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**DETAILED ASSESSMENT OF OBSERVANCE OF
INSURANCE CORE PRINCIPLES ISSUED BY THE
INTERNATIONAL ASSOCIATION OF INSURANCE
SUPERVISORS**

March 18, 2022

Prepared By
**Monetary and Capital
 Markets Department**

This Detailed Assessment Report (DAR) was prepared by IMF staff in the context of an IMF Financial Sector Assessment Program (FSAP) in the United Kingdom. The FSAP was led by Mr. Udaibir Das. The DAR contains technical details and recommendations underpinning the assessment of UK's observance of the ICPs. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

ALM	Asset-Liability Management
AML-CFT	Anti-Money-Laundering/Countering Terrorist Financing
APM	Alternative Performance Measures
BI	Business Interruption
BoE	Bank of England
CDR	Commission Delegated Regulation (EU) 2015/35
CEO	Chief Executive Officer
COBS	Conduct of Business Sourcebook
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
CRO	Contractual Run-Off Regime
DEPP	Decision Procedure and Penalties Manual
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
EU	European Union
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FICOD	Financial Conglomerates Directive (2002/87/EC)
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FRF	Future Regulatory Framework Review
FSAP	Financial Sector Assessment Program
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
HMT	Her Majesty's Treasury
IAIG	Internationally Active Insurance Group
IAIS	International Association of Insurance Supervisors
ICOBS	Insurance Conduct of Business Sourcebook
ICP	Insurance Core Principle
ICS	Insurance Capital Standards
IFRS	International Financial Reporting Standard
ISPV	Insurance Special Purpose Vehicle
IMF	International Monetary Fund

IOSCO	International Organization of Securities Commissions
JMSLG	Joint Money Laundering Steering Group
LIBOR	London Interbank Offering Rate
LTG	Long-Term Guarantee
MA	Matching Adjustment
MCR	Minimum Capital Requirement
ML/TF	Money-Laundering/Terrorist Financing
MMoU	Multilateral Memorandum of Understanding
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
NECC	National Economic Crime Centre
NRA	National Risk Assessment
ORSA	Own Risk and Solvency Assessment
OSP	Outsourced Service Provider
PIF	Proactive Intervention Framework
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
PSM	Periodic Summary Meeting
QIS	Quantitative Impact Study
RMP	Risk Mitigation Programme
SCO	Secondary Objective
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report
SM&CR	Senior Managers and Certification Regime
SMF	Senior Management Function
SONIA	Sterling Overnight Index Average
SPV	Special Purpose Vehicle
SRO	Supervised Run-Off Regime
SS	Supervisory Statement
SYSC	Systems and Controls Sourcebook
TMTF	Transitional on Technical Provisions
TPR	Temporary Permissions Regime
UBD	Unauthorised Business Department

