LONDON MARKET GROUP

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A PLAN FOR THE FUTURE

ONE YEAR ON AND NEXT STEPS

THE LONDON INSURANCE MARKET TODAY

The London insurance market remains a vital part of the UK economy and a major contributor to making the UK the most globally connected financial centre, providing services around the world.

Commercial (re)insurance oils the engine of economic growth. Without it, many public and private investments would be too risky to carry out and companies would be required to carry substantially more capital. Hence fewer investments would be made, significantly slowing down economic development. Commercial insurance plays a fundamental role in supporting and stimulating economic growth through the reallocation of risk.

THE LONDON MARKET REMAINS VITAL

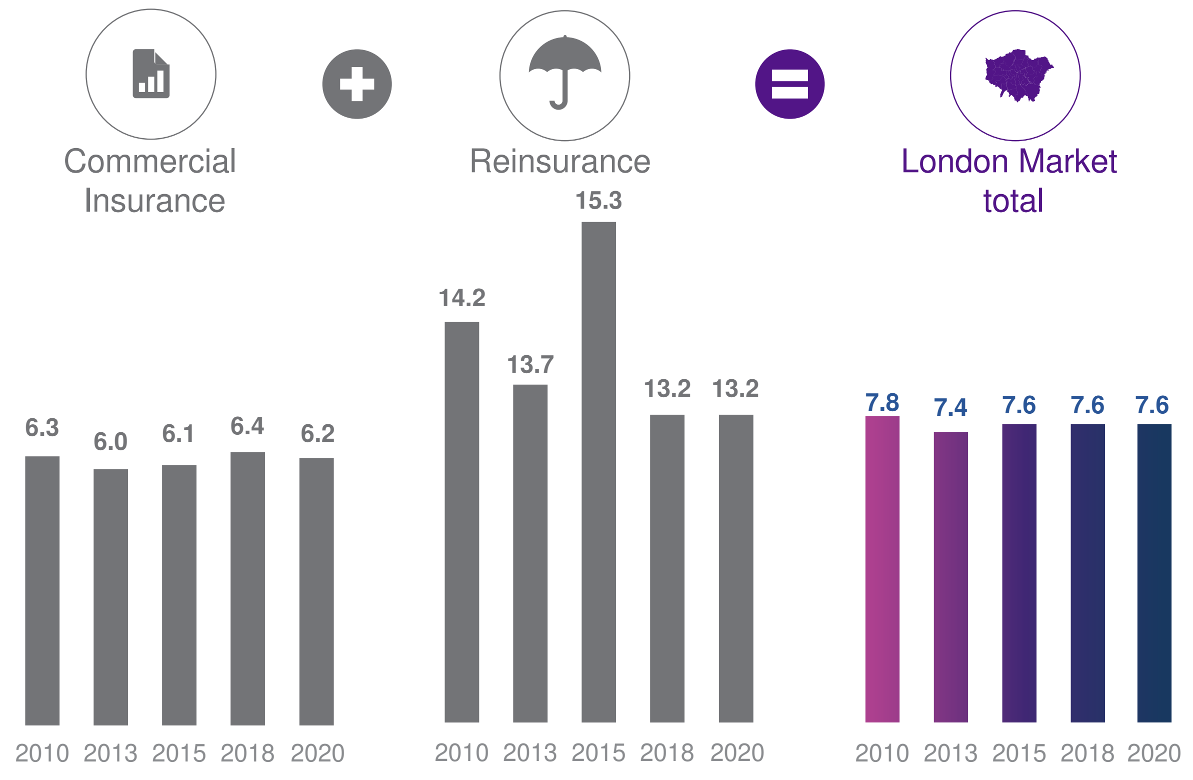
The London Market remains the largest commercial (re)insurance hub globally. In 2020 it earned $121bn in premiums, an increase of $11bn – or just under 5% from 2018.

The London Market, by virtue of its status as a global hub for commercial insurance and reinsurance, is a significant export industry, employing a growing number of people and attracting investments into the UK. In addition, some of the assets which back claims paid by the London market insurers are invested in UK assets.

