pensions Markets Team at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Joe Jones at HM Treasury Telephone: 07977907774 or email: Joe.Jones@hmtreasury.gov.uk.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 Prudential regulation ensures that insurance firms act safely and reduces the chance of them getting into financial difficulty. This instrument makes a series of technical amendments to legislation to ensure that the UK's insurance regulatory regime functions as intended following implementation of the Solvency II reforms and the revocation of assimilated (formerly termed retained EU law) EU law at the end of 2024. This includes restatement with modification of assimilated EU law on the risk margin; making saving provision for Gibraltar groups and undertakings; amendment of provisions in the Financial Services and Markets Act 2000 (c. 8) ('FSMA 2000'), and amendments to other legislation.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdictions which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 This instrument forms part of the series of instruments needed to implement the Solvency II reforms announced in November 2022 Other instruments are the

Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 (S.I. 2023/1346); the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 (S.I. 2023/1347) and the Insurance and Reinsurance Undertakings (Prudential Requirements) (Transitional Provisions and Consequential Amendments) Regulations 2024 (S.I. 2024/594).

5.2 Many of the Solvency II reforms are being implemented by the PRA through changes to its rulebook, including changes to replace aspects of assimilated law that will be revoked by the Government to deliver a Smarter Regulatory Framework for financial services. Where there is a significant public policy objective that could not be achieved through the regulators acting in accordance with their statutory objectives alone, the Government will retain certain requirements relating to the Solvency II regime (with modifications where necessary) by restating relevant legislation onto the UK statute book.

Restatement of risk margin provisions

5.3 The risk margin is intended to cover the potential costs of transferring insurance liabilities to a third party should an insurer fail. It protects policyholders by giving them a high degree of confidence that they will continue to have a claim on a viable business.

5.4 In December 2023, the Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 made transitional amendments to assimilated EU law to reform the risk margin calculation, to address limitations identified in the HMT's review of Solvency II.

5.5 This instrument will restate the relevant provisions of the amended assimilated law into the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 so that the reforms persist when the assimilated law is revoked.

5.6 This instrument also affirms the PRA's power to make rules permitting insurance firms to adopt proportionate approaches in determining the risk margin. This preserves the flexibility within the current regime found at articles 56 and 58 of Commission Delegated Regulation (EU) 2015/35 of 10th October 2014.

Saving provisions for Gibraltar insurance groups and undertakings legislation

5.7 This legislation saves the relevant parts of assimilated law so that UK supervisory arrangements in relation to Gibraltarian firms continue unchanged after the revocation of assimilated law at the end of 2024. In due course, market access arrangements for Gibraltar groups and undertakings will be covered by the Gibraltar Authorisation Regime set out in Schedule 2A to FSMA 2000 (Gibraltar-based persons carrying on activities in the UK).

Amendment of provisions of FSMA 2000

5.8 FSMA 2000 contains some technical definitions that are relevant to the operation of the UK's insurance regulatory regime.

5.9 Some of these definitions cross-refer to the EU's 2009 Solvency II Directive. This legislation amends these definitions so that they can operate without reference to the Solvency II Directive, which is consistent with the principles of the Smarter Regulatory Framework.

5.10 Some of these definitions relate to areas of the prudential regime where assimilated law is revoked and replaced by PRA rules, as part of the Smarter Regulatory Framework. In view of the restatement of this material, specific technical definitions

such as “third-country insurance” or “reinsurance undertaking” are no longer required within legislation. This legislation removes these definitions.

5.11 The legislation also amends Schedule 6 to FSMA 2000 (threshold conditions for PRA supervision) so that supervisory arrangements in relation to Gibraltarian firms continue unchanged after the revocation of assimilated law at the end of 2024.

Amendments to other legislation

5.12 Section 833A of the Companies Act 2006 (c. 46) (distributions by insurance companies authorised under the Solvency 2 directive) cross refers to the matching adjustment legislation in the Solvency 2 Regulations 2015 (S.I. 2015/575) and Commission Delegated Regulation (EU) 2015/35. The relevant legislation is revoked by the Financial Services and Markets Act 2023 (Commencement No. 4 and Transitional and Saving Provisions) (Amendment) Regulations 2023 (S.I. 2023/1382). The instrument amends the Companies Act to substitute references to the restated matching adjustment legislation and PRA rules.

5.13 The legislation amends FSMA 2000 (Disclosure of Confidential Information) Regulations 2001 (S.I. 2001/2188) to facilitate publication of stress test results for individual insurance and reinsurance firm (which are captured under the reformed Solvency II regime).

5.14 The legislation amends FSMA 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) to align it to the broader changes made to FSMA 2000 outlined above in paragraph 5.10.

5.15 The legislation amends FSMA 2000 (Variation of Threshold Conditions) Order 2001 (S.I. 2001/2507) so that it does not set prescriptive requirements in areas where the PRA is making rules and other policy materials under the Smarter Regulatory Framework.

5.16 The legislation amends the Bank of England Act 1998 (Macro-prudential Measures) Order 2013 (S.I. 2013/644) to align it to the changes made to FSMA 2000 outlined above in paragraph 5.10.

5.17 The legislation amends the Financial Services and Markets Act 2000 (Prescribed Financial Institutions) Order 2013 (S.I. 2013/165) to align the meaning of “insurance holding company” in that Order with the definition provided in PRA rules, in line with the broader policy objectives.

What was the previous policy, how is this different?