EXECUTIVE SUMMARY¹

1. **The regulatory framework for insurance supervision in the United Kingdom is sophisticated and the authorities are leaders in supervisory techniques.** Observance with the Insurance Core Principles (ICPs) is very high compared to peers with 17 ICPs observed and only 6 out of 24 ICPs determined to be largely observed and 1 partly observed.
2. **The insurance sector in the United Kingdom is highly developed, being the fourth largest insurance market globally, and with a penetration and density in the life sector considerably above those in peer markets.** In terms of balance sheet assets, the size of the insurance sector amounts to 129 percent of U.K. GDP. However, since 2016 growth rates are muted and the number of licensed insurers has significantly declined, revealing trend of consolidation and restructuring.
3. **Solvency ratios of U.K. insurers have been extremely stable since the implementation of Solvency II, well above regulatory thresholds, but consistently lower than those of European peers.** Structural factors partially explain the lower solvency ratios, like e.g. the design of the GBP risk-free term structure which makes more usage of market rather than extrapolated data than the Euro one. In addition, U.K. insurers are significant users of internal models to calculate the required capital. While less than 20 percent of solo entities use either a full or a partial internal model, these insurers represent around 80 percent of the sector in terms of assets. On average, using an internal model results in capital savings of around one quarter. The use of the Matching Adjustment (MA) and the Transitional Measure on Technical Provisions (TMTP)—both integral parts of Solvency II—results in additional capital savings.
4. **A top-down solvency stress test of 14 larger U.K. insurers showed vulnerabilities stemming from lower interest rates and equity price declines, particularly for life insurers.** Increases in bond spreads are partly offset through the MA. A second scenario with rising interest rates would benefit the life sector, while the impact is more mixed for general insurers—especially in combination with higher inflation rates, their earnings would likely decline. With regard to liquidity risks, the FSAP found that life insurers are largely resilient to variation margin calls in their interest rate swap portfolio, but cash buffers at the group level differ markedly across firms. A more comprehensive analysis which incorporates liquidity drains and reduced market liquidity of certain assets, would however require more granular data and a monitoring framework, particularly for annuity writers and insurers with large derivative holdings—this should be considered in forthcoming liquidity plans.
5. **The FSAP occurs at an important and historic time for the insurance sector in the United Kingdom and the regulatory framework for insurers in the United Kingdom.** The industry has just weathered the COVID-19 pandemic with issues still to resolve in terms of Business Interruption (BI) insurance and catastrophe claims. When endorsed for use in the United Kingdom,

¹ This assessment was carried out by Peter Windsor (MCM) and Timo Broszeit (IMF External Expert) from June 2021 to November 2021 entirely through virtual meetings.

IFRS 17 will involve a significant overhaul of insurers' accounting systems, particularly for those who have long-term insurance contracts. This is a resource intensive change to accounting. It is important that supervisors monitor the implementation progress and ensure that those insurers lagging behind do not excessively pull resources from other critical projects and day-to-day risk management and control functions.

6. Brexit has occurred and those U.K. insurers wishing to continue their business in the EU either already had suitable subsidiaries in the EU or needed to establish suitable subsidiaries in the EU. The European Insurance and Occupational Pensions Authority (EIOPA) published recommendations to national authorities supporting recognition or facilitation of continued servicing of contracts existing at the end of the transition period that were not moved to EU-based subsidiaries. The EU have not made any decision on equivalence of the U.K. framework even though it is currently identical to the EU regulatory framework. Following Brexit, the United Kingdom is undertaking its Future Regulatory Framework Review (FRF) which will be important in setting out the objectives and responsibilities of the regulators in a context in which they are not part of the EU regulatory system. There are some clear benefits to proposals in the latest consultation on the FRF Review. Some proposed changes will need to be designed and implemented carefully to ensure that the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) maintain focus on their primary objectives and can retain their operational independence. As part of this reform process, consideration should be given for the legislative framework for insurance supervision be simplified and streamlined, making it easier for firms to navigate.

7. The Solvency II Review is underway at the time of the mission and will enable better tailoring of the Solvency II framework to the unique characteristics of the U.K. market and address shortcomings identified since the introduction of Solvency II at the beginning of 2016. However, given that the United Kingdom has inherited legislation that puts highly technical matters such as the design and calibration of the risk margin and matching adjustment in legislation, the review does not allow sufficient space for the PRA to make policy judgements independently, and publicly. The Solvency II review consultation is Her Majesty's Treasury (HMT) led and ultimate decision making is ministerial. One way forward to address the identified independence issue with the current legislative structure, would be to ensure that requests for advice from the PRA are made transparently by HMT and that the PRA can provide that advice in an independent and transparent way. Any variation in final policy compared to PRA advice would then be clear.

