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FCA publishes FG16/5: Guidance for firms outsourcing to the "cloud" and other third party IT services

In November 2015, the Financial Conduct Authority (FCA) consulted on proposed guidance for firms outsourcing to the "cloud" and other third party IT services. On 7 July 2016, the FCA published the finalised guidance. The FCA’s response to the feedback received is set out in the annex to the finalised guidance.

The FCA says that it does not consider that the feedback received requires substantial changes to its guidance and proposed approach as set out in the guidance consultation. However, in some areas it has amended the draft guidance, mostly to clarify its expectations.

The guidance is intended to illustrate ways in which firms can comply with the relevant rules. The FCA expects firms to take note of the guidance and, where appropriate, use it to inform their systems and controls on outsourcing.

The FCA says that in producing the guidance, it has worked closely with Project Innovate to identify areas where its regulatory framework needs to adapt to enable further innovation in the interests of consumers.

PRA updates two reporting supervisory statements

On 6 July 2016, the Prudential Regulation Authority (PRA) published the following updated supervisory statements (SS):

- SS11/15 - Solvency II: regulatory reporting and exemptions: template reference numbers in Table A of SS11/15 have been updated to reflect those published in the Commission Implementing Regulation (EU) 2015/2450 of 2 December 2015. There are no changes to the content of Table A. SS11/15 was originally published in March 2015;

- SS40/15 - Solvency II: reporting and public disclosure - options provided to supervisory authorities: chapter 4 of SS40/15 has been updated to address the options for supervisory authorities in accident or underwriting year reporting and disclosure. It also includes references to template S.29.03.01. The instructions for template S.29.03 give supervisory authorities discretion to stipulate accident or underwriting year reporting. SS40/15 was originally published in October 2015.

PRA publishes CP23/16: Solvency II: external audit of the public disclosure requirement

In its November 2015 consultation paper, CP43/15, the PRA consulted on its proposal for external audit of the Solvency II public disclosure. Following feedback, the PRA has made some minor amendments to the rules, though the broad policy approach has not changed and on 4 July 2016, it published a consultation paper, CP23/16.

The draft rules and supervisory statement set out in appendices 1 and 2 to the consultation paper include those minor amendments and the PRA’s responses to consultation feedback have been included in chapter 3. In addition to those minor amendments the PRA proposes a clarification of the duty of care of auditors to the PRA in the proposed rules. While there is no substantive change in the PRA’s policy, and the amendment does not change the substance of what an auditor or actuary must do to comply with the PRA’s rules, the rule has been amended to provide clarity. CP23/16 seeks views on this proposed clarification.
Subject to the changes and clarifications described in chapter 3, the rules proposed in the consultation paper continue to reflect the proposals in CP43/15. The proposals clarifying the duties of auditors are discussed in chapter 2.

Comments are requested by 4 August 2016.

**Getting culture and conduct right - the role of the regulator: speech by Jonathan Davidson, FCA**

On 12 July 2016, the FCA's Director of Supervision - retail and authorisations, Jonathan Davidson, spoke at the 2nd Annual Culture and Conduct Forum for Financial Services Industry. In his speech Mr Davidson discussed getting culture and conduct right and the FCA's role within this.

Among other things, Mr Davidson said that:

- the FCA’s ambition is for the conduct element of culture: that mindsets and incentives will shift to make doing the right thing for consumers and the markets the objective that is always considered;
- the role of all leaders is to encourage a culture of personal responsibility and impress upon all staff the value of good culture to the health of the firm and the financial services industry more widely;
- more firms are forming the view that a strong conduct culture which builds consumer trust in firms and markets and inspires employees is in the economic self-interest of the firms and their shareholders.

Mr Davidson also discussed the Senior Managers and Certification Regime, saying that the FCA is, on the whole, pleased with how firms have approached the regime.

**FCA publishes CP16/18: Changes to disclosure rules in the FCA Handbook to reflect the direct application of the PRIIPs Regulation**

On 18 July 2016, the FCA published a consultation paper, CP16/18, on proposed changes to its disclosure requirements in order to reflect the direct application of the Regulation on key information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs) (PRIIPs Regulation) from 31 December 2016.

