# EXPLANATORY MEMORANDUM TO

# THE RISK TRANSFORMATION AND SOLVENCY 2 (AMENDMENT)(EU EXIT) REGULATIONS 2019

## 2019 No. 1233

## 1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

## 2. Purpose of the instrument

2.1 This instrument is being made to address deficiencies in retained European Union (EU) law in the Solvency II Delegated Regulation (EU 2015/35) ("the S2 Delegated Regulation"), as amended by the Commission Delegated Regulation (EU 2019/981) ("the S2 Delegated Regulation amendment"). The S2 Delegated Regulation was recently amended by the European Commission to update the regime's approach to risk management for insurance and reinsurance firms and the setting of capital requirements for those firms. Some of these amendments became applicable across the EU on 8 July 2019 and will therefore form part of UK law at exit. This instrument also addresses deficiencies in the UK's Risk Transformation Regulations 2017 ("the RTR") and related legislation. The RTR implements a competitive UK regime for Insurance Linked Securities (ILS) business, in line with Solvency II requirements. This instrument ensures that Solvency II and related legislation will continue to operate effectively once the UK has left the EU.

***Explanations***

*What did any relevant EU or UK law do before exit and how is it being changed?*

*The Solvency II Delegated Regulation, as amended*

2.2 The Solvency II Directive (2009/138/EC) ("the S2 Directive") is the basis of the EU's prudential regulation regime for insurers and reinsurers. The S2 Delegated Regulation was made under the Directive to set further detail on how requirements in the Directive should be met. Deficiencies in the S2 Delegated Regulation, as it would have formed part of UK law at the original exit day of 29 March 2019, were addressed by the Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 ("the S2 Exit SI"). Since the S2 EU Exit SI was made in January 2019, the European Commission has revised the S2 Delegated Regulation. The revisions cover the approach used for setting capital requirements, including: simplified capital calculations; more consistent approaches to capital requirements across insurance and banking legislation; and updated standard parameters to reflect developments in the risk management techniques that insurance and reinsurance firms must use.

2.3 Some of the S2 Delegated Regulation revisions which will form part of UK law at exit will be deficient after the UK has left the EU. This instrument addresses those deficiencies by amending the S2 Delegated Regulation as it will form part of UK law

and the S2 Exit SI. References to the EU, the European Economic Area (EEA) and EU institutions, are replaced with references to the UK and appropriate UK bodies. References to EU legislation are replaced with references to relevant EU and UK legislation as it will form part of UK law at exit.

*The Risk Transformation Regulations 2017*

2.4 The RTR created the regulatory and supervisory regime for Insurance Linked Securities (ILS) in the UK. ILS are an alternative form of risk mitigation for insurance and reinsurance firms. They offer insurance and reinsurance firms a means of transferring risk to a special purpose vehicle which issues securities to raise sufficient capital to cover the insurance risk it has taken on. The RTR created a new regulated activity under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, called "insurance risk transformation", and introduced a new form of body corporate called a "protected cell company" to act as a special purpose vehicle in ILS transactions.

2.5 The S2 Directive and delegated acts made under the Directive set requirements on the transfer of insurance risk to special purpose vehicles, including the authorisation and supervision of special purpose vehicles. The RTR rely on a number of references to EU law. This instrument replaces those references with references to Solvency 2 legislation as it will form part of UK law at exit, and to relevant Financial Conduct Authority (FCA) rules and guidance made under the Financial Services and Markets Act 2000.

2.6 The S2 Directive makes provision for EEA insurers or reinsurers transferring risk to an EEA special purpose vehicle, but not to third country insurers or reinsurers using a special purpose vehicle in the EEA. Accordingly, the RTR introduced two separate regimes for insurance risk transformation: the transfer of risk by EEA insurers or reinsurers to a UK special purpose vehicle; and the transfer of insurance risk by non-EEA insurers or reinsurers to a UK special purpose vehicle. The RTR oblige the PRA to apply requirements equivalent to those in Solvency 2 for special purpose vehicles accepting risk from non-EEA insurers or reinsurers. This approach will be deficient after the UK has left the EU as Solvency 2 legislation in retained EU law will be UK-wide only. This instrument deletes the distinction between EEA and non-EEA insurers and reinsurers. Regulation 12 of this instrument amends the S2 Exit SI (principally through the insertion of a new definition of "special purpose vehicle" in the S2 Delegated Regulation) and Regulation 13 amends the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 so that the relevant Solvency 2 requirements in retained EU law will apply to all UK special purpose vehicles, regardless of whether the insurer or reinsurer transferring the risk is regulated in the UK or elsewhere.