Nearly three quarters of London's business is generated from outside the UK, making a significant contribution to the UK's economy. In 2020 the London Market's total GDP contribution was £32bn, an increase of 3.7% pa on 2018 figures. As a proportion, this economic contribution equates to nearly a quarter of the City's GDP.

It has attracted investment from every one of the top 20 global insurance and reinsurance firms, all of which are active in London, and it employs nearly 50,000 people, 29% of whom are outside the South East.

BUT MARKET SHARE IS STAGNANT



While total income is growing, the London insurance market has only maintained its global market share in the last decade.

Businesses have choices about where they place capital, income and people, and regulation is a vital part of that decision-making process. The quality of our financial regulation is a major asset for the UK, nobody is looking for a reduction in those standards. The burden and cost of regulation and supervision can create a negative perception which damages the ability of London to attract capital to support the commercial insurance market.

The London Market cannot rest on its laurels and must continue to fight to maintain its leading position.

A PLAN FOR THE FUTURE: ONE YEAR ON AND NEXT STEPS

In June 2021, the London Market Group (LMG) launched a five-point plan to help seize new global market and trade opportunities.

Nearly one year on, as the world emerges from the COVID-19 pandemic, and as the Government's Future Regulatory Framework (FRF) and Solvency II Reviews progress, this is an important time to review what has been achieved so far and set out the next steps in reaching our goals.

In less than a year we have already seen significant progress in delivering on those goals:

1

Ensuring that the London Market remains the most attractive home for large risks through an international competitiveness duty for UK regulators.

- In April 2022, the House of Lords Industry and Regulators Committee concluded its inquiry and in recommendations to the City Minister[1] called on the Government to introduce a greater focus on proportionality in the UK's regulatory framework.
- Following the LMG's campaign the PRA has said[2] it will move to authorise more quickly and proportionately without necessarily having all capital and executives in place.

2

Recognising the nature of the large complex risks we cover and the sophisticated corporate buyers we serve through a more proportionate approach to regulation.

- In November 2021 the Government adopted the LMG's proposal for a competitiveness and growth duty[3] for both regulators, recognising that "the financial services sector is not just an industry in its own right but an engine of growth for the wider economy."
- The Industry and Regulators Committee similarly backed our calls for a competitiveness objective, and went further by backing the LMG's call for a "clear criteria and appropriate performance measures" alongside it to ensure accountability.

1. https://committees.parliament.uk/publications/9596/documents/162439/default/
2. The future of international insurance in the UK - speech by Alan Sheppard | Bank of England
3. Future Regulatory Framework (FRF) Review: Proposals for Reform - GOV.UK (www.gov.uk)

3

Making London a natural home for foreign (re)insurance companies by reforming the Solvency II regime.

- HM Treasury is progressing its review of the Solvency II regime and has proposed a number of amendments, including the removal of some reporting requirements.
- At the end of 2021 the Prudential Regulation Authority (PRA) created a Solvency II Reporting Requirements Working Group, with LMG members represented, to consider what reporting requirements can be removed or amended.
- HM Treasury has also announced[4] proposals to remove the requirements for UK branches of foreign insurers to calculate branch capital requirements and to hold local assets to cover them. This reform should benefit around 160 branches immediately, as well as any other branches that establish in the UK in the future.
- The PRA is considering a "green lane" for ILS applications to speed up approvals with more detail to follow.

4

Increasing the choice of buyers and growing the market by developing and promoting a UK captives market.

- The LMG has presented its proposals to HMT and the PRA, and a dialogue is underway to take this work forward through a joint working group.

5

Gaining access to emerging markets around the world, to help them build resilience against natural disasters and climate change events through trade negotiations, regulatory dialogues and market promotion.

- Both the UK-Australia[5] and UK-New Zealand[6] Free Trade Agreements (FTA) include commitments on the provision of "large risk" business.
- This was the first time such provisions have been included in UK FTAs, establishing an important precedent for the UK's trading relationships with other nations in the future.