8. Macroprudential supervision of the insurance sector could be enhanced through a more structured and regular consideration of macroprudential risk of the insurance sector. While the Financial Policy Committee (FPC) requests deep dives and analysis of specific activities, the last sectorial deep dive for the insurance sector was undertaken in 2016. Regular reporting should be provided by the PRA Insurance Directorate on broad trends in the insurance sector that may have near-term or long-term consequences for the functioning of the insurance market and other financial sectors. A process, for example, inspired by the IAIS Global Monitoring Exercise (GME) and

implemented in a domestic context might be appropriate and the process could be tied to the qualitative input required for the GME.

9. Reflecting the United Kingdom’s key role in global insurance markets the BoE should undertake a deep dive review on the role and potential systemic relevance of Lloyd’s and the London Market in international markets. Such a review should be done in cooperation with other supervisors and focus on substitutability and market share given London’s preeminent role in insuring specialist risks around the world.

10. Further work is required to complete the crisis management framework for the U.K. insurance sector and the mission supports the United Kingdom’s current proposals to develop a comprehensive insurer resolution regime. The United Kingdom has been able to successfully deal with the need for small and medium-sized firms to exit the market using the range of exit strategies available to market participants under U.K. statute and the tools available to the PRA. The Financial Services Compensation Scheme (FSCS) has been able to protect policyholders for a number of insurers unable to meet their obligations to policyholders. However, there is a less certainty over the United Kingdom’s ability to deal with the failure of a significant insurer or Internationally Active Insurance Group (IAIG), one that the PRA categorizes as a Category 1 insurer². The PRA and HMT have acknowledged the gap created by the lack of a comprehensive insurer resolution regime. Resolution plans are not in place for all IAIGs. Resolution plans that are in place are constrained by the legal entity level of powers available to the PRA and would benefit from more focus on the group rather than UK legal entities. The mission supports the proposal to enhance the PRA’s toolkit for dealing with insurers in financial distress by adapting the write-down power in section 377 of the Financial Markets and Services Act 2000 (FSMA) to make it available before insolvency, to improve the process of this power’s application and extend the FSCS to protect the pre-written-down amounts. Crisis Management Groups should be put in place for all IAIGs. Currently these are in place for two of the three IAIGs and it is expected that the final one will be put in place in the course of 2022.

11. Overall, the PRA’s approach to supervision is sophisticated, structured and well anchored in its statutory objectives but one area of concern is a lack of on-site supervisory activity targeted at business processes within firms and discussions with frontline staff. Deep dive reviews do not always involve discussions with firm staff who do not hold senior positions. The PRA approach is very much anchored in senior management responsibility at regulated firms. Deep dive reviews may only involve extensive desk review of documentation and discussions with senior management. Section 166 reviews by skilled persons are undertaken as an alternative to some PRA-staffed deep dive reviews. The PRA should use the full range of its existing tools and so increase and deepen its on-site inspection activity and consider bringing in-house some of the deep dive reviews outsourced to skilled persons (cost recovery options for PRA resourced on-site inspections under FSMA should be explored). The section 166 review is a useful tool in a number of circumstances but the PRA’s use does not cover the scope covered by other jurisdictions in their own on-site inspections.

² See detailed assessment of ICP 9 for an explanation of the PRA categories

12. Overall, the FCA’s approach to supervision of insurers with an emphasis on portfolio supervision and some dedicated fixed firm supervision appears an appropriate compromise in allocation of resources for a conduct regulator. The FCA should continue to review its approach to fixed and portfolio supervision to ensure effective risk-based approach to supervision in accordance with business needs and industry developments. In doing so, it should consider its recent reduction in fixed firm supervision in preference for more portfolio supervision in the insurance sector. The incremental resource implications of the FCA extending its fixed firm supervision to all PRA Category 1 and 2 firms appears minimal in the overall context of FCA supervision resources. Overall, insurance sector supervision is optimized where PRA and FCA information sharing is amplified for the most significant firms.

ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

13. This assessment of insurance supervision and regulation in the United Kingdom was carried out as part of the 2021 Financial Sector Assessment Program (FSAP).