The PRIIPs Regulation will require firms to prepare, publish and provide a KID for each PRIIP manufactured. In order to prepare for the direct application of the PRIIPs Regulation, the FCA expects all affected firms to plan for changes to their retail disclosure documents and related processes.

In CP16/18, the FCA details its approach and proposals to amend affected disclosure provisions in the FCA Handbook so they reflect the PRIIPs Regulation. The FCA proposes to:

- amend or delete disclosure rules in the FCA Handbook, where these would otherwise duplicate or conflict with PRIIPs Regulation requirements to prepare and produce a KID;
- amend or maintain certain disclosure rules in the FCA Handbook that set out how firms may provide additional information to supplement the KID required by the PRIIPs Regulation;
- amend provisions in the FCA Handbook relating to the use of colours to align them with the approach of the PRIIPs Regulation, where a similar approach is desirable and in the interests of consumers.

Comments are requested by 19 September 2016. The FCA plans to publish a policy statement making final rules in November 2016.
PRA publishes Dear CEO letter on analysis and observations from regulatory returns and monitoring-the-market questionnaire

On 18 July 2016, the PRA published the text of a Dear CEO letter sent by its Director of General Insurance, Chris Moulder, to general insurance firms.

Due to the continuation of soft market conditions in the commercial sector, the PRA has decided to share some observations based on its analysis of PRA returns, as well as analysis from a recent questionnaire completed by London market insurers titled "monitoring-the-market". While much of the PRA's analysis is focused on the commercial sectors, it starts with some observations based on an analysis of reserves that is relevant to all insurers.

The PRA says that it hopes that the observations and analysis provided in the annex to the letter allows firms to better understand how it uses the information submitted. It will continue to use this type of analysis to track broad trends across the insurance industry, as well as to inform and assist with its individual firm supervision. In the latter case, the PRA says that it is well aware that much of the information in the letter is based on market averages, as a result, the information is used to support rather than drive a PRA supervisor's knowledge and view of key risks.

Looking ahead, the PRA is already receiving a significant increase in firm-level information under the new Solvency II Directive reporting requirements. It is responding by continuing to invest in its analytical capabilities to maximise the value of this new data.

Over the coming years, firms can expect the PRA to increase its use of analytics to support its forward-looking, judgement-based supervision, both for prioritising activities and assessing the risks faced by, and business models of, individual insurers. The PRA recognises that at a class of business level, the quality of data supporting the Solvency I PRA returns was not always consistent and, over time, this reduced some of its value. With the new Solvency II information, the PRA is focusing on understanding trends from the introduction of the new regime on 1 January 2016, including developing and maintaining a sector-level view that is grounded in firm-level intelligence. To do this, the PRA needs to ensure that data quality is front of mind from the outset. Insurers can therefore expect the PRA to ask questions based on the new data, particularly if its analysis highlights anomalies in a given firm's data relative to the past and/or other firms.

As this is the PRA's first letter providing feedback on market trends in the general insurance sector, it welcomes feedback.

PRA publishes Dear CEO letter on insurance firms in run-off: firm engagement with the PRA

On 20 July 2016, the PRA published a "Dear CEO" letter, dated 18 July 2016, reminding insurance firms in run-off of their continuing responsibilities in the way they engage with the PRA. This follows a number of instances where the PRA has not been engaged by firms at a sufficiently early stage.

In addition to the Threshold Conditions, all PRA-authorised firms are required to comply with the PRA's eight Fundamental Rules, as set out in Fundamental Rules in the PRA's Rulebook. In particular, firms are reminded of the requirements of PRA Fundamental Rule 7, which provides that a firm must deal with its regulators in an open and co-operative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.

Similarly, Notifications 2.3 in the PRA Rulebook also requires that a firm give the PRA notice of, among other things, any breach of PRA rules, proposed restructuring, reorganisation or business expansion, which could have a significant impact on the firm's risk profile or resources. The PRA also expects notification of any action which a firm proposes to take which would result in a material change in its capital adequacy or solvency.
The PRA expects firms to engage with it on these matters at "an early stage": that is, a reasonable amount of time before making any formal regulatory submissions that might be required.