4. Solvency II Review: Consultation - GOV.UK (www.gov.uk)
5. UK-Australia Free Trade Agreement: benefits for the UK (publishing.service.gov.uk)
6. UK New Zealand Free Trade Agreement Benefits for Sectors of the UK Economy (publishing.service.gov.uk)

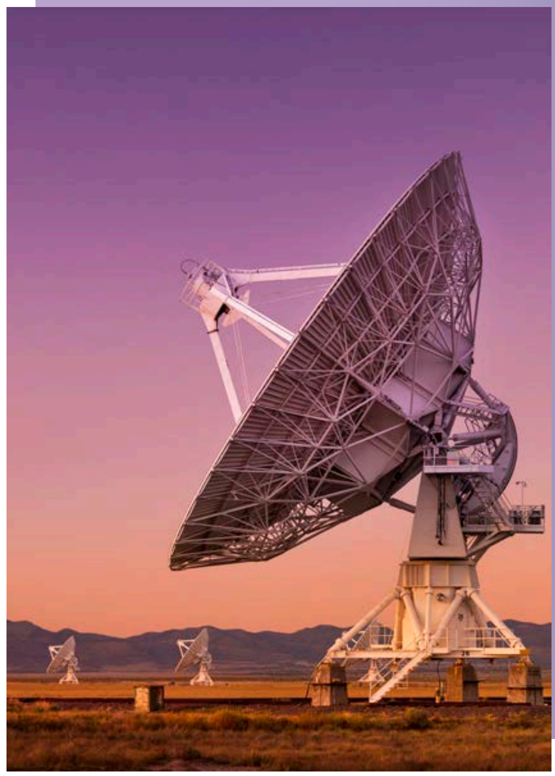
1 AN INTERNATIONAL COMPETITIVENESS DUTY FOR THE UK REGULATORS

We welcome that HM Treasury has backed the LMG's long standing campaign and now proposes to introduce new growth and international competitiveness objectives for both the PRA and FCA.

WHAT IS THE ISSUE?

However, the objectives alone are insufficient, as the House of Lords Industry and Regulators Committee concluded. There now needs to be further emphasis on how the regulators will implement the duty and how they will be held to account in meeting its requirements.

In other words, how can we ensure the duty has the necessary 'teeth' to be effective and to make a difference to the UK's competitive position.



WHAT IS THE SOLUTION?

The focus should now be on the annual reporting requirement for the duty and what issues or criteria this should cover, including:

- Progress of rationalisation and indexation: A consistent focus on regulatory consolidation and simplification is a simple, immediate and measurable step that the regulators could take to improve competitiveness. Post-Brexit, there is a unique opportunity to revisit and reframe existing regulation to ensure it is fit for the future and able to support growth and innovation in the industry.
- Accountability and transparency: HM Treasury must play an active role in setting the reporting parameters for the regulators on the new competitiveness and growth duty, using the forthcoming financial services legislation to set out in statute the parameters and reporting requirements in some detail. To help with that process LMG has published Metrics for success which suggest what might be measured to bring about cultural change.
- Reporting on process and decision making: Decisions as to where to bring investment and business are affected by supervisory behaviour and culture, including the speed and responsiveness of the regulators and the overall efficacy of the application process and interactions. This can be measured, and targets created to ensure that the regulators are operating effectively.

As well as reporting parameters being set by HM Treasury for the new competitiveness and growth duty, to ensure that it is not reduced to a 'tick box' exercise, there also needs to be a process in place – clearly set out within the Financial Services and Markets Bill - that regulators can follow, which will ultimately lead to a change of behaviour, and can be tracked against a publicly available performance criteria that will allow the Government, Parliament and industry to adequately hold them to account.

