Treasury Committee Inquiry into Solvency II - Terms of Reference

1. Solvency II will continue to have an impact on insurance companies if the UK remains in the EEA, or if UK firms establish subsidiaries in the EU in order to passport into other EU member states. And it will most probably continue to have an influence, even if the UK has a looser relationship with the EU[1].

2. The UK has a variety of options for its future relationship with the EU. These include, but are not limited to:
   - Remain in (or immediately re-join) the EEA – *for insurance, this would mean retaining the Solvency II directive and implementing in domestic legislation any changes to it that are subsequently agreed by the EU.*
   - Leave the EEA but seek to retain passporting rights for financial services – *for insurance, this would almost certainly mean retaining the Solvency II directive and implementing any subsequent changes to it in domestic legislation.*
   - Sever all connections with the EU/EEA, releasing itself from any obligation to adhere to EU law, but retaining all UK legislation which has implemented EU directives – *for insurance, this would mean retaining the effect of Solvency II as at the date of Brexit, but not incorporating any subsequent amendments to the directive.*
   - Sever all connections with the EU/EEA and repeal all legislation which derives from EU law, replacing it with domestic legislation where the UK Parliament deems it to be desirable – *for insurance, this would mean that we could revert to the old ICAS regime, develop it unilaterally in any way which is considered desirable, or select the elements of the Solvency II regime which are considered desirable.*

3. The Treasury Committee has decided to undertake an inquiry into the introduction and operation of Solvency II to supplement its work on the relationships that the UK might now seek with the EU. It is important to understand the strengths and weaknesses of Solvency II in its existing form and its status in the context of insurance regulation internationally - as background to decisions on the various options.

4. The objectives of the inquiry are to:
   - Consider the options for the UK insurance industry that are created by the decision to leave the EU.
   - Assess any impact of Solvency II on the competitiveness of the UK insurance industry.
   - Examine the impact of Solvency II on the role of insurance in meeting the needs of UK customers and the wider UK business economy.
   - Assess any learning for both regulators and industry from the introduction of this major piece of insurance harmonising legislation.

Questions to the insurance industry and interested parties

1. **Competitive implications of Solvency II**

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[1] When these Terms of Reference mention Solvency II, they refer not only to the Directive itself but also to the relevant UK legislation, which will still apply (until or unless it is repealed) whatever relationship exists between the UK and the EU.

a) Lord Turnbull suggested in evidence to this Committee that Solvency II makes it more difficult to expand into non-European markets because a European-based and regulated insurance company is at a disadvantage, relative to a Canadian or an American insurance company[2]. What are the competitive implications of Solvency II for UK insurance firms? Please answer within the context of the UK, European and global markets.
b) What impact is Solvency II having on the development of global regulation? Will we see the development of two-tier regulation as firms attempt to move to less rigorous regulatory frameworks either inside or outside their territories, or reinsure risks to other territories?
c) Could Solvency II create a potential competitive disadvantage for UK insurance firms in relation to firms from outside the insurance industry (including "disrupters" and companies who are not subject to any form of EU or EEA regulation) who may operate substantially in the same market?
d) What effect has Solvency II had on product innovation and the ability for new entrants to join the market?

2. **Development of Solvency II**
   a) What are the principal developments or adjustments that you would like to see made to Solvency II in an ideal world? Where relevant, please include an indication of timescale, priority, rationale and "real world" constraints.
   b) Given the potential increased flexibility that may be available following the UK's exit from the EU, should the UK seek alternatives to Solvency II for insurance regulation (such as a regime similar to the old ICAS regime, or a differentiated regulatory regime which varied according to an insurer's size or customer base)?
   c) Lord Turnbull said in evidence to this Committee that "it will actually help insurance companies if we can leave the [Solvency II] arrangement" which "treats insurance companies as though they were banks"[3]. Should the UK Government seek to withdraw from Solvency II?
   d) Sam Woods said in evidence to the Committee that there were elements which he would like to change – he said that the calculation of the risk margin (projecting forward insurance and capital grants until they run off and then discounting them back at the risk-free rate, so that the risk margin increases as the risk-free rate drops) "is the most obvious one" and "I would like to have some more macroprudential flexibility in the regime"[4]. Should the UK seek to amend, or withdraw from, these, or any other elements of Solvency II?
   e) Is Solvency II a price worth paying for the passporting of insurance services across the EEA?

3. **Implementation of Solvency II**
   a) What lessons have we learned from the implementation of Solvency II in the UK?
   b) With the benefit of hindsight, how well has the implementation of Solvency II met its stated objectives?

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[2] Treasury Committee, Oral evidence: Follow up to the Committee's Report on The UK's Future Economic Relationship with the European Union, HC 483, Tuesday 28 June 2016, Q23
[3] Ibid, Q21
[4] Treasury Committee, Oral evidence: Appointment of Sam Woods as Deputy Governor for Prudential Regulation and Chief Executive of the PRA, HC 567, Tuesday 19 Jul 2016, Q70

c) How did the implementation of Solvency II in the UK compare with other European member states, both in overall approach and specific guidance?
d) Where relevant, please give an indication of the costs of implementation for your firm - both internal (e.g. staff costs) and external (e.g. consultancy costs). *[If you would like us to keep this information confidential, producing only aggregated or anonymised data in our Report, please make that clear in the "additional information" box on the website. And if you are content for us to publish the rest of your submission, please send a redacted, publishable, version to treascom@parliament.uk]*
e) Solvency II has a number of transitional provisions (for up to 16 years in some circumstances). Are these provisions effective, practical and flexible enough?

4. Safety and soundness

a) How effective has Solvency II been in increasing the safety and soundness of the UK insurance industry?
b) What are its principal strengths, both technically, and in its influence on Boards?
c) What are its principal limitations?
d) What are your views on the concept of internal and standard models and does the concept work well in practice? If not, what refinements could be made?
e) Is the new regime flexible enough to withstand another financial crisis?
f) Can you think of any circumstances where Solvency II would not operate effectively or could increase the risk to the UK insurance industry?

5. Proportionality

a) Do you consider that the ongoing regulation under Solvency II is cost effective and proportionate with regards to the areas below?
    i. Pillars I and II
    ii. Pillar III
    iii. Solvency II's requirements to identify key function holders as implemented in the UK's new SIMR regime
b) Has the implementation of Solvency II allowed sufficiently for the different sizes and types of firms?

6. Financial reporting

There are a number of international developments (e.g. IFRS and EEV) attempting to clarify and simplify financial reporting and valuation for insurance entities. How does Solvency II factor in to this debate?

7. Wider implications of Solvency II.

What are the implications of Solvency II for:

i. UK policyholders;
ii. The wider UK business economy; and
iii. Regulators.