14. This assessment has been made against the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in November 2019. The assessment includes standards of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) included within the ICPs. Topical issues were also covered including the Solvency II Review, the Future Regulatory Framework Review, supervision of climate risks, Brexit, LIBOR transition and the transition to International Financial Reporting Standard 17 (IFRS 17). This long list of significant impending changes to the U.K. regulatory landscape for insurance demonstrates that this FSAP has occurred at a time of transformation.

15. In 2015, the IMF conducted an FSAP where a focused review of the insurance sector was undertaken rather than a full assessment against the ICPs. A technical note was published which contained a number of recommendations.³ Annex 1 contains a table of those recommendations along with progress made in addressing those recommendations. Progress against those recommendations was taken into account in the assessment against the ICPs.

B. Information and Methodology Used for Assessment

16. The level of observance for each ICP reflects the assessment of its standards. Each ICP is rated in terms of the level of observance as follows:

- a) **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.

³ <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Kingdom-Financial-Sector-Assessment-Program-Insurance-Sector-Technical-Note-43969>

- b) **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
- c) **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
- d) **Not observed:** where no substantive progress toward observance has been achieved.

17. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in June to November 2021. While this assessment does not reflect new and on-going regulatory initiatives, key proposals for reforms are summarized by way of additional comments in this report. The authorities provided a full and comprehensive self-assessment, supported by examples of actual supervisory practices and assessments, which enhanced the robustness of the ICP assessment.

18. The assessment necessarily focuses on the supervision and regulation of the largest insurers as these are of most concern from a financial stability perspective. As such the assessment of prudential supervision focused on the implementation of Solvency II. The supervision of insurers not subject to Solvency II has not been assessed. Firms not subject to Solvency II are known as 'non-directive' firms and while they account for 25 percent of authorized insurers, they account for a very small share of the U.K. market.⁴

19. In line with paragraph 50 of the Introduction and Assessment Methodology of the IAIS ICPs, the IMF and U.K. authorities agreed that ComFrame standards would be included in the assessment. The United Kingdom is the group-wide supervisor for IAIGs and therefore the ComFrame standards applicable to group-wide supervisors have been assessed as part of the assessment of each ICP that contains ComFrame standards.

20. The assessors are grateful to the authorities and private sector participants for their cooperation. The assessors benefitted greatly from the valuable inputs and insightful views from meetings with staff of the Bank of England (BoE), FCA, HMT, insurance companies and industry and professional organizations.

C. Overview—Institutional and Macroprudential Setting

21. Insurers are dual-regulated firms, meaning that they are regulated by the PRA and the FCA. The PRA and the FCA have responsibility for the supervision of a wide range of firms, the PRA for prudential matters and the FCA for conduct matters. The PRA regulates 138 life insurers and 245 general insurers. The FCA is the conduct regulator for about 51,000 firms and prudentially supervises about 49,000 of these firms which are solo-regulated firms.⁵ In the United Kingdom the Parliament establishes the legislative parameters within which HMT sets the regulatory perimeter through

