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LONDON MARKET GROUP

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LLOYD'S MARKET ASSOCIATION

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A PLAN FOR THE FUTURE



INTRODUCTION

Insurance is the lifeblood of trade, investment and commerce – without it, planes would not take off, ships would not sail, vital infrastructure would never be built.

The UK's commercial reinsurance and insurance markets, centred within the City of London, lead the world in providing specialty commercial insurance, taking on the most difficult and sophisticated risks. The London Market earns over US\$100 billion in income a year, is growing at a rate of just under 14% per annum and is bigger than all its nearest competitors combined.

London also brings considerable foreign investment into the UK. The London Market Group's latest research highlights that over 66% of the capital that comes to the UK's commercial insurance market is foreign owned. The market thrives because overseas firms – from the EU, Switzerland, the US and Japan – want to trade within London to access business and take advantage of the significant expertise and world leading eco-system that exists here.

This is the only place that brings together the breadth of expertise, flexibility of thinking and weight of capital to address the universe of risks that decision makers are facing. Our clients are multi-national corporations and large businesses, advised by sophisticated intermediaries drawn to London from all over the world.

While we have an advantage, it is crucial we do not rest on our laurels. Action must be taken to maintain the UK's competitive position, grow our exports and deliver increased levels of foreign inward investment into both London and across the regions of the UK, where the market is expanding.



THE LONDON MARKET GROUP HAS DEVELOPED A FIVE-POINT PLAN FOR THE FUTURE OF THE COMMERCIAL INSURANCE INDUSTRY:

1



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

2



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

3



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

4



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

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.



1 INTRODUCING A MORE PROPORTIONATE APPROACH TO REGULATION

The activity-specific approach to regulation set out in within Phase II of the Government's Future Regulatory Review is an opportunity to recognise the differences between industries, such as the services they provide and the nature of their clients and customers within the broader financial services sector.

A more proportionate approach to individual sectors within the insurance industry and the type of client they serve. This would make a greater contribution to the UK's economic recovery, boost UK competitiveness and make the London Market more attractive to international investors.

We would welcome a regulatory approach which recognises the nuances between the different insurance markets that operate within the UK.

The framework should recognise the specific characteristics of the London Market: that it is providing cover for large, complex risks, to sophisticated corporate entities and that it is primarily an export driven industry.

This would allow the regulators to develop regulatory models which can better support these valuable markets, allowing them to deliver wider benefits to the UK economy and international investment.

For example, London market brokers play a crucial role in bringing over US\$110 billion of gross written premium to London each year, predominantly from overseas. The market relies on brokers to bring business into the UK, proactively working to manage both existing risks but also new and emerging risks, attracting premium to the market that would otherwise have gone elsewhere or perhaps not have been spent at all.

At present these brokers are regulated by a 'one size fits all' approach by the FCA. Despite the fact that they deal with sophisticated corporate clients with significant resources and professional advisers at their disposal. They are not consumers in need of protection in the way that individuals or SME customers may be. However, the FCA makes almost no distinction in the way it supervises a London Market broker working in the specialty markets in London from the way it supervises a retail insurance broker dealing with an individual's domestic and motor insurance requirements.



In the next phase of the Future Regulatory Framework review, the Government should bring forward proposals to deliver a more stratified and proportionate approach to individual sectors within the insurance industry and the type of client they serve. Separate models for personal lines, commercial lines and reinsurance which reflect the nature of the risks of these different sectors would significantly aid UK competitiveness. Individual consumers and SMEs will still need consumer like protection but large corporate clients who have their own professional brokers and advisers need much less.



2 AN INTERNATIONAL COMPETITIVENESS DUTY FOR THE UK REGULATORS

The emergence of centres of capital in places such as Singapore, Dubai and Miami has significantly increased the number of markets able and willing to write risks that previously might have had no choice but to go to London. While these new centres do not currently have London's depth of knowledge or expertise, they are a lot cheaper to operate in. Over time our concern is that these new centres will become far more viable alternatives and compete for premium, putting further pressure on London's share.