7. Taskforce on Innovation, Growth and Regulatory Reform independent report - GOV.UK (www.gov.uk)

8. MAS: Singapore Competitiveness Factsheet: https://www.mas.gov.sg/-/media/MAS/Why-SG/Singapore-Competitiveness-Factsheet.pdf?la=en&hash=CDEA2155D4A17A68749B26E241233B5CB6BC98DB

2 INTRODUCING A MORE PROPORTIONATE APPROACH TO REGULATION

The London Market is an export driven industry, whose clients are among the FTSE 100, Dow Jones 30 and major stock market listed companies around the world. We need a regulatory approach which recognises that protecting sophisticated corporate buyers armed with advisers is very different to individual consumers who may not have any advice at all.

WHAT IS THE ISSUE?

Current regulation frequently does not make a significant distinction between firm types with respect to its expectations. In particular, rules and supervision models have not been sufficiently clear and adaptable in terms of contributory factors such as a firm's size, complexity of business model, sophistication of clients and capital and liquidity requirements. Proportionality needs to be taken seriously and although it is an existing duty of the regulators, we do not believe it is currently being fulfilled in practice.

In just one example, the FCA General Insurance Pricing Review uncovered some justifiable concerns about the treatment of existing consumers at renewal in the motor and home markets. However, the FCA's fair value product review includes large parts of commercial insurance in its scope. The London Market serves sophisticated corporates in a sector where there is no evidence of this type of market failure. The review is cumbersome, costly and complying with some elements may be impossible for London Market brokers and insurers.

On top of the regulation, there are significant numbers of 'CEO letters', together with policy statements, thematic reviews, ad hoc data requests and even speeches made by senior officials of the regulators. All of this has created a significant body of regulatory requirements and expectations essentially leading to regulatory modifications outside of the more formal rule book. These expectations have layered new requirements on the industry without appropriate and independent checks and balances, creating a significant burden for firms. As 89% of the capital supporting the London market is from outside of the UK, we need to recognise that those capital providers have choices about where to deploy capital. The burden and cost of regulation and supervision are certainly factors and create a negative perception which damages the ability of London to attract capital to support the commercial insurance market.

WHAT IS THE SOLUTION?

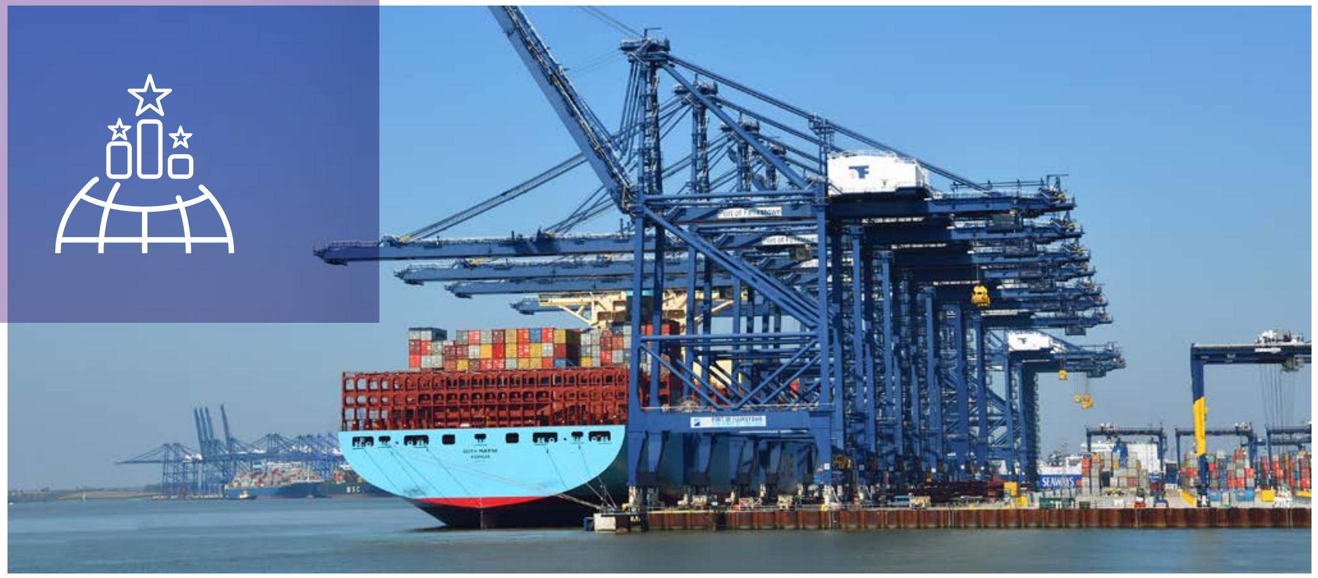
The emerging regulatory approach should facilitate enhanced flexibility on how to classify firm activities and scope. This should more clearly define supervisory considerations with respect to different types of business. However, it should also then evaluate which rules should apply to each sub-sector in order to reduce unnecessary compliance burdens. We would ask HM Treasury as it develops the forthcoming Financial Services and Markets Bill to revisit its position on proportionality and adopt the positions set out in recent policy papers published by the Government regarding regulatory reform.

