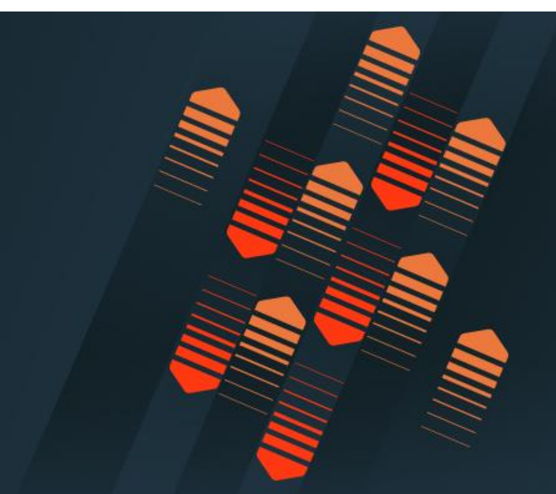
SLAUGHTER AND MAY/

JANUARY 2025

INSURANCE OUTLOOK 2025



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IMPACT OF THE CHANGE OF GOVERNMENT

In our Insurance Outlook for 2024, we commented that a potential change of Government was unlikely to have a major impact on the legislative and reform agenda for the insurance sector in the short term. This has been true in part, with the final package of Solvency II reforms being put in place in line with previous timescales, although other activity appears to have been delayed (such as the proposed new Insurer Resolution Regime).

The new Government has maintained the focus of the previous incumbents on economic growth. In her Mansion House speech in November, the Chancellor Rachel Reeves confirmed that economic growth will be the central mission of the Government and that the financial services sector is seen as a crucial part of that strategy (with insurance and reinsurance highlighted as one of five priority growth opportunities). HM Treasury published a call for evidence on a proposed new Financial Services Growth and Competitiveness Strategy in November. The Prime Minister and Chancellor also wrote to the UK's main regulators in December asking them to come up with ideas for reform which could boost economic growth.

The Government's growth agenda means the regulators are likely to need to navigate a path between lightening the regulatory burden on the one hand and fulfilling their consumer protection and financial stability remits on the other. The Chancellor suggested in her speech that regulatory reforms brought in following the 2007-8 financial crisis have led to a system which seeks to eliminate risk taking. The regulators are under pressure to deliver on their competitiveness and growth objective, as reflected in a number of recent consultations and calls for input. This pressure has also led the FCA to revisit its proposals on "naming and shaming" companies under investigation - the former Chancellor Jeremy Hunt had publicly criticised the original proposals as being contrary to the competitiveness and growth objective. At a House of Lords Financial Services Regulation Committee hearing in January, the PRA CEO Sam Woods commented of the pressures to take a softer approach - "*I don't think we think that's an impossible thing to do, but it is a challenging thing to do*".

Labour is also keen to champion the interests of the consumer and has in particular focussed on issues around the so called "poverty premium", including rising prices in the motor insurance sector. Tackling the "soaring cost of car insurance" was included in the Labour party's election manifesto as a target for the Government and it has established a motor insurance taskforce to look at potential solutions. At the same time, the FCA launched a market study to investigate concerns regarding fair value and competition in the motor and home insurance premium finance market.

It is likely to be easier for the Government to promote its competitiveness and growth agenda in the wholesale and business-facing segments of the insurance market than in the consumer-facing segment, where issues of affordability and fairness will continue to feature heavily in the political debate.

"financial services must play a central part in our economic vision and our plans for economic growth"

(Rachel Reeves, Mansion House speech)

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M&A ACTIVITY IN THE SECTOR

The headline story to round out 2024 has been the proposed takeover of Direct Line by Aviva, following on from Direct Line's successful takeover defence against a possible offer by Ageas earlier in the year. We advised Direct Line on both of these bids. This transaction represents a major consolidation in the home and motor insurance market, which could potentially push other market players into M&A activity in a drive for efficiency. It also represents a continuation of Aviva's progress towards its stated aim of growth in its capital-light businesses, following on from the completion of its acquisition of AIG's UK protection business earlier in the year (on which we advised Aviva).

Meanwhile, whilst there were fewer announced private M&A deals in the sector than some had expected, a stronger pipeline of activity in the second half of 2024 suggests that this year is likely to be busier. The involvement of private capital in the sector has continued to be a significant theme, against a backdrop of stabilising inflation and interest rates, and private capital sponsors holding record levels of committed dry powder. Nonetheless, the impact of increased regulatory scrutiny following the failure of Cinven-owned Italian insurer Eurovita continues to be felt within the sector, with European regulators looking closely at the permanency of capital within acquiring group structures in considering the approval of deals.