As Lord Hill's Listings Review recognised, in recommending a competitiveness duty for the FCA, international insurance and reinsurance hubs in Bermuda, Switzerland, Hong Kong, Australia and Singapore are all regulated by bodies mandated to promote their domestic markets, ensure they are attractive places to do business and promote the reputation of those markets. These markets are seeking to make their regulatory environments as attractive as possible and in some cases actively benchmarking their regulatory regimes against other locations. The business that comes to London is mobile, as is the capital needed to support it. The economic activity in the UK supporting this business is therefore at risk if the regulatory regime is misaligned with more generally accepted international norms.

The London Market Group is not seeking a reduction in UK regulation or a dilution in UK regulatory standards. International clients and investors see adherence to the Solvency II standards as a benefit of doing business in the UK.

Having a more prominent role for international competitiveness within the regulatory structure would send a positive message the UK is 'open for business, that we welcome new investment and trading opportunities, within the context of a robust regulatory

framework, a system that promotes good governance and supports investor and client confidence.

An international competitiveness objective could be used to benchmark against other international financial services hubs, and be used to help nurture innovative new products and promote the reputation and good governance of the UK industry to overseas investors.

To support a greater emphasis on international competitiveness, the regulators should consider their role in encouraging inward investment to the UK, perhaps through a *dedicated inward investment unit*, akin to IDA Ireland, to provide more proactive support and guidance to overseas firms seeking to come to the UK and trade within the London Market. At present, evidence from our member firms suggests this is limited to referring companies to information on the regulators' website.

We would also like to see the *expansion of the Sandbox approach* to regulated activities by the PRA to encourage more innovative products and services to be developed in the UK. Such an approach would bring down costs of innovations and reduce barriers to entry, while allowing the UK regulators to collect valuable information prior to approval.



We would strongly urge the Government, in the next phase of the Future Regulatory Framework review, to bring forward proposals for international competitiveness to become part of the regulators' statutory objectives.



3 REFORMING SOLVENCY II TO ENCOURAGE OVERSEAS INVESTMENT

Solvency II has brought significant benefits and strengths to the London Market. We therefore do not support wholesale changes to the regime but would like to see certain refinements to the UK regime and for some of the unnecessary requirements, specifically regarding the treatment of branches of overseas firms to be scaled back to what is actually important to clients, supervisors and firms.

We would suggest three key reforms to make the London Market an attractive place for overseas firms to do business and encourage further foreign investment:

- Treatment of reinsurance branches: The PRA treats pure reinsurance branches as similar to direct insurance branches, which goes beyond the requirements set out in Solvency II. This includes additional solvency requirements, duplicating reporting requirements as well as additional governance requirements. This approach detracts from the attractiveness of the UK. The clients of reinsurance branches are other insurance companies, and the branch is fully protected by the Group company. Given the cross-border nature of reinsurance we are concerned that continuing such an approach will make the UK less competitive and we will lose further ground as a centre for the global reinsurance market.
- EEA-based branches: In the case where a UK branch of an EEA-based firm is not writing any UK risk, we would suggest that there does not need to be any involvement from the PRA at all, given that all the necessary regulatory compliance will have been undertaken with the firm's home state regulator in the EEA country. We believe such an approach would significantly boost the

UK's competitiveness and its attractiveness to EEA firms seeking to write global cover in the London Market, while presenting no risk to UK policyholders.

- Non-EEA branches: As the UK further develops its regime for overseas firms, the PRA should also be willing to place more reliance on the known quality of supervision provided by non-EU regulators, when supervising UK branches. For example, where a jurisdiction is recognised to be Solvency II equivalent - now the case with Bermuda and Switzerland - in relation to its supervision of groups and reinsurers, the PRA should not apply additional regulation at UK branch level, at least in respect of those areas where equivalence has been found. This approach should also be extended to US firms seeking to create a reinsurance branch in the UK, using the UK-US Covered Agreement as a basis to reduce regulatory burdens on those firms.



To have to go through these additional and unnecessary regulatory processes which duplicate work already performed by other trusted regulators is very costly and time-consuming and acts to inhibit overseas firms from operating in the UK. The PRA has the ability to resolve these issues within the current framework and without compromising its own compliance with the Solvency II regime or the prospects of a subsequent equivalence ruling with the EU.



4 PROMOTING A UK CAPTIVES MARKET

Currently there are no captives based in the UK as it has historically been seen as an unattractive location. Outside of Lloyd's, the UK has no specific regulatory framework for captives, instead treating them as insurance companies, even though they are very different entities.