Restatement of risk margin provisions

5.18 Currently, the risk margin provisions are contained in assimilated law, in particular Articles 37, 39 and 58 of Commission Delegated Regulation (EU) 2015/35, as amended by the Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023. These Articles are due to be revoked on 31st December 2024. The policy is not changing, but legislation is required to restate these provisions into UK legislation.

Saving provisions for Gibraltar groups and undertaking legislation

5.19 There is no change in policy. Gibraltar groups and undertakings will operate with the same requirements as currently.

Amendments to other legislation

5.20 The other amendments include removal of references to Solvency II (and other references of related assimilated EU law), including from the definition of "insurance undertaking" and "reinsurance undertaking" in s.417(1) (interpretation) of FSMA 2000. This definition will include all insurance and reinsurance undertakings authorised as such under FSMA 2000, including overseas undertakings, and Lloyd's.

5.21 The amendment of FSMA 2000 (Disclosure of Confidential Information) Regulations 2001 will give the PRA an additional measure to hold UK insurance firms to account in maintaining safety and soundness and policyholder protection.

5.22 The amendment of FSMA 2000 (Variation of Threshold Conditions) Order 2001 gives space to the PRA to make rules and other policy that differ from the prescriptive requirements previously laid down in this legislation in regard to threshold conditions. This is consistent with the principles of the Smarter Regulatory Framework.

6. Legislative and Legal Context

6.1 Financial Services and Markets Act 2023 ("FSMA 2023") contains a number of new legislative powers which work together as a set of tools as the government repeals assimilated law to deliver a Smarter Regulatory Framework for financial services.

6.2 Section 1 of FSMA 2023 repeals assimilated EU law relating to financial services, covered by Schedule 1 to that Act, subject to commencement by HM Treasury.

6.3 Section 4 of FSMA 2023 contains a power to restate assimilated EU law by amending primary or subordinate legislation, or by making new subordinate legislation. In restating assimilated EU law, HM Treasury has a power to modify the legislation being restated.

6.4 UK insurance firms are currently subject to an EU-derived regime for prudential regulation – 'Solvency II'. The legislative requirements pertaining to the UK regime for the prudential regulation of insurance firms are contained in assimilated EU law, in particular the Solvency 2 Regulations 2015, and the Commission Delegated Regulation (EU) 2015/35. The commencement of this revocation has been undertaken by S.I. 2024/620 (C. 39).

6.5 The regulations in this instrument will be implemented simultaneously with updated PRA rules relating to the risk margin under Section 4 of FSMA 2023. These Regulations in places refer directly to definitions contained in PRA rules. The PRA is currently consulting on new rules relating to the risk margin, including those areas of restated assimilated EU law. The consultation paper[1] was published on 22nd April 2024, and the consultation period will close on 22nd July 2024.

How has the law changed?

6.6 The reforms made in the Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 are being restated into the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023. This is detailed in paragraphs 5.3 to 5.6.

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

Why was this approach taken to change the law?

6.7 The assimilated EU law was directly amended on 8th December 2023 by the Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023 to ensure that the cut in the risk margin came into effect by 31 December 2023. This instrument will restate that amended assimilated EU law to ensure that it remains in legislation from the end of 2024 when the remainder of the assimilated EU law relating to Solvency II is revoked.

7. Consultation

Summary of consultation outcome and methodology

7.1 Reforms to the risk margin were subject to consultation in 2022, which HMT responded to on 17 November 2023[2]. These reforms were implemented in line with this response in December 2023 via the Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023. The explanatory memorandum for those regulations outlines the details of this consultation.

7.2 A consultation has not been undertaken for this statutory instrument as this SI enacts technical amendments enabling agreed policy in-line with the consultation noted in 7.1.

8. Applicable Guidance

8.1 HM Treasury does not propose to provide any further guidance in relation to this instrument. The aspects and constructs of the Solvency II regime affected by this instrument are established and well understood by firms subject to the regime. The legislation is part of a wider framework of requirements which includes the PRA rulebook.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

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

Impact on businesses, charities and voluntary bodies

9.2 The legislation is relevant for UK insurance firms. Given the nature of the technical amendments as maintaining existing arrangements by restating EU assimilated law into UK legislation (risk margin; Gibraltar regime), or facilitating implementation of the Smarter Regulatory Framework, most of the reforms will have no, or no significant impact on businesses.

9.3 The amendment of FSMA 2000 (Disclosure of Confidential Information) Regulations 2001 to facilitate publication of individual insurance and reinsurance firm stress test results by the PRA, will impact UK insurance firms in scope of the PRA's periodic insurance stress test exercises.

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

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2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1118359/Consultation_Response_-_Review_of_Solvency_II_.pdf

9.5 The legislation does not impact small or micro businesses. Only firms above the threshold of writing €5 million of gross written premium are governed by these regulations. This will rise to £25 million on 31 December 2024.

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

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is that HM Treasury will engage with industry and the PRA as necessary.

10.2 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, Tulip Siddiq MP has made the following statement: A review clause would not be appropriate for this instrument, given the nature of the technical amendments as maintaining existing arrangements by restating EU assimilated law into UK legislation (risk margin; Gibraltar regime) or facilitating implementation of the Smarter Regulatory Framework.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Insurance and Reinsurance Undertakings (Prudential Requirements) (Amendment and Miscellaneous Provisions) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").

13.2 Notwithstanding the above, this instrument relates to the withdrawal of the United Kingdom from the European Union because it relates to HM Treasury's programme to deliver a Smarter Regulatory Framework for the UK through repealing assimilated law and tailoring regulation to the UK.