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PRA sets out and consults on senior insurance managers regime for non Solvency II insurance firms

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Financial Services: On 13 August 2015 the Prudential Regulatory Authority of the Bank of England issued its Policy Statement PS21/15 and a Consultation Paper CP 26/15. The PRA expects about 100 insurance companies (mainly mutual or friendly societies) to be outside the scope of Solvency II (Non-Directive Firms or NDFs). Almost all of these NDFs have assets of less than £25 million. For these smaller NDFs (those with assets of less than £25m) the PRA has set out its new Senior Insurance Manager's Regime (SIMR). For those larger firms the PRA is consulting further on the SIMR to be applied. There is a parallel consultation that the FCA has issued. The PRA sets out how it will assess the fitness of senior insurance managers. There are also proposals on a requirement for certain firms to appoint an actuarial function holder, a set of proposed new forms and detail on record retention requirements. The deadline to respond to these proposals is 12 October 2015. Risk management insurance expert Charles Portsmouth, a director in accountancy firm Moore Stephens LLP in London comments on these proposals from the PRA.

Original news

The PRA has published its Policy Statement PS 21/15 and its Consultation Paper CP 26/15. This seeks views on the senior insurance managers' regime for those insurers which will be outside the scope of Solvency II. The PRA estimates that there are about 100 such insurers – mainly mutuals and friendly societies who fall outside Solvency II's scope. The paper proposes some limited options available to the PRA on this. This paper is part of a suite of papers from the PRA and FCA on implementing Solvency II. This paper sets out how the PRA proposes to assess the fitness of senior managers. There are also proposals on a requirement for certain firms to appoint an actuarial function holder, a set of proposed new forms and detail on record retention requirements. The consultation closing date is 12 October 2015.

What is the background to consultation paper?

The Solvency II regime introduces for the first time a harmonised, sound and robust prudential framework for insurance firms throughout the EU. It is based on the risk profile of each individual insurance company in order to promote comparability, transparency and competitiveness. Over its 40 years of existence, the prior Solvency I regime showed structural weaknesses. It was not risk-sensitive, and a number of key risks, including market, credit and operational risks were either not captured at all in capital requirements or were not properly taken into account in its approach.

Capital requirements under Solvency II are meant to be forward-looking and economic. They will be tailored to the specific risks borne by each insurer, allowing an optimal allocation of capital across the EU. They will be defined along a two-step ladder incorporating solvency capital requirements and minimum capital requirements in order to trigger proportionate and timely supervisory intervention. Insurers will be free to invest according to the prudent person principle and capital requirements will depend on the actual risk of investments.

On 10 October 2014 the European Commission adopted a delegated act containing implementing rules for Solvency II (which runs to 797 pages). Following its approval by the European Parliament and Council, this was published in the Official Journal on 17 January 2015 as Commission Delegated Regulation **2015/35**.

What did the PRA say in its earlier consultation paper?
In its earlier consultation paper issued on 27 March 2015 (**CP12/15**) the PRA proposed to apply a similar SIMR regime to those firms not within the scope of Solvency II, but with assets of more than £25 million in respect of regulated activities. In March 2015 the FCA issued a companion consultation paper (**CP15/15**) called "Changes to the Approved Persons Regime for insurers not subject to Solvency II".

In the March consultation paper, the PRA proposals in outline covered 4 key areas for these NDFs – controlled functions, fitness & propriety, allocation of prescribed responsibilities and conduct standards.

The PRA intended that the relevant individuals in current controlled functions at NDFs will be grandfathered across to the proposed new senior insurance management functions, without any reassessment of these individuals being required. The PRA proposed to reduce the scope of its mandatory approval regime for NDFs by requiring them to have a minimum of one individual approved and has published a set of prescribed responsibilities which must be allocated to a PRA or FCA approved senior manager. The FCA proposed to make FCA Significant Influence Function (SIF) holders those individuals in executive governing roles who will no longer be pre-approved by the PRA but will ensure they are subject to FCA pre-approval.

On 13 August 2015, the PRA published a policy statement (**PS21/15**) on key elements of the new SIMR for insurance firms that are outside the scope of Solvency II. This policy statement sets out further proposals from the PRA to implement the new SIMR for these firms. The SIMR will replace the PRA's current Approved Persons Regime (APR) and will cover:

- the assessment of fitness and propriety of Senior Insurance Managers or directors,
- the allocation of certain responsibilities to senior individuals, and
- the application of relevant Conduct Standards to senior individuals.