The proposal for a 'Proportionality Principle', first recommended by the Government's Taskforce for Innovation, Growth and Regulatory Reform (TIGRR) , could make an important contribution to the new framework we are proposing. As the TIGRR report states, a renewed focus on proportionality would 'unlock global UK leadership in innovative regulation, will be a major boost to both UK economic recovery and our long-term competitiveness.' The subsequent Benefits of Brexit White Paper has also recognised the need for greater regulatory proportionality, with a strong set of metrics and assessment alongside it, to ensure that regulation is delivering on the intended outcomes and not imposing unnecessary burdens. The House of Lords Industry and Regulators Committee has also confirmed that a disproportionate approach is holding our own market back.

The Government's commitment to implementing the TIGRR report is good but its findings, specifically the implementation of the proportionality principle, must be applied to the UK's financial regulators.

The Financial Services and Markets Bill is an ideal opportunity to strengthen the existing proportionality duties of the financial regulators, developing a new UK-specific framework that boosts UK competitiveness while maintaining the highest regulatory standards. This would complement the reporting requirements of the competitiveness duty and adopt the best practices of competitor jurisdictions across the world.

7. Taskforce on Innovation, Growth and Regulatory Reform independent report - GOV.UK (www.gov.uk)



3 REFORMING SOLVENCY II TO ENCOURAGE OVERSEAS INVESTMENT

Solvency II has brought significant benefits and strengths to the London Market – particularly Pillar II risk management - such as a strong balance sheet; networks of international licences that facilitate access to markets and the ability to write global programmes; and an internationally well-regarded system of regulation that encourages transparency.

WHAT IS THE ISSUE?

Some of the reporting requirements within the solvency regime are quite onerous to complete. The required documentation runs to thousands of pages for each firm. Not only is there a cost in producing and maintaining it, but boards and management are required to review and approve all of it. Not all of that documentation is adding value to firms or to regulators and we should have a process in place to consider the requirements which are no longer necessary or fit for purpose.

The Government's Solvency II Review is a major opportunity to make the UK more competitive, and we're encouraged by the progress that has been made so far, but note that the reforms proposed to date are more applicable to the life and retail sectors. We welcome the latest HM Treasury consultation which now confirms proposals to remove the requirements for UK branches of foreign insurers to calculate branch capital requirements and to hold local assets to cover them. This is a good start but we believe the PRA can go further.