The PRA states that failure to comply with the Fundamental Rules may be relevant to a firm’s ongoing compliance with the Threshold Conditions and may result in formal supervisory action or enforcement proceedings, or both.

**FCA publishes TR16/6: Principals and their appointed representatives in the general insurance sector: findings of the FCA’s thematic review**

On 22 July 2016, the FCA published a report setting out the findings from its thematic review of principal firms and their appointed representatives (ARs) in the general insurance sector. The review focused on principal firms’ understanding of their responsibilities for their ARs and oversight of their activities.

The focus of the thematic review was on general insurance products and services provided primarily to UK retail and SME customers. The initial stage of the review included a survey of 190 principals in the general insurance sector with a diverse range of business models operating a network of ARs. The ARs of these principal firms sold a wide range of products via a range of methods.

The FCA then selected 15 of these principal firms for more detailed work and requested and reviewed further information from these firms. Finally, it visited 14 principals and 25 of their ARs, meeting with and interviewing senior management and staff, reviewing policies, procedures, contractual documentation, customer facing documentation and customer files, and listening to sales calls.

The FCA’s main concern is the material risk of customer detriment arising from the activities of ARs that are not subject to appropriate control and oversight from their principal. Some of the firms did not appear to have understood the full extent of their obligations for ensuring their ARs complied with regulatory requirements. Over half of the 15 principal firms in the FCA’s sample could not consistently demonstrate that they had effective risk management and control frameworks to identify and manage the risks arising from the activities of their ARs.

The FCA also found that almost half of the principal firms in the sample could not demonstrate that they had understood the nature, scale and complexity of the risks arising from their ARs’ activities and in particular the risk to customers.

The FCA also found examples of potential mis-selling and customer detriment as a result of ARs’ actions at a third of the principal firms included in the review, with most of these issues not previously identified by the principals. The poor customer outcomes identified included customers buying products they may not need, products they may not be eligible to claim under or customers not being provided with enough information to make an informed decision. At the ARs of one principal firm there was significant evidence of mis-selling leading to actual customer detriment.

As a result of the findings the FCA has taken early intervention actions in relation to five of the principal firms in the sample. This includes:

- the commissioning of two section 166 skilled person reviews to assess whether detriment has been suffered by customers from mis-selling and consider the adequacy of systems and controls;
- asking two firms to cease sales activities;
- agreeing the imposition of requirements on all five firms’ regulatory permissions to stop them taking on new ARs;
- considering the need for customer redress and whether further regulatory action in relation to the issues identified is required.

Hogan Lovells
Further work will also be undertaken with some of the firms who were in the wider sample but not included in the detailed work. This will focus on principal firms that the FCA believes to be higher risk, as well as those about which it had concerns regarding the quality of data provided to it.

**FCA publishes Dear CEO letter on expectations of principal firms operating in the general insurance sector**

On 27 July 2016, the FCA published the text of a [Dear CEO letter](#) sent by its Director of General Insurance and Protection, Simon Green, to the chief executive officers of principal firms with appointed representatives (ARs) in the general insurance sector setting out its expectations. The letter, which is dated 26 July 2016 refers to the report (see above item) setting out the FCA's findings from its thematic review of principal firms and their ARs.

The FCA says that given its significant concerns, it expects the CEOs to share the letter with their board or equivalent, as the FCA will consider these matters in any interactions with the firm.

The letter states that the FCA Handbook sets out the rules and guidance relating to ARs and the continuing obligations of the principal firm. The main purpose of the FCA's rules and guidance is to place responsibility on the principal firm for seeking to ensure that its ARs are fit and proper to deal with clients in its name, and to ensure that clients dealing with its ARs are afforded the same level of protection as if they had dealt with the principal firm itself.

The FCA expects a principal firm to consider the contents of the thematic review report, assess whether it can demonstrate how it is meeting the FCA's requirements in relation to its ARs, as set out in the FCA Handbook. A firm should ensure that it identifies and addresses any shortcomings in its risk management frameworks, processes and practices in relation to meeting its responsibilities and obligations for its ARs.