2.7 The RTR currently require the FCA to submit information on companies used as special purpose vehicles to the EU e-Justice Portal, in line with requirements in Directive (EU) 2017/1132 on company law. After exit, the UK will no longer be part of the EU's e-Justice portal arrangements, so this requirement will become redundant. This instrument removes the obligation on the FCA.

## 3. Matters of special interest to Parliament

***Matters of special interest to the Joint Committee on Statutory Instruments***

3.1 This instrument is made using the urgent 'made-affirmative' procedure. The Ministerial statement in Part 2 of the Annex to this Explanatory Memorandum explains why use of the made-affirmative procedure is necessary.

***Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)***

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

## 4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the whole of the UK.

4.2 The territorial application of this instrument is the whole of the UK.

## 5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding Human Rights:

"In my view the provisions of the Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations 2019 are compatible with the Convention rights."

## 6. Legislative Context

6.1 This instrument amends secondary legislation and retained direct EU legislation to address deficiencies arising from the withdrawal of the UK from the EU.

6.2 Part 2 of the instrument amends secondary legislation relating to financial services: the Risk Transformation Regulations 2017; the Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018; the Solvency 2 and Insurance (Amendment, etc.) (EU Exit) Regulations 2019; and the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019.

6.3 Part 3 of this instrument amends retained direct EU legislation: Commission Delegated Regulation (EU) 2015/35.

## 7. Policy background

***What is being done and why?***

7.1 It is the duty of a responsible government to plan for all eventualities, including the possibility that the UK leaves the EU on 31 October 2019 without an agreement. Since July 2018, HM Treasury has been using the powers in the EUWA to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios. Parliament had approved all of the legislative amendments necessary to achieve this in time for exit on 29 March 2019. Since the extension to the Article 50 process, new EU financial services legislation will become operative between 29 March and 31 October 2019 and will therefore form part of retained EU law under the EUWA on exit day. Further statutory instruments under the EUWA are therefore necessary to ensure the UK's financial services regulatory regime remains prepared for exit.

7.2 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership, such as legislation implementing EU Directives. This body of law is referred to as "retained EU law." The EUWA gives ministers a power to prevent, remedy or mitigate any failure of retained EU law to operate effectively, or any other deficiency in retained EU law, through statutory instruments. These contingency preparations for financial services legislation are sometimes referred to as 'onshoring.' The financial services onshoring SIs are not intended to make policy changes, other than to reflect the UK's new position outside of the EU, and to smooth the transition to this position. The scope of the EUWA powers is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or to establish a public authority. The power is also time-limited and falls away two years after exit day.

7.3 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. But some change to regulatory requirements will be necessary to ensure the UK's regulatory regime continues to operate effectively after exit.

7.4 If the UK were to leave the EU without an agreement, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the Member State and EU rules that apply to 'third countries'. The European Commission has confirmed that this would be the case.

7.5 The approach in this scenario cannot and does not rely on any special arrangements being in place between the UK and the EU. As a general principle, the UK would need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed, including to provide for a smooth transition to the UK's new position outside of the EU.

7.6 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury's approach to financial services legislation under the EUWA. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act).

## 8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument is being made using the power in section 8 of the EUWA in order to address failures of retained EU law (including UK laws which transpose EU obligations) to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union. In accordance with the requirements of that Act the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

## 9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

## 10. Consultation outcome

10.1 HM Treasury has not undertaken a consultation on this instrument, but has engaged with the Bank and the FCA during the drafting process. HM Treasury has engaged with relevant stakeholders on its approach to Financial Services legislation under the EUWA, including on this instrument, in order to familiarise them with the legislation ahead of laying.

## 11. Guidance

11.1 No further guidance is being published alongside this instrument.

## 12. Impact

12.1 This instrument has an impact on the public sector as, when the instrument becomes law, the PRA will need to fix deficiencies in the rules that it has made under the Financial Services and Markets Act 2000, in line with the deficiency fixes that Treasury will make to the RTR.

12.2 There is no material impact on charities or voluntary bodies.

12.3 An Impact Assessment has not been prepared for this instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £5 million a year. Due to this limited impact, a de-minimis impact assessment has been carried out.

## 13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

## 14. Monitoring & review

14.1 This instrument is mostly made under the EU Withdrawal Act 2018. A review clause is therefore not required.

## 15. Contact

15.1 Edward Crowther at HM Treasury (Telephone: 020 7270 5601 or email: Edward.Crowther@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

15.2 Hannah Malik, Deputy Director for Insurance and Pensions Markets at HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen MP, Economic Secretary to the HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.