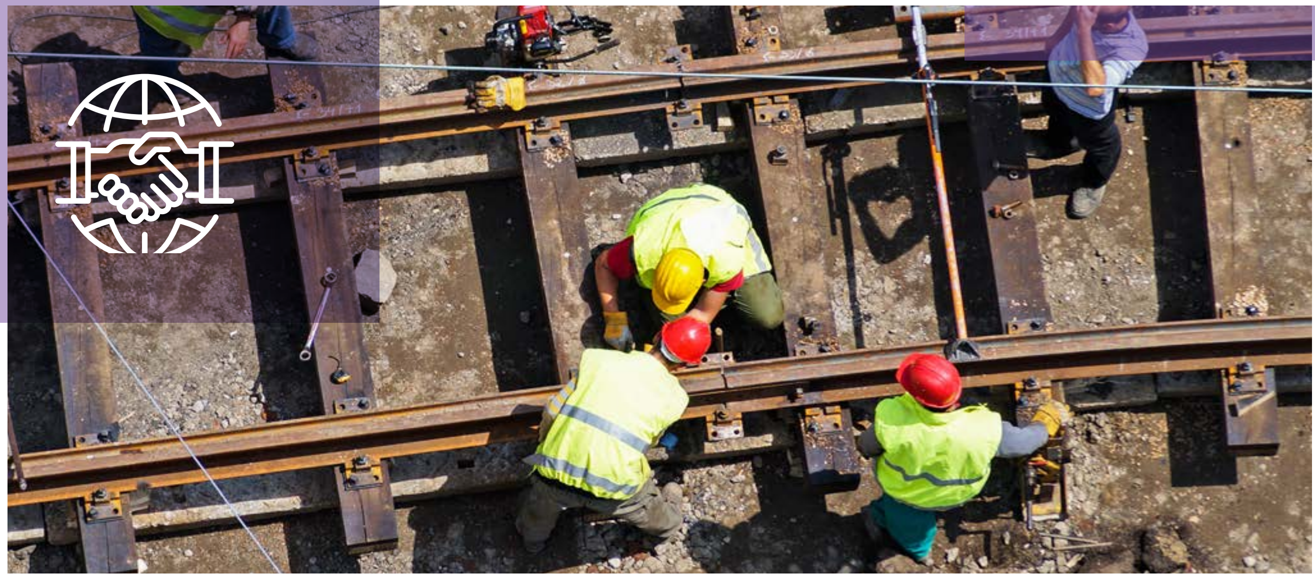
WHAT IS THE SOLUTION?

Looking ahead to the PRA's next consultation on Solvency II reporting requirements, which is due by the summer of 2022, this should focus on the priority areas of risk. It should also ensure that requirements are differentiated according to firm size and activity as appropriate.

There should be a detailed template-by-template cost-benefit analysis of all reporting templates with only those which are demonstrably needed retained. There should also be a cost-benefit assessment of all go-forward changes, since even minor changes bring implementation costs. In doing this there are a number of areas that must be considered:

- Reducing reporting by 50% to half yearly returns, which is consistent with the way that insurers prepare their financial statements.
- Extending data deadlines so that supervisors may get the best possible value from the data.
- Removing reporting requirements that were previously needed for EU-wide financial stability calculations.
- Withdrawing the additional national specific templates and removing the annual Regulatory Supervisory Report (RSR).
- Simplifying and streamlining the Solvency and Financial Condition Report to better meet its original objective of informing policyholders.
- Removing requirements to identify key function-holders as these impose on insurance companies the same broader requirements as those for banks which are a significant gold-plating of the Solvency II requirements.

As far as possible we would ask HM Treasury to prioritise identifying which requirements can be completely removed from the reporting process, over incremental changes or modifications. Minor changes or modifications in the UK could have the unintended consequence of creating additional reporting burdens to these businesses and have a knock-on effect to our overall competitiveness.



4 PROMOTING A UK CAPTIVES MARKET

Captive insurance companies are used by large firms and public bodies to write their own insurance. They have become an increasingly popular form of risk management with a 200% increase in captive creation between 2019 and 2020 and US$54 billion of premium being written globally.

WHAT IS THE ISSUE?

In order to develop new products to attract new buyers to the London insurance market, a much greater focus on an activity-specific model of regulation is required. This approach should also be capable of responding to changes in business models or the development of new industry sub-sectors or investment types. A failure to do this could mean London continuing to lose out to other centres in relation to reinsurance, captives and alternative risk transfer products.

Currently there are no captives based in the UK as it is seen as an unattractive location. UK regulators treat them the same as an insurance company, despite the fact that they only write the risks of their parent or of entities that are part of the group. They pose a very low risk to the overall financial system and indeed can help companies manage their risk more effectively. Despite this the UK regulators continue to take a disproportionate approach, which has seen UK companies and public sector bodies choose to locate their captives - and their capital - in overseas jurisdictions, including a number of EU jurisdictions.