PENSIONS DERISKING

2024 was another strong year for pensions derisking, with the total number of transactions in the first half of 2024 (134) being the highest number of deals ever recorded for a six-month period. Despite this, the latest estimates indicate that the overall level of buy-in volumes may fall just short of the record £49.1 billion written in 2023. We have remained active during this period in our work with trustees and sponsors (including the Trustee of the SCA UK Pension Plan on its £1.1 billion full buy-in, and Hays plc on the £370m full buy-in of the Hays Pension Scheme), alongside our work with various insurers and reinsurers on a number of buy-in transactions and related longevity and funded reinsurance arrangements.

The UK derisking market is expected to remain strong into 2025 and beyond, reflecting continued strength in scheme funding levels and a sustained appetite from trustees and sponsors to transfer risk to an insurer rather than run-on schemes.

Regulatory scrutiny of funded reinsurance continued to be a theme and, following 2023's publication of CP24/23, the PRA published PS13/24 in July 2024 - which we discussed in our July 2024 briefing. Having imposed a 31 October deadline on insurers to submit the information required by PS13/24 and the associated Dear CEO letter, we expect further regulatory scrutiny of funded reinsurance in 2025 as the PRA considers the impact of PS13/24 on the market. We will continue to monitor this over the course of this year.

On the pensions side, the Department for Work and Pensions consulted in February 2024 on "Options for Defined Schemes" which considered, among other things, the treatment of scheme surpluses. The consultation closed in April 2024 but as yet no date for publication of the outcome has been announced. Changes resulting from the consultation could impact the dynamics of the UK pensions derisking market (including the appetite that sponsors and trustees may have to undertake derisking transactions). This is particularly in light of the new legislation introduced in September 2024, discussed in our January briefing, requiring sponsors and trustees to document the long-term objective – whether to run-on, transfer to an insurer or transfer to a commercial consolidator - for their defined benefit scheme. We will continue to monitor any proposed changes coming out of the February 2024 consultation over the course of this year.

THE RETAIL DISCLOSURE FRAMEWORK

On 19 December the FCA published a consultation on a new product information framework for Consumer Composite Investments (**CCIs**). CCIs are investments where the returns are dependent on the performance of or changes in the value of indirect investments and include, among other things, insurance-based investment products.

The new regime will apply to any firm that manufactures or distributes a CCI to retail investors in the UK and will replace the current onshored PRIIPs and UCITS disclosure regimes. The proposal to replace these regimes with a new UK retail disclosure framework was first announced by the (previous) Government in December 2022.

The Government made and published the Consumer Composite Investments (Designated Activities) Regulations 2024 in November 2024, which set out the legislative framework for the establishment of the new regime.

The consultation is open until **20 March 2025** and the FCA plans to publish final rules "**in 2025**". Although the

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proposal is that the new CCI regime will come into force when the policy statement is published, or shortly thereafter, there will be a substantial transitional period during which existing PRIIPs and UCITS key information documents or equivalent disclosures will continue to be considered compliant.

Unlike under the current regimes, the FCA does not propose to prescribe the design or layout of the consumer-facing disclosures. In principle this allows firms more flexibility in how they approach product information disclosures. Detailed requirements are, however, proposed in terms of the information which should be disclosed, and the format it should take, in respect of:

- costs and charges;
- risk and reward metrics; and
- past performance.

Insurers and distributors involved in the manufacture and sale of insurance-based investment products may want to consider responding to the consultation proposals on the detailed disclosure requirements.

THE LONDON MARKET AND SPVs

Captive insurers

As we reported in our Insurance Outlook 2024, in his 2023 Autumn Statement the then Chancellor, Jeremy Hunt, announced a planned consultation on the design of a new framework for encouraging the establishment and growth of captive insurance companies in the UK. Although this consultation did not materialise under the last Government, one was published by HM Treasury in November 2024 with a stated aim of supporting the competitiveness of the UK insurance sector. The consultation, which was highlighted in the Chancellor's Mansion House speech discussed above, runs until **7 February 2025** and key points raised include:

- possible changes to prudential and conduct regulation applicable to captives;
- differentiation between direct-writing captives and reinsurance captives;
- exclusions and limitations, for example excluding captives from writing life insurance; and
- the option to allow businesses to establish a captive cell (rather than an entire captive insurance entity) using the protected cell company framework.

The introduction of a new regime for captive insurers has been lobbied for by the London Market Group over a number of years. In its 2024 A Plan for the Future the LMG states that there are currently no captive insurers domiciled in the UK and argues that this is the result of a regulatory system which does not differentiate between captives and other insurers. In principle, captives present a lower risk to the overall financial system because they only write risks belonging to their own corporate group. The LMG welcomed the announcement of the HM Treasury consultation and commented that "*a UK captive domicile would offer UK plc the ability to build resilience and risk management here at home, while benefitting from an extensive financial services ecosystem*".