**PRA publishes update to SS4/14: Capital extractions by run-off firms in the general insurance sector**

On 28 July 2016, the PRA published an updated version of supervisory statement (SS) [SS4/14](#) on capital extractions by run-off firms in the general insurance sector, which was first published in April 2014.

SS4/14 has been updated to reflect the proposals consulted on in the PRA's November 2015 consultation paper [CP42/15](#) on capital extractions by run-off firms within the general insurance sector, following the change in the UK insurance regulatory regime from individual capital adequacy standards to Solvency II. Details of changes made to SS4/14 are available in appendix 1 of the supervisory statement.

**INTERNATIONAL**

**PRIIPs: ESAs to publish Q&As**

On 1 July 2016, the Joint Committee of the European Supervisory Authorities (ESAs) (that is the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) published the text of a letter sent to the European Parliament and the Council of the European Union (and copied to the European Commission) on the supervisory convergence work by the ESAs in relation to the draft regulatory technical standards (RTS) on key information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs).

The letter says that the timing of implementation has been a key issue arising from consultations with stakeholders, and also with members of the boards of the ESAs. Given the technical challenges in preparing for the implementation, the Joint Committee considers that even a six-month window will be challenging for some stakeholders.
The ESAs have therefore now focused on developing supporting level three material to aid implementation and consistent supervision of the KID. This material will mainly take the form of questions and answers (Q&As) and relates to the technical methodologies included in the draft PRIIPs RTS on risk, rewards and cost disclosure requirements.

In the interests of transparency, the Joint Committee draws the attention of the Parliament and the Council to its intention to publish the Q&As over the course of summer 2016. The publication may take place before the end of the scrutiny period for the RTS. The Committee says that due to their nature, the Q&As would not pre-empt the results of the scrutiny period.

The aim of the Q&As would be to clarify how to apply certain technical provisions related to the methodologies included in the PRIIPs RTS. They would for instance provide clarity which of the different methodological steps need to be followed for PRIIPs by clarifying the different types of different PRIIPs, and explaining in plain language the statistical techniques required.

PRIIPs: European Commission adopts Delegated Regulation on key information documents with regard to product intervention

On 14 July 2016, the European Commission adopted a Commission Delegated Regulation supplementing the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) (the PRIIPs Regulation) with regard to product intervention.

The Delegated Regulation, which is based on two empowerments laid down in Articles 16 and 17 of the PRIIPs Regulation, aims at specifying, in particular, the rules relating to rules on supervisory measures on product intervention by the national authorities and the European Insurance and Occupational Pensions Authority.

The Council of the European Union and the European Parliament must now consider the Delegated Regulation. If neither of them objects, it will enter into force on the twentieth day following that of its publication in the Official Journal of the European Union. It will apply from 31 December 2016.

IDD: EIOPA consults on technical advice on possible delegated acts

On 4 July 2016, the European Insurance and Occupational Pensions Authority (EIOPA) published a consultation paper on its draft technical advice to the European Commission on possible delegated acts concerning the Insurance Distribution Directive (IDD). This follows a request from the Commission dated 24 February 2016.

The consultation relates to technical advice on:

- product oversight and governance (IDD Article 25(2)): arrangements requiring manufacturers of all insurance products to establish processes for company-internal approval of each insurance product before it is distributed to customers. This work is based on EIOPA’s preparatory guidelines on product oversight and governance;
- organisational arrangements to prevent and manage conflicts of interests which may arise between distributors and their customers (for example inappropriate sales incentives) in the course of distribution of insurance-based investment products (IBIPs) (IDD Articles 27 and 28(4));
- specification of the circumstances under which inducements, namely third party payments such as commissions paid by manufacturers to distributors in connection with the distribution of IBIPs, have a detrimental impact on the quality of service provided to the customer (IDD Article 29(2));
- specification of the information that distributors should obtain from their customers to be in a position to assess the suitability or appropriateness of IBIPs for the customer and reporting on the service provided to the customer (IDD Article 30(5)).

Comments are requested by 3 October 2016.
EIOPA will finalise the draft technical advice for submission to the Commission by 1 February 2017. It will hold a public hearing on the consultation on 23 September 2016 in Frankfurt. EIOPA will monitor the issues raised in its technical advice and assess, on the basis of evidence following the implementation of the Level 1 and Level 2 provisions in IDD in February 2018, the need for issuing guidance to further specify particular issues raised in this technical advice.

