

The Standard Formula Solvency II for Insurers

Robert A. Chaplin

Partner / London
44.20.7519.7030
robert.chaplin@skadden.com

Greg Norman

Partner / London
44.20.7519.7192
greg.p.norman@skadden.com

Azad Ali

Of Counsel / London
44.20.7519.7034
azad.ali@skadden.com

George D. Belcher

European Counsel / London
44.20.7519.7280
george.belcher@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

40 Bank Street, Canary Wharf
London, E14 5DS, UK
44.20.7519.7000

The Edinburgh Reforms: Big Bang 2.0 or Thoughtful Change?

Following the recently introduced Solvency UK for insurers, the UK Chancellor of the Exchequer Jeremy Hunt (the UK finance minister) has announced the Edinburgh Reforms, a further series of reforms aimed at the UK financial services sector. Chancellor Hunt stated that the reforms were created in recognition of the importance of financial services to the entire UK, pointing to the 2.3 million people employed in the financial services sector, two-thirds of whom are located outside London.

According to Chancellor Hunt, the intent of the reforms is to “secure the UK’s status as one of the most open, dynamic and competitive financial services hubs in the world”. The reforms are the strongest expression of divergence from EU financial services regulation by the UK to date. Importantly, however, although the UK government’s announcement focuses on Brexit freedoms, many of the reforms are aimed at areas of regulation that originate domestically, for example reform targeting the Consumer Credit Act 1974, the Ring-Fencing Regime for UK banks and the Senior Managers and Certification Regime (SM&CR).

The reforms supplement the Future Regulatory Framework Review (FRF Review) and its implementation through the Financial Services and Markets Bill (FSM Bill), including through the recent policy statement on reforming Solvency II¹. The proposed changes are wide ranging, affecting all areas of financial services regulation including:

- the regulatory framework of the UK and remit of financial services regulators;
- banking regulation;
- regulation of financial markets;
- investment funds; and
- payment services and consumer credit.

Although parts of the reforms are ambitious, our view is the changes do not represent a “Big Bang 2.0” (which is an allusion to genuinely transformational and iconic UK financial services reform in the 1980s). Instead, we view the reforms as representing thoughtful and measured change.

¹ See our November 23, 2022, client alert “From Solvency II to Solvency UK: The UK Government Announces Its Post-Brexit Solvency II Reforms”.

The Standard Formula

Solvency II for Insurers

Many of the proposals are targeted at EU legislation considered by the UK government to be too rigid or prescriptive in nature, resulting in disproportionate burdens on firms. It should nonetheless be noted that the UK regulatory framework is more detailed and prescriptive in many areas relative to the EU, for example the vetting and approval of senior managers and personnel under the SM&CR, and certain bank capital and liquidity rules amongst others. The new Consumer Duty, due to take effect on July 31, 2023, (although with considerable steps required before that date) also represents a greater focus in the UK on consumer protection and a significant undertaking for UK firms compared with the EU.

Retained EU Law and the UK Legislative Framework

When the UK departed the EU on December 31, 2020, the large body of EU legislation that applied directly in the UK at the point of exit was transferred onto the UK statute book by the European Union (Withdrawal) Act 2018 (EUWA). The UK government intends to repeal and fold this retained EU law (REUL) into the model of regulation under the Financial Services and Markets Act (FSMA), which will be delivered in two tranches. The workstreams, split across the two tranches, are set out in full at the end of this update.

Work is already underway on the first tranche, which is focused on delivering the outcomes arising out of the Wholesale Markets Review, the Listing Review, the Securitisation Review and the review of the Solvency II Directive².

The second tranche is focused on areas of reform that the UK government believes will bring the biggest potential for UK economic growth. This includes, but is not limited to, continued work on the MiFID framework, Solvency II, the PRIIPs Regulation, the Short Selling Regulation, the payment services framework, the Insurance Mediation and Distribution Directives, the Capital Requirements Regulation and Directive and the Long-Term Investment Funds Regulation.

Although the announcement covers a wide spectrum of areas, the proposals are at varying stages of maturity, ranging from the creation of task forces, specific commitments and announcements of certain reviews, to calls for evidence and consultations. Key elements of the reforms are set out below.