ISPVs and insurance-linked securities

Also of relevance to the London market, the PRA is consulting on changes to its regulatory regime for Insurance Special Purpose Vehicles (ISPVs). This includes a proposal to create an accelerated pathway for approval of the setting up of certain UK ISPVs, allowing new vehicles to be established within 10 working days, rather than the current 4 to 6 weeks. In the consultation, the PRA comments that it expects that a placement of Rule 144A catastrophe bonds is likely to meet the criteria for the accelerated pathway given their generally standardised legal structure. It is hoped that this will allow the UK to compete with other jurisdictions in the market for issuances of these types of securities. The current UK ISPV regime has had limited take up since the introduction of a new protected cell company framework in 2017 under the Risk Transformation Regulations.

Other areas consulted on in CP15/24 include:

- simplifications to the authorisation process for other standard UK ISPVs;
- clarifications in respect of the calculation of the aggregated maximum risk exposure of the ISPV and the use of limited recourse clauses;
- the introduction of a grace period for satisfying the fully funded requirement at the commencement of a transaction; and
- new requirements in respect of (re)insurers using SPVs for risk mitigation.

The consultation closes on **14 February 2025**.

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SOLVENT EXIT PLANNING AND THE IRR

On 18 December the PRA published a policy statement on solvent exit planning for insurers, along with final rules (which will form a new Preparations for Solvent Exit Part of the PRA Rulebook) and a final supervisory statement (SS11/24).

The PRA confirms in the policy statement that it is predominantly implementing the proposals on which it consulted in January 2024, including the requirements for all in-scope firms to prepare and maintain a solvent exit analysis (SEA), and for firms to produce a solvent exit execution plan (SEEP) if and when there is a reasonable prospect that they may need to execute a solvent exit. We discussed the original proposals in our January 2024 briefing.

Although the core of the proposals remains the same, the PRA has made a number of changes to proposed new rules and guidance to reflect feedback:

Implementation	The implementation date for the new requirements will be **30 June 2026** (this had previously been targeted for the end of Q4 2025), giving firms longer to prepare
Lloyd's	The PRA has decided to take Lloyd's managing agents out of the scope of the policy, on the basis that they can be adequately managed by the Council of Lloyd's, including through co-operation with the PRA under its agreement with Lloyd's
Documentation	The supervisory statement has been amended to clarify that, if appropriate, a firm's SEA could be a discrete section of another document such as the insurer's ORSA, capital management plan or recovery and resolution plan
Timing	The one-month timescale for submission of a SEEP has been removed. Instead the PRA will set a bespoke timescale for a relevant firm to provide its SEEP (which could in theory be sooner than one month)

Some respondents to the consultation queried the interaction of the new solvent exit planning requirements with the proposed Insurer Resolution Regime. The response document to HM Treasury's consultation on this was published in August 2023, which stated that the regime would be introduced via legislation when Parliamentary time allowed. There has been no further update and the PRA comments in the policy statement that "*it is currently not known when the IRR will be introduced*". It has amended SS11/24 to clarify that when the IRR is introduced the PRA will consider the need for any amendments to the solvent exit planning policy, although it also highlights that the objective of the IRR is fundamentally different to a solvent exit.

SOLVENCY II UK

The process of assimilating the onshored Solvency II regime was completed on **31 December 2024**.

As a result, the Onshored Delegated Regulation no longer applies to UK firms and extensive changes to the PRA Rulebook and guidance, as well as the introduction of a number of new Statements of Policy, have come into effect.

Our Guide to Solvency II for clients (available as an App or in desktop form) has been updated to reflect the new regime in the UK. If you do not have access to the guide and would like to request it, please email solvency.two@slaughterandmay.com or speak to your usual contact.

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CHANGES TO THE EU SOLVENCY II REGIME

The EU began its own review of the Solvency II regime in 2020. Proposed amendments to the Solvency II Directive were approved by the EU Council in November 2024 and the amending directive was published in the Official Journal on 8 January. The amending directive enters into force 20 days after publication and Member States have until 29 January 2027 to publish the domestic provisions necessary to comply with the directive. These provisions should apply from 30 January 2027. Implementation of the amendments to the regime are therefore some way behind the UK's Solvency II review.