This consultation is relevant to UK insurance firms not within the scope of Solvency II. It is proposed that these rules will cover run-off firms, on a transitional basis, so long as these firms are not subject to the Solvency II rules in accordance with Transitional Measures 2 in the Solvency II Firms section of the PRA Rulebook. The PRA labels these firms collectively as NDFs.

The PRA says it expects about 100 UK insurance firms will be outside the scope of Solvency II. The majority of these firms are mutuals and many of them are registered as friendly societies.

What are the main provisions contained in the consultation paper?
The consultation is in 5 parts:

- detailed proposals for the application of the SIMR to those NDFs with assets of more than £25 million,
- the PRA's proposal to maintain the requirement for certain NDFs to appoint an actuarial function holder and a with-profits actuary,
- transitional arrangements for all NDFs,
- PRA proposed new forms with explanations as to how they will be used, and
- proposals for the retention of records in respect of the allocation of responsibilities to senior managers at NDFs.

The PRA says firms should read this consultation paper CP alongside a companion paper (**CP 15/25**) that the Financial Conduct Authority has issued on "Changes to the Approved Persons Regime for insurers not subject to Solvency II" in order to understand how both regulators' regimes are proposed to work together.

<u>NDFs with £25million+ assets</u>
In CP12/15, the PRA said its intention was that for firms with assets of more than £25 million in respect of regulated activities it would apply a similar SIMR regime as for Solvency II firms, rather than a streamlined regime it proposes for firms with a smaller asset base. In addition to a chief executive officer, firms will need to appoint chief officers to oversee finance, risk, internal audit, actuaries and underwriting and the PRA will need to approve their appointment. The PRA proposes that firms should ensure that all persons who perform key functions are fit and proper on an ongoing basis.

Some individuals at firms may be performing a combination of regulated activity functions in relation that could be regarded as needing separate approval from both the PRA and FCA. The PRA proposes to include a rule that where an individual is approved by the PRA for a SIMF then, subject to appropriate conditions, any FCA governing functions would be absorbed within the PRA function. The PRA proposes to apply the principle of proportionality, so that firms have the flexibility to combine responsibilities for different functions allocated to a single individual. This would be subject to satisfactory transparency, accountability and appropriate management of conflicts of interest.

The PRA will also need to approve the appointment of any non-executive directors who will serve as either the board chairman or chairs of the risk committee, audit committee, remuneration committee and the senior independent director.

The PRA proposes a new rule which would require NDFs with assets of more than £25 million relating to regulated activities to compile and maintain a governance map. This document is to record the key functions at the firm and the relevant individuals responsible for these functions. It should also record the allocation of significant management responsibilities and reporting lines for each of these senior persons within the firm.

<u>Actuarial function holder</u>
The supervision section of the PRA Handbook (**SUP 4**) already requires certain NDFs writing long-term insurance business to appoint an actuarial function holder and, if they are writing with-profits business, a with-profits actuary. The PRA proposes to maintain this requirement. The PRA proposes to re-draft SUP 4 in respect of NDF actuaries under the Non-Solvency II Firms – Actuarial Requirements Part of the PRA Rulebook to be effective from 1 January 2016.

Further from 7 March 2016 the PRA proposes to insert into 3.2 of the PRA Rulebook an actuarial function and a with-profits actuary function (**SIMF20** and **SIMF21**) for these NDFs. These functions would correspond to the actuarial function holder (**CF12**) and the with-profits actuary (**CF12A**) roles under SUP 4 of the PRA Handbook. Function holders will be expected to seek pre-approval from the PRA to ensure they are fit and proper and be subject to the PRA's conduct rules. The PRA proposes that individuals who currently hold either CF12 or CF12A approval can be grandfathered into SIMF20 and SIMF21 where they continue to perform the same role

The PRA expects firms to take reasonable steps to ensure that an appointed actuary does not perform any other function on behalf of the firm that could give rise to a conflict of interest and that (s)he has the necessary skills, experience and qualifications to perform the functions. The PRA believes that there are relatively few NDFs for which this ongoing requirement will apply.

<u>Transitional arrangements</u>
The PRA and the FCA propose that individuals currently approved to perform a controlled function and who will be moving from a current PRA CF to an equivalent PRA SIMF [or from a current PRA CF to an FCA Significant Influence Function (SIF)] should be grandfathered into the new regime.

Firms will need to submit a grandfathering notification form to the PRA. A sample is at appendix 5 of the paper. This form should describe how the firm's existing approvals should transition to the new regime. The deadline for such notifications is 8 February 2016. The PRA will require all grandfathered individuals in a SIMF to fulfil the requirements of the SIMR from commencement on 7 March 2016.

