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CLIENT ALERT

The Prudential Regulation Authority Gives Further Clarity on Prudential Regulation in a Post-Brexit World

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I. Introduction

The PRA has provided further insight on aspects of its proposed approach to insurance regulation in the post-Brexit world.

This topic was covered in a speech given recently by Alan Sheppard, Head of Insurance Policy at the PRA, at the Westminster Business Forum entitled 'The Future of International Insurance in the UK'. In it, Mr. Sheppard acknowledged the importance of the UK as a centre for international insurance and reinsurance business, and also that the PRA has a role in fostering greater international competitiveness for the UK by implementing reforms to current prudential regulation.

Mr. Sheppard's speech covered a range of proposals, but focused on the PRA's desire to provide greater support for innovation, to ease the regulatory burden on UK branches of overseas insurers and to streamline the current authorization process.

These themes are likely to be of particular interest to potential entrants into the London Market, such as offshore reinsurers or international insurance groups who currently do not have a UK presence, when assessing the relative merits of choosing a jurisdiction.

II. The PRA's Proposed Reforms

The PRA's key themes as set out in the speech are as follows:

(i) Support for Innovation

- The PRA remains of the view that a robust prudential regime is important to maintaining an international reputation as a trusted insurance market, and therefore intends to expect and employ high standards in regulation.

- However, the PRA will shift its approach from relying on detailed black-letter regulation to adopting greater levels of flexibility and proportionality, particularly when overseeing innovation in the insurance industry. For example, the PRA is focused on taking a proportionate approach to supervising the growth and development of cyber insurance in the London Market, as firms have been able to set their own risk appetite and develop their own systems to measure and manage insurance risk.

(ii) Support for UK branches of third-country insurers

- A significant focus of the speech was the proposed treatment of UK branches of third-country insurers, as around 130 entities are expected to graduate from the Temporary Permissions Regime to becoming PRA-authorized branches.

- The PRA recognizes that branches pose advantages for both insurers and regulators by reducing unnecessary duplication between home and host-state regulators. Accordingly, the PRA intends to invest heavily in forging constructive relationships with home-state supervisors, and to rely upon their regulatory supervision when it is prudent to do so. The PRA has already had positive engagement with EEA supervisors and is working to establish 'split of responsibilities' agreements with them.

- In addition to the practical steps that the PRA has already taken to ease regulatory requirements on branches (for example, by waiving branch capital requirements for pure reinsurance branches), the PRA also proposes the following to further reduce branches' regulatory burden:

    - branches will be able to obtain modifications by consent to exclude non-UK risks that they have underwritten from their technical provisions calculations and capital calculations. These capital burdens could instead be assumed by their head office; and

    - small branches, or branches that only underwrite non-UK risks, will be able to apply for waivers in relation to certain additional reporting requirements.

III. The Authorization Process

- The PRA intends to encourage new capital into the London Market by introducing greater speed and flexibility in its authorization process. The PRA's proposals, which relate to both traditional insurance ventures and to insurance-linked securities (**ILS**), are as follows:
  - **ILS –** In order to address the disappointing levels of ILS transactions in the London Market, the PRA intends to develop a more proportionate 'green channel' for a category of 'standard' short-tail, general insurance structures, which will give applicants more certainty over the outcome of their applications earlier in the process. The PRA will also consult on certain changes to the relevant Supervisory Statement to clarify and strengthen its approach to the ILS regime.
  - **Traditional ventures –** The PRA will streamline its approach to authorizing traditional insurance ventures by addressing: (i) the speed of the authorization process; (ii) the depth of its review of applicants' proposed business plans; and (iii) the level of documentation required at the point of engagement with the PRA.
  - In particular, the PRA will increase its focus on specific issues at the outset, taking into account the nature of the underlying business, the experience of the proposed members, the clarity of the business plan and the availability of material capital levels. The PRA will also aim to give clearer guidance to applicants that reduces the uncertainty of the eventual outcomes of applications.

IV. Conclusion

Mr. Sheppard's speech reflects the longstanding view of both the PRA and the UK government that the approach to prudential regulation can operate as a tool to increase international competitiveness following Brexit. The proposals contained within it are also consistent with the PRA's recent 'Prudential Regulation Authority Business Plan 2022/23', which discusses how the PRA will approach its new secondary statutory objective to 'support competitive and dynamic regulated markets' if the UK Government's latest Finance Bill is approved by Parliament later in 2022.

International firms that are not yet direct market participants therefore may regard this speech, and the PRA's general approach to international competition, as a potential business opportunity. In particular, reinsurers who underwrite business from the United States may consider that it could soon be time to move to onshore. A presence in the UK, and direct authorization from the PRA, would enable reinsurers to strengthen their connection with the domestic insurance market (for example, by commencing direct marketing within the jurisdiction), and could end the difficult balancing act of ensuring that their operations remain outside of the UK regulatory perimeter. The old trade-offs connected with establishing a branch would be reduced under the PRA's proposed regime, given that the proposals include the absence of significant capital localisation requirements and the PRA’s targeted reduction of duplicative regulatory obligations imposed by home and host state regulators.

Current UK firms are already considering the recently published HM Treasury consultation paper on reforms to Solvency II and the PRA’s discussion paper on potential reforms to risk margin and matching adjustment within Solvency II. These papers deal with other aspects of possible reforms to the UK’s regulatory regime but detailed rule changes are not expected until later this year.

However, firms and customers may both be cautiously encouraged by the PRA’s proposed approach. The PRA recognizes that trust in its prudential regime is key to the UK market’s continued success, and will seek to ensure that its current standards are not diluted by a departure from certain Solvency II rules. Further, the introduction of greater flexibility and proportionality in domestic regulation could result in a regime that is bolder, more flexible and better at fostering innovation and effective competition.

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