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Balance of Competences Review – Single Market: Financial Services and the Free Movement of Capital
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Dear Sirs

Lloyd's Comments: Call for Evidence on the Review of the Balance of Competences between the United Kingdom and the European Union - Single Market: Financial Services and the Free Movement of Capital

Introduction

We welcome the opportunity to respond to the Government's Call for Evidence on the balance of competencies between the UK and the European Union (EU) on the single market: financial services and the free movement of capital.

Lloyd's is an insurance market, comprising members who carry on insurance business through syndicates writing insurance and reinsurance contracts. Lloyd's aggregate gross written premium income in 2012 was £25.5bn. Over 80% of Lloyd's business comes from outside the UK, including 16% from other European countries[1]. Lloyd's is therefore very interested in proposals which could affect the transaction of international insurance business from the UK

Lloyd's is at the heart of the London insurance market, the world's leading international insurance and reinsurance centre, estimated to employ at least 50,000 people. The UK insurance industry is the largest in Europe and the third largest in the world, after the US and Japan. UK insurance and pension funds, excluding intermediaries and other auxiliary services, contribute around 1.6% of GDP and in the 2010/11 financial year paid £10.4bn in taxes, equivalent to 1.9% of Government tax receipts[2].

[1] Lloyd's Annual Report 2012
[2] *Insurance Briefing*, January 2013, TheCityUK

Key points

- EU rules on financial services have a beneficial effect on Lloyd's.
- The EU's insurance regulatory regime compares favourably with regimes elsewhere in the world, in terms of ease of doing business.
- The EU's existing insurance regulatory framework incorporates important principles of mutual recognition and harmonisation, which have provided clear benefits to insurers and their customers.
- Globally, there is a powerful trend towards the framing of financial services regulation at international rather than national level
- We do not wish to see significant additional EU action on insurance regulation at this time. Its priority should be to finalise and put in place the Solvency II regime.
- Although Lloyd's supports the fundamental principles of Solvency II, it is concerned about the volume of rule-making that Solvency II has entailed.
- The EU is a strong voice in the global community. It plays a major role on the international stage in shaping trade and regulatory debates.

Our detailed responses to the questions asked of relevance to Lloyd's are attached.

Please get in touch if you have any questions.

Yours sincerely

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Call for Evidence on the Review of the Balance of Competences between the United Kingdom and the European Union - Single Market: Financial Services and the Free Movement of Capital - DETAILED RESPONSES TO QUESTIONS

1. How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

EU rules on financial services have a beneficial effect on Lloyd's. The EU's Insurance Directives give Lloyd's underwriters access to the insurance and reinsurance business of a market of 30 other countries (including EEA members), with a total population of over 500m.

The EU's insurance regulatory regime compares favourably with regimes elsewhere in the world, in terms of ease of doing business. Within the EU, it is straightforward to obtain authorisation to conduct cross-border business and home state responsibility for prudential insurance regulation means that there are no expensive and unnecessary requirements to maintain regulatory reserves in other Member States. Outside the EU there is an increasingly challenging regulatory environment, sometimes characterised by protectionism and extraordinary levels of prudence, with little or no mutual recognition.

EU insurance regulation is in a period of significant change, including:

- **New European Supervisory Authorities:** established in 2009, they include the European Insurance and Occupational Pensions Authority (EIOPA); and
- **Solvency II:** under development for many years and due to be implemented from 1 January 2016.

These changes are shifting regulatory responsibility from Member States to the EU and EU agencies. UK financial services regulators retain day-to-day supervisory responsibility for UK insurers and can influence the design of EU-wide rules for the insurance industry, but otherwise their role is to apply regulations drafted by EIOPA or at EU level and they have little or no discretion to depart from approaches agreed there. It is too early to judge the impact of this change on the UK's insurance sector.

Proportionality

Although Lloyd's supports the introduction of Solvency II, there is a view that Solvency II, a complex and substantial body of legislation, is not, in its totality, strictly necessary to achieve Treaty objectives so its proportionality could be questioned.

However, Solvency II was developed with the support of successive British Governments and the UK insurance industry. Furthermore, UK insurance supervisors had a substantial role in the regime's design. Consequently, this was not a legislative package imposed by the EU on the UK: rather it is a regulatory regime for which UK authorities are in part responsible and which Lloyd's and other UK insurers support overall, even as they seek changes to some of its details.