A firm may continue to apply for approval under the current approved persons' regime between the date the rules are made and the commencement date of SIMR on 7 March 2016. Where an application is approved before the new regime begins, an individual will need to be grandfathered in.

New applications (in-flight applications) made in the run-up to commencement of the new rules might not be determined until after the commencement date. These will be treated as if they had been made for the equivalent SIMF under the new regime. This will mean that firms will be required to update the application to make clear which SIMF/SIF will be performed. The PRA proposes that the statutory time period for determining applications will continue to run for these in-flight applications and the clock will not restart at the commencement date. However, the clock will stop while the PRA (or FCA) is waiting to receive any additional information requested.

New PRA forms

NDFs with assets of £25 million or less

These firms need to submit either Form A or E as well as a Scope of Responsibilities form to apply for approval for an individual to perform a PRA SIMF (or FCA SIF/CF). These new Forms A and E are based on the current forms for insurers but the PRA proposes some modifications to them. These new forms will be available from 1 January 2016.

In **CP12/15** the PRA proposed that firms be required to submit a document with all SIMF approval applications setting out the intended scope of the candidates' responsibilities. This document is to include any allocation to the individual of those prescribed responsibilities that have to be allocated to a suitable approved person by 7 March 2017. The PRA says it believes this document will be a helpful way of enhancing individual accountability.

NDFs with assets of more than £25 million

These firms will need to submit either Form 5.7 A or E as well as a Scope of Responsibilities form to apply for approval for an individual to perform a PRA SIMF or (FCA SIF/CF). Again these new forms will be available from 1 January 2016.

For individuals grandfathered to a new PRA SIMF (or FCA equivalent) the PRA proposes that firms should submit a Scope of Responsibilities form by 7 September 2016. A specimen is at Appendix 5 of the consultation paper.

Firms will also have to complete a new notification form for all key function holders who take up their posts after 7 March 2016 and who will not be in either a PRA SIMF (or FCA equivalent) so that the PRA can assess the 'fit and proper' status of them. The PRA proposes that firms use the existing "Notification of the appointment of a NED or key function holder" form. This form is at Appendix 5 of **CP7/15**.

Key function holders who are in post on 7 March 2016 and who are neither in nor applying to be in a PRA SIMF (or FCA equivalent) will also be required to complete this new form and to send it to the PRA by 7 September 2016.

The PRA says it will apply a proportionate approach to these fit and proper person assessments. This is meant to take into account the relevant skills or experience of an individual and also the nature, scale or complexity of the business.

Record retention

The systems and controls section (**SYSC 2)** of the PRA Handbook already requires firms to retain records for 6 years (from the date on which it was superseded by a more up-to-date record) of the apportionment of significant responsibilities to those persons performing controlled functions. The PRA proposes that this continues for NDFs.

Moreover, the PRA proposes a similar requirement for record retention showing the allocation of significant responsibilities to senior persons at NDFs. These senior persons would comprise all PRA SIMFs (or FCA equivalents) in a relevant senior management function and key function holders at large NDFs.

How will firms be affected by the proposals and what changes will they have to make to their systems?

For smaller NDFs the Policy Statement contains no real surprises as it follows much of the original Consultation. Small changes have been made in a couple of areas and full compliance is not required until 7 March 2017. Firms therefore have time to think through their governance arrangements and consider their fitness for the new regime adapting and/or changing processes and procedures as appropriate.

For larger NDFs and firms in run-off, this later Consultation Paper sets out what is effectively a transitional regime. The likelihood is that the majority of the firms to which these rules will apply are firms in run-off and therefore many of the requirements will not be new to them.

What advice should firms be giving to their clients?

Moore Stephens offers the following top ten tips to help NDFs prepare for compliance with the new regime:

- Review current governance arrangements for the firm to ensure they are appropriate for the new Prudential Regime for NDFs the subject of consultation in CP27/15,
- Review and update Fitness and Propriety policy for SIMR,
- Determine the appropriate functions required for the business,
- Assign PRA SIMFs and FCA SIFs to individuals,
- Assign any Key Function Holders to individuals,
- Update the following
    - relevant job descriptions or role profiles (job title, regulatory approvals if required),
    - prescribed responsibilities,
    - conduct rules, and
    - reporting lines
- Create a governance map, related governance and review the process,
- Identify current approved persons who can be grandfathered and notify the PRA,
- Identify new key function holders, carry out fit & proper checks (where necessary) and notify the PRA, and
- Consider appropriate training for staff on SIMR and the conduct standards applicable to their role.

Interviewed by David Bowden of David Bowden Law (www.DavidBowdenLaw.com).

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.