# Annex

## Statements under the European Union (Withdrawal) Act 2018

## Part 1

### Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

| Statement | Where the requirement sits | To whom it applies | What it requires |
|---|---|---|---|
| Sifting | Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7 | Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI | Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees |
| Appropriate-ness | Sub-paragraph (2) of paragraph 28, Schedule 7 | Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 | A statement that the SI does no more than is appropriate. |
| Good Reasons | Sub-paragraph (3) of paragraph 28, Schedule 7 | Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 | Explain the good reasons for making the instrument and that what is being done is a reasonable course of action. |
| Equalities | Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7 | Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 | Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them.<br><br>State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010. |
| Explanations | Sub-paragraph (6) of paragraph 28, Schedule 7 | Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2<br>In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs | Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law. |
| Criminal offences | Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7 | Ministers of the Crown exercising sections 8(1), 9, and | Set out the "good reasons" for creating a criminal offence, and the penalty attached. |

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|---|---|---|---|
| | | 23(1) or jointly exercising powers in Schedule 2 to create a criminal offence | |
| Sub-delegation | Paragraph 30, Schedule 7 | Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument. | State why it is appropriate to create such a sub-delegated power. |
| Urgency | Paragraph 34, Schedule 7 | Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Schedule 7. | Statement of the reasons for the Minister's opinion that the SI is urgent. |
| Explanations where amending regulations under 2(2) ECA 1972 | Paragraph 13, Schedule 8 | Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA | Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law. |
| Scrutiny statement where amending regulations under 2(2) ECA 1972 | Paragraph 16, Schedule 8 | Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA | Statement setting out:<br>a) the steps which the relevant authority has taken to make the instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament,<br>b) containing information about the relevant authority's response to—<br>(i) any recommendations made by a committee of either House of Parliament about the published instrument, and<br>(ii) any other representations made to the relevant authority about the published instrument, and,<br>c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument which is to be laid. |

# Part 2

## Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

### 1. Appropriateness statement

1.1 The Economic Secretary to the HM Treasury, John Glen, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view the Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations do no more than is appropriate."

1.2 This is the case because the instrument does only what is necessary to ensure that the relevant legislation relating to the prudential regulation of the insurance and reinsurance sectors continues to operate effectively at the point at which the UK leaves the EU. This can only be achieved through the legislation contained in this instrument.

### 2. Good reasons

2.1 The Economic Secretary to the HM Treasury, John Glen, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action."

2.2 These are: if the government were not to proceed with this legislation, then aspects of the UK's regulatory regime for the insurance and reinsurance sectors would become legally inoperable. This could affect UK market confidence and create financial instability.

### 3. Equalities

3.1 The Economic Secretary to the HM Treasury, John Glen, has made the following statement(s):

"The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts."

3.2 The Economic Secretary to the Treasury, John Glen MP has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In relation to the instrument, I, John Glen MP, Economic Secretary to the Treasury, have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010."

### 4. Explanations

4.1 The explanations statement has been made in section 2 of the main body of this explanatory memorandum.

## 5. Urgency

5.1 The Economic Secretary to the Treasury, John Glen MP, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

5.2 "In my view, by reason of urgency, it is necessary to make the Risk Transformation and Solvency 2 (Amendment) (EU Exit) Regulations 2019, without a draft of the instrument containing the regulations being laid before, and approved by a resolution of, each House of Parliament."

5.3 This is appropriate because: the instrument is essential to ensure critical deficiency fixes to retained EU law are made in time for exit from the EU on 31 October 2019. Under Solvency 2, which provides for the prudential regulation of insurance and reinsurance business, firms must carry out their full process for valuation of assets and liabilities in order to submit their annual supervisory reports to the Prudential Regulation Authority (PRA) by 31 December. The detailed rules that apply to the valuation process will need to be fixed so that they operate effectively after exit. If these changes are not in law by 31 October, firms and the PRA will not have legal certainty around the rules that firms should be using for the valuation process that is central to supervisory reporting. This will result in disruption to UK firms and will compromise the PRA's ability to supervise insurance and reinsurance firms effectively. Making this instrument now will give industry and the PRA the legal certainty they need to prepare for exit in an orderly way.

5.4 For the reasons set out above, the Government has concluded it is essential to make this instrument using the made-affirmative procedure. While this instrument has now been made, it will cease to have effect at the end of the period of 28 days beginning with the day on which this instrument is made, unless during that period, it is approved by a resolution of each House of Parliament (subject to extension for periods of dissolution, prorogation or adjournment for more than four days).