**EIOPA to launch EU-wide thematic review on market conduct**

On 5 July 2016, EIOPA announced that it is launching an EU-wide thematic review of market conduct among insurance companies operating in the unit-linked life insurance market. The review aims to cover 60% of each national market in terms of both gross written premiums and assets of unit-linked funds.

The purpose of the review is to identify potential sources of consumer detriment stemming from the relationships between insurers and providers of asset management services. In particular, EIOPA intends to analyse how remuneration paid by asset managers to insurers could influence their choice of investments and how this choice could impact policyholders.

The thematic review focuses on three key issues:

- existence and characteristics of monetary incentives and remuneration;
- how insurance undertakings address conflicts of interest;
- how insurance undertakings structure unit-linked life insurance products.

The thematic review will be conducted in close cooperation with national competent authorities (NCAs). NCAs will identify participating insurance companies, gather the relevant data and information in their national market and also serve as a primary contact point for insurers in case of questions. EIOPA will manage and coordinate the EU-wide exercise as well as prepare the final in-depth analysis of the results of the thematic review.

Participating insurance companies are expected to report back by September 2016 and the results of the thematic review will be disclosed in early 2017.

**IAIS publishes application paper on approaches to supervising the conduct of intermediaries**

On 1 July 2016, the International Association of Insurance Supervisors (IAIS) published for consultation an application paper on approaches to supervising the conduct of intermediaries.

The paper discusses approaches that its members may wish to consider when developing or revising their supervisory regimes for the supervision of intermediaries, and implementing insurance core principle (ICP) 18 (intermediaries) and relevant aspects of ICP 19 (conduct of business) in their supervisory frameworks.

The paper does not set out requirements. It provides additional material related to the ICPs, such as examples that may help practical application of IAIS supervisory material. The paper discusses different types of intermediaries and the diversity of intermediation, supervision of intermediaries in the context of a broader supervisory framework, and supervisory approaches that may promote good conduct of business by intermediaries with reference to ICPs 18 and 19.

Comments are requested by 1 August 2016. After the consultation is closed, a public discussion of the comments and proposed resolutions will be organised in October 2016.

**IAIS launches thematic self assessment and peer review on information exchange and supervisory co-operation**

On 14 July 2016, the IAIS published a questionnaire for firms relating to a thematic self-assessment and peer review on information exchange and supervisory co-operation under insurance core principle...
Responses are requested by 14 August 2016.

**OECD consultation on revising guidelines on insurer governance**

On 12 July 2016, the Organisation for Economic Co-operation and Development (OECD) published a consultation on a draft recommendation on guidelines on insurer governance.

The draft recommendation revises the guidelines published in May 2011 and complements the G20/OECD principles of corporate governance, which were published in September 2015.

The guidelines are organised around four main sections:

- governance structure;
- internal governance mechanisms;
- groups and conglomerate; and
- stakeholder protection.

Comments are requested by 29 August 2016.

**IAIS consultation paper on risk-based global insurance capital standard**

On 19 July 2016, the IAIS announced that it has launched a consultation on the risk-based global insurance capital standard (ICS).

This consultation is the second IAIS consultation in a multi-year process to develop the ICS. The IAIS first consulted on the ICS in December 2014.

This version of the ICS (version 1.0) is scheduled for adoption for purposes of confidential reporting in mid-2017. ICS version 2.0 is planned for adoption in late 2019. The ICS will be part of ComFrame, the common framework for the supervision of internationally active insurance groups.

The consultation paper covers three key components of ICS version 1.0 for confidential reporting purposes:

- valuation methodologies;
- qualifying capital resources;
- implementation of risk-based approaches to determine regulatory capital requirements.

The focus of ICS version 1.0 is on a standard method, with consideration of other methods of calculation of the ICS capital requirement to be addressed in version 2.0.

Comments are requested by 19 October 2016.

The IAIS has also published a document containing information on its development of the ICS, including its ultimate and interim goals, principles for development and delivery process.