Subsidiarity

It may be doubted whether EU institutions ever pay much attention to this principle: their integrationist instincts are too strong.

The EU's efforts to move regulatory powers from Member States to EU institutions must be put in context. Globally, there is a powerful trend towards the framing of financial services regulation at international rather than national level, as demonstrated by the activities of the G20 and the Financial Stability Board. This has been evident for many years in banking, through the activities of the Basel Committee on Banking Supervision. It has been less apparent in insurance, although today the International Association of Insurance Supervisors (IAIS) has an important and expanding role in the development of regulation, as shown by its work on international capital standards

Determination of regulatory standards at international level has the support of larger financial services firms in the UK and elsewhere and, we believe, of the British Government. Unilateral action by the UK to change this situation is unlikely and would probably make little difference.

2. How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

In general, not every problem is susceptible to resolution through legislative action at either EU or national level. There is scope for legislators at all levels to consider carefully before proposing new rules and regulation.

We do not wish to see significant additional EU action on insurance regulation at this time. Its priority should be to finalise and put in place the Solvency II regime. Lloyd's supports Solvency II's principles and the Lloyd's market has spent a great deal of time and money on preparing for Solvency II. Once Solvency II is in force, adjustments should be made when experience suggests they are necessary, but the imposition of further regulatory burdens should be avoided.

The IAIS is currently designing international capital standards for internationally active insurance groups. It will be unfortunate if EU implementation of these standards means redrafting key elements of the Solvency II regime shortly after it is put in place.

In response to the financial crisis, the EU has sometimes tried to apply similar regulatory approaches to the banking sector, in which the crisis originated, and to the insurance

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sector. Often these reforms do not take into account the differences between banks and insurers business models.

Competition enquiries

We fully support the objectives of EU competition law, but do not view competition enquiries as alternatives to legislative action. The EU has exclusive competence for competition rules. It launches sector inquiries when it believes a market is not working as well as it should and thinks that breach of competition rules may be a contributory factor. Sector inquiries can be expensive and time-consuming for the sectors concerned and can initiate new legislation.

3. How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

The introduction of a single European insurance market in the 1990s undoubtedly enhanced prospects for growth and for the competitiveness of the European insurance industry, including UK insurers.

It is too early to judge whether Solvency II will help to achieve the objectives listed.

4. Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

The EU's existing insurance regulatory framework incorporates important principles of mutual recognition and harmonisation, providing clear benefits to insurers and their customers.

More recent EU financial legislation can be complex and difficult to implement, for supervisors and undertakings alike. The EU legislates to address regulatory challenges in large and varied insurance sectors spread across 28 countries.

Many large financial institutions, with operations in several Member States, welcome detailed EU rule-making, so that their subsidiaries across the EU are subject to similar rules. They also want to avoid regulatory arbitrage and competitors in other Member States getting competitive advantages from laxer regulatory standards. However, detailed EU rules can mean that national supervisors are unable to recognise the particularities and nuances of their national markets or to adjust supervisory approaches to cater for institutions or industry sectors which depart significantly from standard business models.

Although Lloyd's supports the fundamental principles of Solvency II, it is concerned about the volume of rule-making that Solvency II has entailed:

- Solvency II Directive – 312 Articles and 7 Annexes over 130 pages.
- Omnibus 2 Directive – The text agreed in November 2013 is 156 pages long
- Delegated Acts –The Commission's draft Delegated Acts published in January 2014 contain 368 Articles and 21 Annexes, over 399 pages.
- Regulatory Technical Standards: 15 provisions.
- Implementing Technical Standards. 22 provisions.
- Regulatory guidelines and recommendations – not yet finalised. 39 separate sets of guidelines have been drafted to date.

Lloyd's supports the EU's Single Insurance Market, but considers that it sometimes leans too far in the direction of maximum harmonisation, rather than mutual recognition. EU legislation should concentrate at the highest level ("Level 1") at which fundamental principles are laid down and avoid the imposition of detailed EU-wide rules, unless demonstrably necessary. The intended benefit of EU activity is not always clear.

5. How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally?

For the most part, Third Country insurer access to the EU remains at Member State level, an approach which we support.

Solvency II contains provisions on equivalence in three areas, reinsurance, group solvency and group supervision. These provisions are intended to facilitate greater international supervisory co-operation and harmonisation. We particularly welcome equivalence in reinsurance, which aims to "*improve liberalisation of reinsurance services in third countries*"[3]. This could help to counter measures which, in some non-EU jurisdictions, discriminate against foreign, or "alien", reinsurers.

6. Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?

We do not see the need for more EU-level regulation in retail financial services. EU legislation should establish and maintain the EU internal market, in accordance with the Treaties. The regulation of retail financial services is not an obstacle to the internal market and so further EU-level regulation is unjustified.

The European Commission intends to revise the Insurance Mediation and the Markets in Financial Instruments Directives. These exercises need to be approached carefully,

[3] Solvency II Directive, 2009/138/EC, Recital 89

as consumer benefits may be outweighed by detriments such as higher costs, reduced availability of products and less efficient markets. Once EU legislation is in place it is difficult and time-consuming to amend it.

7. What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?

EIOPA's role in facilitating consistency and co-ordination in supervisory practices across the EU is helpful and it provides the EU with a strong voice in global regulatory debates.

EIOPA is more than the sum of the national supervisory authorities represented on its Board of Supervisors. It has strong institutional views of its own and extensive rule-making powers under the Regulation establishing EIOPA[4]. This raises questions about EIOPA's accountability. In theory, EIOPA is accountable to the European Parliament and the Council[5] but there are no formal mechanisms to give this force.

It is desirable for a regulatory authority to be largely independent from national governments and legislatures. At the same time, financial regulation has a substantial impact on economic success and prosperity. There are risks that regulators without sufficient oversight from the executive or legislature will veer towards excessive regulation, thereby curtailing the activities they are regulating.

On Solvency II, EIOPA's role has been advisory and other entities could intervene before legal texts were finalised. Once Solvency II is in place EIOPA's ability to regulate by exercising its formal powers under Regulation and less formally through the publication of letters and other documents will be subject to very limited challenge. The UK and other Member State Governments will have little or no powers to change or to block the actions of EIOPA, irrespective of the consequences of those actions for national insurance industries.

The Commission is due to publish a review of the European System of Financial Supervision. We do not think that this review should recommend extensions in EIOPA's powers or a merger of EIOPA with other European Supervisory Authorities.

8. Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

[4] Regulation 1094/2010
[5] Article 3 Regulation 1094/2010

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The UK has the EU's largest insurance industry, with net premium income of nearly £187bn in 2011[6]. It is therefore appropriate for the UK to have a substantial, constructive influence on EU legislation affecting insurance.

Many different UK entities can exert influence on the EU legislative process, raising the question of co-ordination. In our experience, the most influential Member States in the EU legislative process are those with clear policy objectives, which all those from the Member State concerned – in Government, in industry, in Parliament or in supervisory authorities are prepared to work towards. The UK has not always been in this situation and it is not always clear that there is an agreed "UK position" on particular legislative issues. It is helpful when Government departments co-ordinate action to bring this about, including consultation with industry. HM Treasury's insurance team did this effectively during the development of Solvency II.

A point that should not be overlooked is that the EU's working language is English, facilitating the comprehensible presentation of arguments by UK nationals at EU meetings.

Personnel in the EU are important informal channels of UK influence: "*all EU Member States rely significantly on the nationals they have in the EU institutions as part of their collective networking strength.*"[7] The UK particularly benefits when a Briton holds an influential Commissionership and is perceived to be effective in this role. Although the UK makes up 12.5% of the EU's population, only 4.6% of Commission staff are from the UK and the number fell by 24% from 2005 to 2012[8]. Similar reductions in UK staff are evident in other EU institutions. It is therefore important that the Government continues with efforts to increase the UK staff presence in EU institutions. These efforts must not be undermined by perceptions of uncertainty over UK membership of the EU.

How different would rules be if the UK was solely responsible for them?

UK prudential insurance regulation would not be very different if the UK was solely responsible for the rules. Individual Capital Assessments are an important element in the UK's existing regime and these were devised and implemented by the UK rather than the EU. The forthcoming Solvency II regulations draw on this UK model and elements such as the focus on risk management also reflect UK supervisory approaches.

Modern prudential financial regulation originates with bodies such as the G20 and the Financial Stability Board and the insurance regulations applied by national supervisors are increasingly drafted by the IAIS. National supervisors meet and exchange ideas regularly and there is usually a broad consensus on the direction in which insurance regulation should travel. Harmonised supervisory approaches across countries can

[6] *Key Facts about UK Financial and Professional Services* TheCityUK, January 2013
[7] Sir Colin Budd, quoted in *The UK staff presence in the EU institutions*, House of Commons Foreign Affairs Committee, July 2013

[8] *The UK staff presence in the EU institutions*, supra

facilitate cross-border trade. It would not therefore be credible for the UK to seek to implement a prudential insurance regulatory system that was dramatically different from that of its major trading partners.