Repealing and replacing the PRIIPs Regulation: The UK PRIIPs Regulation captures any firm that offers a packaged retail and insurance-based investment product (PRIIP) to retail investors in the UK. The UK government is proposing to repeal the PRIIPs

Regulation, as issuers in UK and EU capital markets have struggled with the scope of the PRIIPs Regulation and the highly prescriptive requirements for the key information document (KID). This has dissuaded certain issuers from making securities available to retail investors in the UK and EU, resulting in fewer corporate securities being available for purchase by retail investors. Although this repeal will be a welcome change for the industry, it remains to be seen whether the resulting regime will result in significant benefit for issuers, given that issuances made to the EU market will still be subject to the EU PRIIPs Regulation.

Further, to the extent that firms are no longer required to provide information in a formulaic way to UK customers, they may still need to consider the Consumer Duty, which could require firms to provide similar information (albeit in a less prescriptive form), for example when manufacturing or distributing products and services to retail customers.

Short Selling Regulation (SSR): The SSR regulates the short selling of shares listed on a UK market. The UK government published a Call for Evidence on December 9, 2022, in respect of the SSR, focusing on the restrictions on uncovered short selling. It asks whether the mandatory covering arrangements, the public disclosure requirements and the FCA position reporting requirements are fit for purpose, bearing in mind broader objectives of market integrity and international competitiveness.

Securitisation Regulation (Sec Reg): Securitisation is regulated in the UK primarily through the Sec Reg, which has aimed to encourage securitisation activity after a general decline following the global financial services crisis. Further to a Call for Evidence and building on relevant reforms identified in its 2021 review, the UK government has published a draft Statutory Instrument illustrating how it will reform the Sec Reg, with changes primarily relating to due diligence requirements for institutional investors.

Review of the MiFID framework: The UK government intends to continue to build on the suggestions from the Wholesale Markets Review. It has laid out a draft Statutory Instrument aiming to reduce the compliance burden of providing information on investment services to retail investors on a durable medium. The Statutory Instrument also removes a requirement for investment firms providing portfolio management or entering into contingent liability transactions to notify investors where the portfolio or value of the instruments depreciates by 10%. These are quite modest changes on the periphery but should be understood against earlier proposals to reduce the strictures of MiFID II in the UK, for example in relation to commodity derivatives and in respect of best execution reporting under RTS 27 and 28.

² See our November 23, 2022, client alert "[From Solvency II to Solvency UK: The UK Government Announces Its Post-Brexit Solvency II Reforms](#)".

The Standard Formula

Solvency II for Insurers

Amendments to the Payment Accounts Regulation and the UK payment services regime: The Payment Accounts Regulation 2015 requires providers of payment accounts to provide a standardised Fee Information Document (FID) and annual Statement of Fees (SoF) to retail customers to whom they provide a payment account. The consultation does not propose to repeal other requirements arising out of the Payment Accounts Directive, such as the provision of a switching service or access to basic bank accounts, focusing instead on whether the requirements to provide a FID and SoF are fit for purpose in the UK. The UK government is of the view that it is unlikely that retail customers are using these disclosures to compare current accounts given the fewer fees and charges associated with current accounts in the UK. These changes will reduce the compliance burden for providers of payment accounts.

Further, payment service providers are currently not regulated under the FSMA framework, but rather under the Payment Services Regulations 2017 and the Electronic Money Regulations 2011. Under the current framework, the FCA's ability to change the regulatory ruleset for payment services providers is limited. While the consultation proposes that the regulation of payment service providers will eventually be folded into the FSMA framework, initially the changes will be focused on enhancing and expanding the scope of the FCA's rulemaking powers.

Method of Repeal

The repeal of EU legislation will be conducted via the following legislation, currently making its way through the UK Parliament:

- the Retained EU Law (Revocation and Reform) Bill, which will automatically repeal any remaining REUL (other than financial services law — see below) at the end of 2023; and
- the FSM Bill, which will repeal REUL relating to financial services and replace it with a comprehensive new model framework, that is customized to the specific profile of the UK's financial services industry.

