

The Government's response to the conclusions and recommendations of the Treasury Select Committee on the Solvency II Directive and its impact on the UK Insurance Industry

Introduction

The Treasury Select Committee published a report on the Solvency II Directive and its impact on the UK Insurance Industry, on 27 October 2017. The majority of the recommendations are for the Prudential Regulation Authority (PRA) which will respond separately. There are two recommendations for HM Treasury, set out in paragraphs 5 and 34 of the TSC's report, for which the response is set out below.

Response

Paragraph 5. The Treasury should immediately review the PRA's approach to its competition objective, at least for insurers, and consider giving the secondary competition objective equal primacy with the PRA's other statutory objectives, introducing primary legislation if necessary.

The Prudential Regulation Authority (PRA) is responsible for the prudential regulation and supervision of around 1,500 banks, building societies, credit unions, insurers and major investment firms. The PRA has two primary objectives:

- a general objective to promote the safety and soundness of the firms it regulates; and
- an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders.

In addition, on 1 March 2014 the PRA was given a secondary competition

objective (introduced through the Financial Services (banking reform) Act 2013) in response to a recommendation from the Parliamentary Commission on Banking Standards).

The secondary competition objective of the PRA states that, when discharging its general functions in a way that advances its primary objectives, the PRA must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA authorised persons in carrying out regulated activities.

This ensures that where there are choices to be made by the PRA, as to how it advances its general objective to promote the safety and soundness of the firms it regulates, it must consider which course of action is the best for facilitating competition. Prior to March 2014 the PRA was merely required to 'have regard' to competition, which in practice meant that competition considerations were not given sufficient weight in decision making.

The letter from the Chancellor to Mark Carney, of 8 March 2017, setting out recommendations for the Prudential Regulation Committee also states that where the PRC considers how to advance the objectives of the PRA it should, where relevant and practical, take into account that the government is keen to see more competition in all sectors of the industry. This includes minimising barriers to entry and ensuring a diversity of business models within the industry. The letter says that the PRA should factor this objective into their assessment of the costs, burdens and benefits of potential rules or policies.

The Government believes that it would be wrong to go further than this and to give the PRA's secondary competition objective equal primacy with the PRA's other statutory objectives.

Giving the PRA a primary objective on competition would distract from their crucial role in ensuring the safety and soundness of firms. It would also create duplication with the role of the primary concurrent competition regulators active in the financial services sector, namely the Financial Conduct Authority, the Payment Systems Regulator (PSR), and the Competition and Markets Authority (CMA).

The Government believes that the benefits of the regulatory regime are best achieved if the primary focus of both the FCA and the PRA are on their own core responsibilities (as set out by their primary objectives), but with both institutions fully committed to working together and co-ordinating firm supervision and regulation across the full range of regulated activities.

The TSC also suggest that the Treasury immediately reviews the PRA's approach to its competition objective, at least for insurers.

The Government reported in its 2015 Productivity Plan (Fixing the foundations: creating a more prosperous nation) on how it had asked both the PRA and FCA to publish Annual Reports on how they are delivering against their respective competition objectives across financial services, to set out clearly the steps being taken to drive more competition and innovation.

To date the PRA has published two Annual Reports on competition, in 2016 and 2017, that set out how they are delivering against their competition objective. This includes in relation to insurers.

The 2017 report published on 6 July summarises the action that the PRA has taken to embed its competition objective into its policy and supervisory decision making and its response to recommendations set out by the Bank's Independent Evaluation Office in 2016 on how to improve the way the PRA approached its competition objective.

Paragraph 34. The insurance industry should be regarded as a priority sector during the Article 50 negotiations. The Government should consider bespoke reciprocal agreement with the EU, similar to, but far more comprehensive than, the agreements that the EU has with Switzerland and more recently with the United States. Such an agreement could provide a solution for other parts of the financial services sector. At the very least, if the Government wants to meet its objective of a "smooth and orderly exit" from the EU, then it needs to address the urgent issue of pre-Brexit cross border contracts, perhaps through the mutual recognition of pre-Brexit insurance contracts written in UK or EU member states. (Paragraph 201)

As the Prime Minister said in her speech in Florence on 22 September 2017, the Government's objective is to achieve a deeper and more comprehensive agreement with the EU than a traditional, existing Free Trade Agreement. The Government has already committed to faithfully implement prudential standards as set at the international level, but its ambition is for a new EU–UK relationship where there is a strong shared commitment to regulatory coherence. The UK starts from a unique position of regulatory alignment and our future relationship with the EU should recognise this. The Prime Minister has been clear that we need to think creatively about our options. The details of a new EU/UK relationship are a matter for the negotiations.

As the Committee notes, one of the Government's priorities is to ensure a smooth adjustment from the current structures of membership to the new relationship, avoiding outcomes that impose unnecessary costs and disruption on individuals and businesses. The Government has been actively engaging with the UK regulators and with the financial services sector to understand how the UK's exit from the EU could impact financial services firms and their customers, including through the effect of withdrawal on existing contractual relationships.

In its November 2017 Financial Stability Report¹, the Financial Policy Committee set out its judgement that the largest identified risks to the continuity of outstanding cross–border contracts relate to over–the–counter derivatives and insurance contracts. Both UK and EU financial services firms and their customers could be affected. The Government is considering all options for mitigating risks to the continuity of outstanding cross–border financial services contracts.

¹ <http://www.bankofengland.co.uk/publications/Pages/fsr/2017/nov.aspx>