9. How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

We are pleased that EU policymakers conduct public consultation and follow up with summaries of responses and their feedback. This is an important part of the legislative process. Nevertheless, there is a risk of "going through the motions" with consultation processes, although this is scarcely unique to the EU. Overall, we think that the European Commission's openness to outside feedback varies. We are not aware of any occasions on which it has been persuaded to drop a legislative proposal, whatever the arguments presented for its lack of necessity. On the other hand, in the earlier stages of Solvency II's development, the Commission was quite open to receiving and acting on stakeholder comments, even if its priority now is to finalise the necessary legislation.

Impact assessments are generally helpful, but can be difficult to conduct realistically. For example, the European Commission's impact assessment of proposals on offshore safety was challenged by the UK oil and gas industry. The Commission therefore arranged a technical peer review, chaired by Dr Bill Nixon of the UK Health & Safety Laboratory, which reported in 2012. Its report[9] noted that:

"It is clear that a detailed, comprehensive risk assessment and cost-benefit analysis, which reflects both the historical position and… potential changes… is difficult to conduct. The data and resource requirements would be very significant and it would take time to achieve a degree of consensus on some key assumptions…in reality, in light of the inherent uncertainties…it is difficult, …to evaluate the extent to which any analysis is or is not conservative. In essence, none of the analyses is wholly right or wrong."

Similar considerations apply to other impact assessments and there is consequently a danger of policymakers picking the assumptions that justify the line of action they are inclined to adopt. The European Commission has Impact Assessment Guidelines, dated 15 January 2009. Assessments drafted in accordance with these Guidelines are usually informative documents.

Legislative proposals for which there are no impact assessments can be flawed. Within the EU legislative process this can happen if the European Parliament substantially

[9] Peer Review Meetings on the Assessment of Risks in the Offshore Oil & Gas Industry, 28 March 2012 & 2 May 2012 Summary Report, available at: http://ec.europa.eu/energy/oil/offshore/standards_en.htm

amends a legislative proposal: the revised provision is likely not to undergo an impact assessment, even though its effects differ substantially from what has been assessed.

10. What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives?

We do not have direct experience of these restrictions. Nevertheless, in general we support the EU Treaty freedoms, including the freedom of movement of capital.

11. What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?

The direct impact on insurance regulation of the banking union and the UK's non-membership of the euro area is likely to be limited. It may be viewed as a precedent for the establishment of a pan-European insurance supervisor. We would not support such a proposal, if it were made. The supervision of insurers should remain at the national level, where relevant expertise and knowledge are concentrated. The justifications for the ECB's assumption of supervisory powers over Eurozone banks – especially the Eurozone financial crisis - do not arise for the EU's insurance sector.

Euro-area authorities can make proposals affecting insurers. When they do so, it is unclear to what extent they affect non-euro area insurers and whether the Bank of England, as a non-euro area Central Bank, has any input into the proposals or will adopt them once they are in force. This makes it difficult for UK undertakings to respond to such proposals. For example, the ECB intends to collect extensive financial data from insurers, which could be an onerous administrative burden. It is unclear whether this will apply outside the euro-zone, so UK insurers find it difficult to respond to this proposal.

12. Do you have any further comments about issues in addition to those mentioned above?

The EU is a strong voice in the global community. It plays a major role on the international stage in shaping trade and regulatory debates. Its economic size and political influence give it substantial weight in international institutions and in the negotiation of bilateral and multilateral agreements with third countries.

The European Commission represents all Member States in insurance trade and regulatory negotiations and has concluded agreements that benefit the UK insurance industry, including Lloyd's. For example, the EU-Chile Free Trade Agreement concluded in 2003 allows UK insurers access to Chile marine, aviation and transport insurance business. The EU is in the process of negotiating agreements with other countries, which may bring further opportunities to Lloyd's and other UK insurers.

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The EU-US Dialogue is being pursued with renewed vigour and its agenda includes co-operation in the context of insurance. Foreign insurers operating in the US are currently subject to punishing rules on collateral obligations. We hope that this Dialogue will accelerate long-overdue reforms of these expensive discriminatory requirements.