Under the FSM Bill, each repeal will take effect only once the government makes an instrument bringing the repeal into force. In doing so, the government may either (i) repeal and not replace, or (ii) repeal but restate (either wholesale or with modifications, either in statute or working with the two main UK financial services regulators — the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA)). In this way, the government will be able to construct a new regulatory regime that combines the best of REUL and international best practice with regulatory innovation designed to reflect and best serve the UK economy. Equally, given the sheer volume of

work ahead, it seems likely that some financial services REUL will remain on the statute book in the short to medium term.

A key feature of the Edinburgh Reforms is the devolution of responsibility away from the UK government in favour of the PRA and the FCA. This more flexible system will be comprised of (i) primary legislation (principally the FSMA), (ii) HM Treasury-made secondary legislation and (iii) rules made by the PRA and FCA under their general rulemaking powers, setting out specific detail and responsibilities. This approach may be seen as a return to the status quo ante in the UK prior to the dramatic expansion of EU financial services law, in particular following the 2007/2008 financial crisis. Under the FSM Bill, the UK government will be able to set specific “have regards” that the PRA/FCA must consider (alongside the other parameters within FSMA) when making specific rules. The FSM Bill also includes a power for the UK government to require the PRA and the FCA to make rules (or review their rules) in a specific area.

Reform of Domestic UK Regulation

In addition to repealing and reforming EU legislation, the reforms set out a number of changes to domestic UK legislation.

New remit letters for the PRA and FCA: The reforms will amend the FSMA to introduce a secondary objective for the FCA and PRA, to facilitate the international competitiveness of the UK economy. The remit letters provide further guidance to the regulators regarding the UK government's objectives of international competitiveness and its priorities, which include:

- swiftly implementing the outcomes of the FRF Review;
- promoting inward investment into the UK;
- supporting innovation and new developments such as crypto, AI and machine learning; and
- ensuring the UK is attractive to internationally active financial services firms and activities.

Ring-fencing and proprietary trading: Following the independent review on the [ring-fencing and proprietary trading regime](#), the UK government will consult on changes to the Ring-Fencing Regime by mid-2023, which will review and update the list of activities which ring-fenced banks are restricted from carrying out. These reforms will also take banking groups without major investment banking operations out of the regime and raise the deposit-taking threshold (being the threshold at which a bank is subject to the regime). Lastly, the UK government is considering the independent review's recommendation to align the Ring-Fencing and bank resolution regimes, where banks that are deemed to be resolvable can be removed from the Ring-Fencing Regime.

The Standard Formula

Solvency II for Insurers

Consumer Credit Act 1974: Although the Consumer Credit Act 1974 (CCA) has mostly transferred into the Consumer Credit Sourcebook (CONC), there is still some overlap such that firms operating in the consumer credit space must consider both the CCA and the CONC. Recognising the complexity of this, and the fact that consumer credit has significantly evolved since the drafting of the CCA, the UK government is consulting on how to recast the CCA fully into the CONC. This is a welcome announcement given the myriad complicated rules that consumer credit lenders must consider, especially lenders that only lend through digital channels, though the UK government has noted that this will likely be a lengthy process requiring several years to complete.

Value Added Tax (VAT) treatment of fund management: This consultation follows a call for input in 2021 and seeks to codify current practices regarding VAT treatment of fund management services into UK law, covering existing UK exemptions and another exemption arising out of EU case law and REUL. This will provide a clearer legislative basis for decisions made by fund managers and HMRC.

SM&CR: The UK government and regulators will also commence a review of the SM&CR regime by Q1 2023 and will look to launch a Call for Evidence to look at the effectiveness, scope and proportionality of the SM&CR.

Other Announcements

The UK government also announced the following initiatives:

Central bank digital currency: A consultation exploring a sovereign digital pound will be brought forward, along with a Technology Working Paper setting out technological considerations for a potential build, developed by the Bank of England. This is in addition to the amendments made to the FSM Bill to establish a framework to regulate digital assets and stablecoins.

Consolidated tape: The UK government is committed to having a regulatory regime in place by 2024, which will support a UK consolidated tape for market data. This mirrors developments in the EU, where the EC's recent legislative package proposed to make it easier to establish a consolidated tape in the EU.

Investment research review: The independent review will examine the investment research landscape in the UK and its contribution to UK capital markets competitiveness.

