EXPLANATORY MEMORANDUM TO

THE INSURANCE AND REINSURANCE UNDERTAKINGS (OVERSEAS INSURANCE REGIME, TRANSITIONAL PROVISIONS, ETC.) REGULATIONS

2024 No. 1116

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 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, reducing the chance of them getting into financial difficulty. In particular, this includes minimum requirements for quantum and quality of capital that must be held by firms.

4.2 Transitional provisions contained within this instrument ensure that on 31st December 2024 approvals in force immediately before 31st December 2024, relating to how capital requirements should be applied for individual firms, remain valid. These are in relation to approvals granted by the Prudential Regulation Authority (PRA) under assimilated EU law in Regulations 43 to 49, 53, and 54 of the Solvency 2 Regulations 2015 (S.I. 2015/575). These include all prior approvals, as they had effect immediately before 31st December 2024, which constitute a firm's, or a group's, internal model under Regulations 48 and 49 of the Solvency 2 Regulations 2015 (S.I. 2015/575) which become a single permission.

4.3 The instrument will also establish an overseas regime covering three areas of insurance prudential regulation. These are currently covered by existing regimes in assimilated law, which are being revoked. As such, this new regime will continue enabling the recognition of these aspects of insurance regulation in other jurisdictions. This instrument will also preserve existing designations recognising certain overseas prudential regimes as equivalent to the UK.

4.4 Finally, the instrument makes some minor and technical amendments consequential on the revocation of assimilated law referred to in the following paragraph.

4.5 The legislative changes made by this SI relate to revocations on 31st December 2024 made by the Financial Services and Markets Act 2023 (Commencement No. 6) Regulations 2024 (S.I. 2024/620) and the Financial Services and Markets Act 2023 (Commencement No. 8) Regulations 2024 (S.I. 2024/1071) under section 1 of, and Schedule 1 to, the Financial Services and Markets Act 2023, including the revocation of the Solvency 2 Regulations 2015 (S.I. 2015/575), the Commission Delegated Regulation (EU) 2015/35 of 10th October 2014 and existing decisions under assimilated law recognising overseas jurisdictions.

Where does the legislation extend to, and apply?

4.6 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.

4.7 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 From 31st December 2024, insurance firms who want to use certain methodologies for calculating capital requirements, or to include certain ancillary forms of capital in their balance sheets, must apply to the PRA for a permission under section 138BA of the Financial Services and Markets Act 2000 ('FSMA 2000'). Section 138BA of the Financial Services and Markets Act 2000 (Disapplication or Modification of Financial Regulator Rules in Individual Cases) Regulations 2024 (S.I. 2024/539) give the PRA the power to waive or modify how firms from comply with their rules. Permission to use alternative methodologies to calculate capital requirements, or to include certain forms of ancillary capital in balance sheets, would be granted by exempting firms from complying with certain PRA rules via those powers.

5.2 This instrument provides that firms who have approval from the PRA to use alternative methodologies or to include certain ancillary forms of capital immediately before 31st December 2024 under Solvency 2 Regulations 2015 (S.I. 2015/575), do not have to re-apply from the point at which those regulations are revoked and transferred to the PRA's rulebook. Without this instrument, re-application would take up capacity in insurance firms and the PRA, which would likely be costly and time consuming. Such reapplications would have no practical benefits given firms' likelihood to be approved under the new wider regime.

5.3 The instrument will also introduce a new framework for making overseas recognition decisions for non-UK jurisdictions, and will preserve pre-existing Solvency II overseas recognition decisions assimilated into UK law following EU exit.

5.4 The new framework for the overseas insurance regime, provided by this instrument, will allow HM Treasury to make designations recognising aspects of insurance regulation in relation to reinsurance contracts, group supervision and capital requirement rules in other jurisdictions. HM Treasury can make these decisions when doing so is aligned with its objectives for supporting and growing the UK's financial services sector and fulfilling certain prudential regulation objectives.

5.5 Finally, this instrument will make amendments consequential to the revocation of the Solvency 2 Regulations 2015 (S.I. 2015/575) to ensure the new regime functions as intended.

What was the previous policy, how is this different?

5.6 From 1st January 2025, if a firm wishes to alter their existing permission or make a new application, they will still have to apply to the PRA to do this. There is no change in policy in that regard.