Key changes to the Solvency II directive include:

• the introduction of streamlined requirements for "small and non-complex" undertakings and groups	• exemptions and limitations to quantitative regular supervisory reporting and changes to reporting deadlines
• new requirements to develop quantifiable targets and processes to monitor and address sustainability risks and to carry out climate change scenario analysis	• new requirements in respect of macroprudential considerations
• division of the SFCR into a customer facing part and a market facing part	• reduction of the cost-of-capital rate used in the risk margin to 4.75% and introduction of a time-dependent element to the risk margin calculation
• changes to the extrapolation of the risk-free interest rate term structure and the calculation of the volatility adjustment	• new requirements for liquidity risk management plans and supervisory actions in the case of the emergence of liquidity risks
• new provisions on supervisability of insurance groups	• a requirement for EIOPA to produce an assessment of the potential effects of a dedicated prudential treatment of exposures to ESG related assets

Of these changes, only the amendments to the risk margin and the streamlining of reporting requirements are ones with direct read-across to the UK review, although the UK regime also addresses the supervisability of insurance groups and management of liquidity and sustainability risks, albeit in a different manner than the EU's proposals.

Once the amending directive has come into force, the Commission is expected to consult on changes to the Level 2 Delegated Regulation. A number of the areas of potential change highlighted in the Commission's communication on the review have, however, now been addressed in the directive amendments (including changes to the risk margin mentioned above and the criteria for long-term equity investments)

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FCA COMPETITIVENESS INITIATIVES

The FCA published two documents in summer 2024 focussing on its competitiveness and growth objective - a call for input on the streamlining of its retail conduct rules and guidance and a discussion paper on the regulation of commercial and bespoke insurance business. The FCA is expected to outline its approach in respect of retail conduct rules in **early 2025**. A consultation paper on the regulation of commercial insurance business may also emerge in **Q1 2025**.

FCA REVIEW OF PURE PROTECTION PRODUCTS

The FCA is expected to launch a market study into the distribution of pure protection products to retail consumers in **2025** (timing TBC). The draft terms of reference were published for feedback in August 2024. Pure protection products include term assurance, critical illness cover, income protection insurance and whole of life insurance. Unlike insurance-based investment products, the sale of these products was not part of the FSA's retail distribution review, conducted in 2009-2012, which resulted in a ban on commission payments to intermediaries in respect of relevant products.

The FCA plans to look at the design of some commission arrangements, whether some pure protection products provide fair value to consumers, and the strength of competition in the market. It commented in the draft terms of reference that it is starting the market study with an "open mind", but if evidence of harm to consumers is found there are a range of options open to the FCA, including, for example, the banning of commission arrangements.

PREMIUM FINANCE

In October 2024 the FCA launched a market study into the provision of premium finance for motor and home insurance, including publication of proposed terms of reference. The FCA is concerned about the extent to which this product represents fair value to customers, and whether there is effective competition in the market. The terms of reference for the market study include investigation of whether commission arrangements between specialist premium finance providers and premium finance intermediaries are creating misaligned incentives and not working in the interest of customers. The FCA expects to publish an interim report on the market study and proposed next steps in **H1 2025**.

The FCA closely links the issue of premium finance to its more general work on motor and home insurance and to the ongoing cost of living crisis. The need to spread the cost of home and motor insurance by using premium finance is one of the factors contributing towards the "poverty premium" identified by organisations such as Fair by Design, and as such is also linked to the Government's work on tackling the cost of motor insurance for consumers, referred to in our discussion of the impact of the change of Government above. Issues regarding commission arrangements have also been a key focus of the FCA's work in respect of motor finance, discussed below.

THE MOTOR FINANCE CASES

The Supreme Court is scheduled to hear the appeals in the cases of *Wrench v FirstRand Bank*, *Johnson v FirstRand Bank* and *Hopcraft & Anr v Close Brothers* between **3 and 5 April 2025**. Although the cases did not involve the provision of insurance, the decision of the Court of Appeal that it was unlawful for car dealers to receive a commission from a lender providing motor finance to a customer unless it was disclosed to the customer and they gave informed consent to the payment, and the findings of the existence of fiduciary duties in all three cases, could have significance for the sales of other financial services products.

The breadth of the Court of Appeal ruling caused some consternation in the industry, in particular in the extent to which it went beyond FCA disclosure requirements in applying common law and equitable principles. It is hoped that the Supreme Court will provide greater clarity both within the motor finance industry and more widely. As a result of the court ruling and planned appeal, the FCA has extended the time for motor finance firms to respond to complaints about past discretionary commission arrangements and for consumers to refer their complaints to the Financial Ombudsman. The FCA launched a review of historical motor finance commission arrangements in January 2024.

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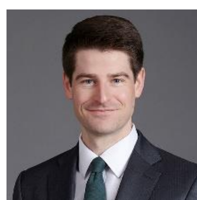

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