**IDD: Insurance Europe proposed format for IPID**

On 20 July 2016, Insurance Europe announced the publication of a position paper on its proposed format for the standardised insurance product information document (IPID) for non-life insurance products, as required under the Insurance Distribution Directive (IDD).

Insurance Europe says that the IPID is an essential part of the IDD, which will require insurance distributors to provide consumers with relevant information about non-life insurance products prior to the conclusion of a contract. The IDD stipulates that this information shall be provided in a standardised IPID on paper or on another durable medium.
Insurance Europe says that it has developed its own proposed format to support the work of the European Insurance and Occupational Pensions Authority and the European Commission in developing a standardised IPID.

**EIOPA signs up to IAIS MMoU**

On 28 July 2016, EIOPA and the IAIS announced that EIOPA has become a signatory to the IAIS' multilateral memorandum of understanding (MMoU), which now has 56 signatories.

The MMoU is a global framework for cooperation and information exchange among insurance supervisors. It sets minimum standards to which signatories must adhere. All applicants are subject to review and approval by an independent team of IAIS members. Through membership of the MMoU, supervisors are able to exchange relevant information with and provide assistance to other signatories, thereby promoting the financial stability and sound supervision of cross-border insurance operations for the benefit and protection of consumers.

**IAIS publishes summary of responses to consultation on non-traditional non-insurance activities and products**

On 25 November 2015, IAIS published a consultation paper on an analytical framework for non-traditional non-insurance (NTNI) activities and products.

On 22 July 2016, the IAIS published a document summarising the comments that were received to the consultation paper, together with the IAIS' response to the comments. Due to the large number of responses, comments are presented on a thematic basis.

**IAIS consults on proposed updated assessment methodology on G-SIIs**

On 25 November 2015, the IAIS published a consultation paper on proposed updates to its 2013 initial assessment methodology to identify insurance-dominated financial conglomerates whose distress or disorderly failure, because of their size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity. These changes in relation to revisions and improvements and indicators (see section IV), a new five-phase assessment process (see section V), annual G-SII data collection and data instructions (see section VI), entry and exit from the G-SII list (see section VII) and improved transparency (see section VIII).

On 22 July 2016, the IAIS published a document summarising the comments that were received to the consultation paper, together with the IAIS' response to the comments. Due to the large number of responses, comments are presented on a thematic basis.

**SOLVENCY II**

**European Commission request for advice from EIOPA on review of Delegated Regulation**

On 20 July 2016, the European Commission published a request to EIOPA for technical advice on the review of specific items in the Solvency II Delegated Regulation, together with a letter from the Director-General of the Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Olivier Guersent, to the EIOPA Chairman, Gabriel Bernardino.

The Commission has requested the technical advice in preparation for the review of the Solvency II Delegated Regulation, which is expected to be carried out in 2018.

In September 2015, the Commission published a call for evidence on the EU regulatory framework for financial services. The Commission says that the call for evidence provided further insights into the functioning of the Solvency II framework, and based on that input, the following areas merit further reflection:
proportionate and simplified application of the requirements: further work could be done to ensure that all requirements are proportionate to risks;
removal of unintended technical inconsistencies: with regard to recital 150 of the Solvency II Delegated Regulation: the call for evidence confirmed that the review could address significant weaknesses experienced by stakeholders and consider more consistency across sectorial rules to the extent possible;
removal of unjustified constraints to financing: respondents to the call for evidence highlighted that the Solvency II framework may create unintended barriers to long-term investment. The Commission believes that additional work may be needed to identify investments creating growth and jobs and offering sufficient transparency and credit quality to justify improved risk sensitiveness in the standard formula.

In the call for advice, the Commission requests technical advice from EIOPA on 18 topics relating to the Commission’s work on a proportionate and simplified application of the requirements and the removal of unintended technical inconsistencies. As regards removal of unjustified constraints to financing, the Commission is in the process of conducting an in-depth assessment of investment classes that merit further investigation, and may request EIOPA’s technical support at a later stage where required.

EIOPA is asked to provide its final technical advice to the Commission by 31 October 2017. However, the Commission says that, where necessary, a staggered approach could be adopted and partial advice submitted before the submission of the final advice. EIOPA is asked to provide a timetable for submitting its advice.