5.7 Under existing assimilated law, HM Treasury can make overseas market access decisions. This allows HM Treasury to grant appropriate firms in overseas jurisdictions the same regulatory and supervisory treatment as that of UK firms, in the following areas of insurance regulation:

- Deeming reinsurance contracts with firms in another jurisdiction as equivalent to reinsurance contracts with UK firms.
- Recognising as equivalent the approach to supervision of insurance groups in another jurisdiction.
- Allowing solvency rules in another jurisdiction to be considered as equivalent when a UK insurance group with subsidiaries in that jurisdiction is calculating its capital requirements.

5.8 The overseas regime provided for by this instrument is intended to replicate the scope and effect of existing decisions that grant equivalence to other jurisdictions in relation to reinsurance contracts, group solvency or capital requirements rules.

5.9 In relation to HM Treasury's decision as to whether to make a designation, under the existing equivalence framework, HM Treasury can make designations only if specific elements of insurance regulation in another jurisdiction are equivalent to the UK's. The new framework takes a different, outcomes-based approach. Under the new framework, HM Treasury can make a decision only if it judges doing so would be compatible with certain policy outcomes set out in this instrument. As long as this compatibility with policy outcomes is established, other jurisdictions will be able to maintain different regulatory approaches to insurance business and still be considered suitable for designation.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument grants powers to HM Treasury to make overseas regime designations, covering three areas of insurance regulation, in relation to other jurisdictions through the overseas insurance regime. It sets out the scope and effect of designation in each of the three areas of insurance regulation covered. This instrument converts the existing equivalence determinations into overseas regime designations.

6.2 This instrument makes a transitional provision for firms with approvals to use alternative methodologies, or to include certain ancillary forms of capital on 31st December 2024, when the regulation under which those approvals were given is revoked. It provides that firms can continue to apply the relevant alternative methodologies, or to include certain ancillary forms of capital from that point.

Why was this approach taken to change the law?

6.3 This approach makes clear that existing applications to use alternative methodologies or to include certain ancillary forms of capital can continue, but in accordance with the legislation set out in Regulation 5. This is simpler than having different rules apply to different cases depending on when the application was made.

6.4 The provisions in relation to enabling HM Treasury to make overseas regime designations preserves the current effect (under assimilated law), but also creates a framework on making designations which is more aligned with the Government's objective to grow the UK's financial sector. Further, these provisions preserve the pre-existing equivalence determinations, which will be revoked on 31st December 2024.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury has not undertaken a formal consultation for this instrument, which maintains existing policy: ensuring existing approvals remain valid under the new regime as of 31st December 2024, and replicating the effects of an overseas recognition regime in existing assimilated EU law. HM Treasury has consulted with the PRA to enable the regulator to prepare for the changes to the Solvency II regime and ensure that the regulations in this instrument can work effectively with relevant regulatory rules.

8. Applicable Guidance

8.1 HM Treasury will not provide further guidance in relation to this instrument. It will be for the PRA to advise firms should they wish to make changes to their permissions from 31st December 2024.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A de minimis Impact Assessment is published alongside the Explanatory Memorandum on legislation.gov.uk.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies as a result of this instrument. This is because transitional provisions for approvals mean that firms will not have to make a new application from 31st December 2024,the new overseas recognition regime will replicate the effects of the existing framework under assimilated EU law, and other technical consequential amendments will not make any policy changes.

9.3 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.

9.4 There is no, or no significant, impact on the public sector. Only private sector insurance and reinsurance firms can apply for permission to use alternative methodologies, or to include certain ancillary forms of capital.

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. Transitional provisions provide for a one-off conversion of approvals to use alternative methodologies, or to include certain ancillary forms of capital, and it is neither practicable nor useful to revisit a provision of this nature. Firms seeking a variation of their permission from 31st December 2024 can apply to the PRA for this. Additionally, the new overseas regime will maintain the effect of the existing framework under assimilated EU law, and therefore will have minimal impacts on small businesses."

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 (Overseas Insurance Regime, Transitional Provisions, etc.) 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 new regulatory framework for financial services, through repealing assimilated law and tailoring regulation to the UK.