Accelerated Settlement Taskforce: The taskforce will explore the potential benefits of moving to a T+1 industry standard for settlement, with its first report due by end of 2024.

Timeline and Next Steps

The UK government will not rush the Edinburgh Reforms, but there is a clear political incentive to deliver certain key wins ahead of the next general election (to be held no later than January 2025). It will also need to be mindful of ongoing relations with the EU, particularly in light of the desks-mapping review undertaken by the European Banking Authority and proposals from the European Securities and Market Authority in relation to tied agency pass-porting, all against the backdrop of the EU's limited desire to grant equivalence decisions or other forms of market access.

Retained EU Law Reform and Prioritisation

Category	Acronym	Key EU Instrument	Priority
Market Regulation	MiFID/MIFIR	Markets in Financial Instruments Directive and Regulation	Tranche 1 – Implementing the UK government's Wholesale Markets Review
	PRIIPs	Packaged Retail Investment and Insurance-based Products Regulation	Tranche 2
	Prospectus	Prospectus Regulation	Tranche 1 – Implementing Lord Hill's review
	LD	Listings Directive	Tranche 1 – Implementing Lord Hill's review
	TD	Transparency Directive	
	MAR	Market Abuse Regulation	
	SSR	Short Selling Regulation	Tranche 2
	Sec Reg	Securitisation Regulation	Tranche 1

The Standard Formula

Solvency II for Insurers

Retained EU Law Reform and Prioritisation *(Continued)*

Category	Acronym	Key EU Instrument	Priority
Market Regulation <i>(Continued)</i>	SFTR	Securities Financing Transactions Regulation	
	BMR	Benchmarks Regulation	
	CRAR	Credit Rating Agencies Regulation	
Credit	CCD	Consumer Credit Directive	
	MCD	Mortgage Credit Directive	
Financial Market Infrastructure	CSDR	Central Securities Depositories Regulation	Tranche 1 – Implementing the UK government’s Wholesale Markets Review
	EMIR	European Market Infrastructure Regulation	Tranche 1 – Implementing the UK government’s Wholesale Markets Review
	SFD	Settlement Finality Directive	Tranche 1 – Implementing the UK government’s Wholesale Markets Review
Funds	AIFMD	Alternative Investment Funds Managers Directive	
	ELTIF	European Long-Term Investment Funds Regulation	Tranche 2
	EuVeCa	European Venture Capital Funds Regulation	
	EuSEF	European Social Entrepreneurship Funds Regulation	
	MMFR	Money Market Funds Regulation	Tranche 2
	UCITS	Undertakings for the Collective Investment in Transferable Securities Directive	
Green	SFDR	Sustainable Finance Disclosure Regulation	
	Taxonomy	Taxonomy Regulation	Tranche 2
Insurance	IDD	Insurance Distribution Directive	Tranche 2
	IMD	Insurance Mediation Directive	Tranche 2
	IRR	Insurers (Reorganisation and Winding-up) Directive	
	LACD	Life Assurance Consolidation Directive	
	MID	Motor Insurance Directive	
	Solvency	Solvency II Directive	Tranche 1 – The UK government has already laid out the details of its priorities for Solvency II reform.
	RD	Reinsurance Directive	

The Standard Formula

Solvency II for Insurers

Retained EU Law Reform and Prioritisation *(Continued)*

Category	Acronym	Key EU Instrument	Priority
Payments	CbPEu	Cross-Border Payments in Euros Regulation	
	EMD	E-Money Directive	Tranche 2
	IFR	Interchange Fee Regulation	
	PAD	Payments Accounts Directive	Tranche 2
	PSD	Payment Services Directive	Tranche 2
Prudential Banking	CRR/CRD	Capital Requirements Directive and Regulation	Tranche 2
	CID	Credit Institutions (Reorganisation and Winding Up) Directive	
Resolution	BRRD	Bank Recovery and Resolution Directive	
Shares	SRD	Shareholder Rights Directive	
Miscellaneous	DGSD	Deposit Guarantee Schemes Directive	
	DMCFS	Distance Marketing of Consumer Financial Services Directive	
	FCaD	Financial Collateral Arrangements Directive	
	FCoD	Financial Conglomerates Directive	