WHAT IS THE SOLUTION?

For a captive regime to succeed in the UK, the PRA should work with Government to create a new class of insurer – captives – and develop specific guidance for captives which focuses on reduced prudential risk assessments, a swifter approval process (30 – 60 days from application to licensing), reduced reporting requirements, lower capital requirements and reliance on wider group functions such as auditing etc.

The most successful domiciles have a dedicated captive regulatory unit and while this may not be feasible from the start, the PRA should ensure sufficient capacity is available to respond to captive enquiries and applications in an expediated process.

A well-planned marketing campaign would be required to educate the risk and insurance community of the unique proposition offered by the UK.

Implementing such a regulatory environment would be an opportunity to demonstrate the UK's increased regulatory flexibility post Brexit. This regime would be complemented by London's leading reinsurance and other financial services infrastructure, providing a unique captive domicile proposition.

A committed and proportionate regulatory regime is now the biggest factor in domicile selection for captive insurers. An ambitious regulatory model for captives, combining a proportionate risk-based solvency regime with London's global reinsurance market, would make the UK a unique and attractive location for captives.

To make this a success it is now important that Government and the regulators work together to develop the necessary legislative and regulatory changes required to create an attractive UK captive regime. In order to progress this further we would welcome the formation of a joint working group between industry, HM Treasury and the PRA to formalise the dialogue already underway and work towards implementing these proposals.

Ultimately we believe the best way this can be achieved is to create a new class of insurer – captives – and develop specific guidance for captives which focuses on reduced prudential risk assessments, a swifter approval process, reduced reporting requirements, lower capital requirements and reliance on wider group functions such as auditing etc.

5 ACCESS TO NEW AND EMERGING MARKETS

Over the past year, the UK Government has successfully negotiated FTAs with Australia and New Zealand, which included commitments on the provision of "large risk" business, which has been a long-standing LMG ask.

This was the first time such provisions have been included in UK FTAs, establishing an important precedent for the UK's trading relationships with other nations in the future. These developments have built on the successful negotiation of the UK-US Covered Agreement for Reinsurance.

There is also encouraging progress being made between the UK and Switzerland regarding negotiations for a mutual recognition agreement on financial services, which is expected to reduce costs and barriers for UK firms accessing the Swiss market, and vice versa. It would be the first financial services free trade agreement in the world.

9. The Benefits of Brexit: How the UK is taking advantage of leaving the EU (publishing.service.gov.uk)

WHAT IS THE SOLUTION?

The LMG will continue to input its expert analysis into the Government's negotiations with a range of third countries. In its Benefits of Brexit White Paper, the Government rightly points to the value of 'regulatory diplomacy', particularly in areas such as trade, which affect the UK's long-term strategic advantage, economic security and competitiveness. Commercial insurance and reinsurance must be part of this approach.

We believe the London Market and the services we offer can contribute significantly towards this goal. In drawing attention to the economic benefits of reducing barriers to large risk/corporate clients, we hope this will become the template for future trade negotiations as well as Economic and Financial Dialogues.

The nature of the risks and the fact that the clients are large corporates with their own advisory teams and capabilities should provide reassurance to international regulators that they can allow greater market access between countries, relying on home state regulation, with a much lower risk of consumer harm. These are well-defined concepts and precedents in international regulatory systems, and concepts already recognised by many regulators across the world.

ABOUT THE LONDON MARKET GROUP

The London Market Group is the only body which speaks collectively for all practitioners in this significant market, representing the views of insurance brokers, those insurers and reinsurers operating within Lloyd's, and branches of overseas insurers and reinsurers operating in London – reflecting the full extent of the Market.

This plan reflects the perspectives of the International Underwriting Association of London (IUA), the Lloyd's Market Association (LMA) and the London & International Insurance Brokers' Association (LIIBA) and Lloyd's of London.

FOR FURTHER INFORMATION CONTACT:

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