Captives, on the whole, only write the risks of their parent or of entities that are part of the group. There is no recognition within the UK's regulatory system that captive insurers present a low risk to the overall financial system.

Due to this uncompetitive environment, no company has chosen to set up a captive in the UK, despite our extensive financial services ecosystem. This is despite the fact that London Market brokers have world leading experience of managing their clients' captives across the world and could easily replicate these services within the UK.

Many UK public sector bodies with captives choose to locate in overseas and offshore jurisdictions, meaning UK taxpayer's money is held offshore. This could come back to the UK if the regulatory regime was more attractive.

A number of jurisdictions, including EU jurisdictions, take a differentiated and proportionate regulatory approach, reflecting the nature of the risk that these captives are writing.

Popular domiciles in the EU - such as Ireland, Luxembourg and the Netherlands - interpret Solvency II in a more proportionate manner than UK regulatory authorities, interpreting the governance and reporting requirements, roles and responsibility clauses enshrined within Solvency II more flexibly, meaning that they are able to operate with more agility, allowing the captives to operate at lower costs.

The Central Bank of Ireland (CBI), has recognised that captives need to be treated differently and has adopted a 'differentiated supervisory approach'. This has reduced a number of regulatory requirements and contributed to making Ireland an attractive location for captives. Captive insurance is not defined or referred to in the Irish Insurance Acts or regulations. Instead, the CBI uses the definitions of a 'captive' in Solvency II. If the captive falls within this definition, it can then avail itself of the 'differentiated supervisory approach' taken by the CBI.

The potential of attracting captive business currently sitting offshore to the UK is significant. Marsh alone estimates that offshore domiciles currently account for 41% of its captive business, which in 2018 held total assets of more than US\$374bn.



We believe that there are few barriers to the UK creating a domestic captives market. Captive insurance is not defined or referred to in the Irish Insurance Acts or regulations. Instead, the CBI uses the definitions of a 'captive' in Solvency II as the basis and justification for its differentiated approach.

The current Solvency II Review offers the UK an opportunity to develop a more attractive regime for captives. We would welcome further discussion with HM Treasury and the PRA about taking this work forward.



5 ACCESS TO NEW AND EMERGING MARKETS

We welcome the Government's recent trading successes and the emphasis that has been placed on UK financial services as a key element of the UK's appeal as a trading partner. The extensive capital and expertise at our disposal means that the London Market is a natural trading partner to complement local insurance markets, not compete with them.

The London Market also provides reinsurance capacity, so that in the event of significant losses occurring - such as through a natural disaster - claims are paid and the domestic insurance market is protected. The London Market can help protect them against emerging risks such as cyber-attacks, build resilience against natural disasters and climate change events and support commerce and trade.

We need to gain better access to high growth emerging markets - particularly markets in South East Asia and Latin America - which is vital if the UK commercial insurance market is to maintain its share of global specialty commercial insurance. Asia remains the highest growth market globally but was the region in which the UK has lost most ground in commercial insurance, mainly to growing regional insurance hubs, most notably Singapore which has seen an annual growth rate of 4%.

The challenge is that many economies have in place domestic regulatory barriers on the amount of reinsurance that can be bought from overseas providers and prevent entirely the UK insurance market providing primary insurance. These regulatory barriers include:

- restrictions on reinsurance;
- requirements to localise capital in-country; and
- mandatory requirements to cede business to state-owned insurance entities.

These requirements can prevent the most efficient and effective diversification of risk globally, leading to less available capacity and less choice for clients.



We would like to see the UK's trade and regulatory dialogues focus on how concepts of writing non-life, commercial "large risks" for sophisticated commercial clients could be used as a framework for future cross border trade discussions, potentially allowing UK-based brokers and insurers greater cross border market access into those countries.

The nature of large risks, and the fact that the clients are large corporates with their own advisory teams and capabilities, should provide reassurance to the regulators in target markets that they can allow greater market access between countries, relying on home state regulation, with a much lower risk of consumer harm.

Reducing these domestic regulatory barriers does not necessarily need to be done through a formal free trade agreement. The UK Government and regulators can make progress now in the form of regulatory diplomacy via Financial and Financial & Economic Dialogues, High Level Talks and regulatory working groups, to take forward these discussions and promote the offer of the London Market.

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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.

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