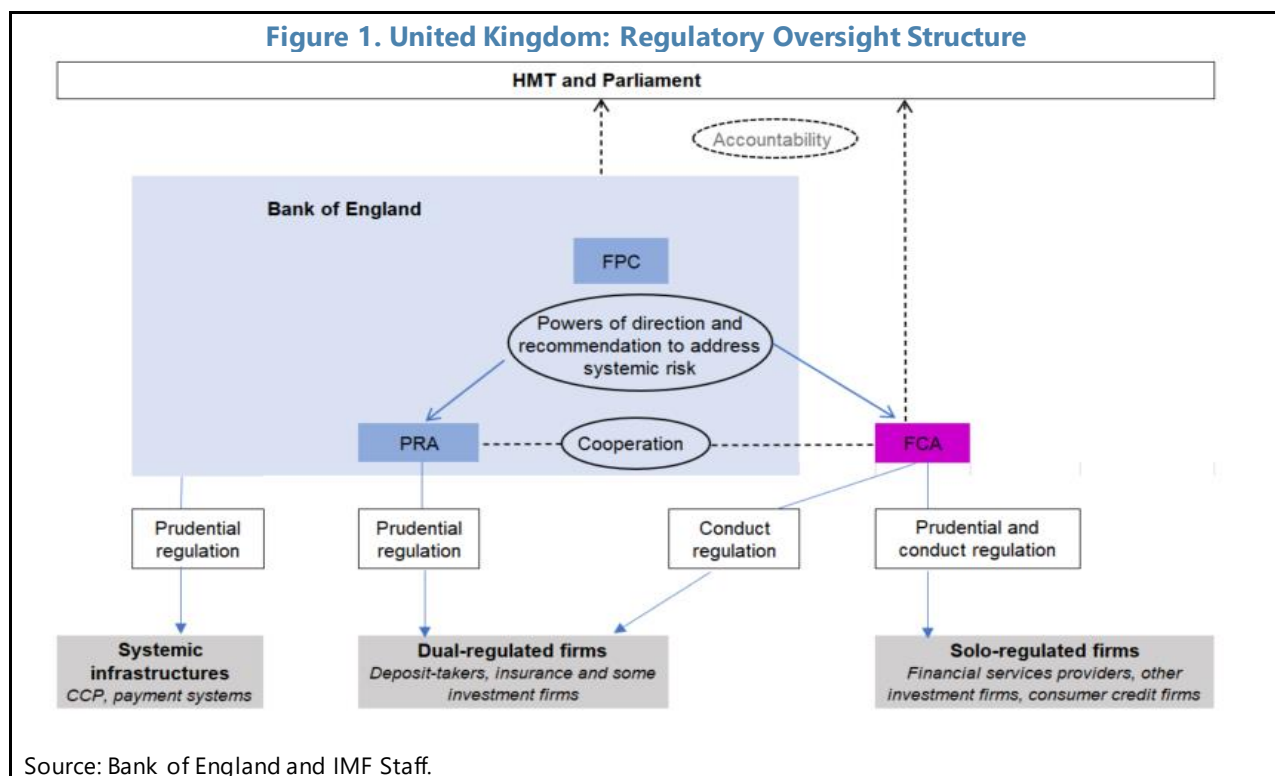
⁴ Only two non-directive insurers have substantial assets (combined £11 billion) and they are non-directive insurers for technical reasons. Other non-directive insurers represent £20 million of premium compared to an industry total of £270 billion and assets of approximately £200 million compared to an industry total of £2,564 billion. Note figures regarding non-directive insurers (other than the 2 with substantial assets) are highly approximate as they have no annual reporting obligation.

⁵ The FCA regulates the conduct of the U.K.'s financial services. The FCA is also the prudential regulator for all firms that are not dual-regulated firms (i.e., authorized by the PRA and regulated by both the PRA and the FCA).

secondary legislation, specifying which financial activities should be regulated. The regulatory oversight structure is illustrated in Figure 1.

22. Insurance distribution activities are subject to FCA regulation and most entities carrying out these activities are solo regulated firms subject only to FCA supervision. The FCA is therefore also the prudential regulator for insurance intermediaries.

23. The two authorities have separate and independent mandates, set out in statute, reflecting the United Kingdom’s ‘Twin Peaks’ model. Under FSMA, the PRA’s general objective is to promote the safety and soundness of PRA-regulated firms. The PRA’s insurance objective is ‘contributing to the securing of an appropriate degree of protection for those who are or may become policyholders’. The PRA has a secondary objective (SCO) to facilitate, insofar as reasonably possible, effective competition in the markets for services provided by PRA-regulated firms in carrying on regulated activities. The PRA’s SCO became effective in March 2014. The SCO only applies to the PRA’s exercise of general functions which are: making rules under FSMA and technical standards under retained EU law, preparing and issuing codes under FSMA, determining general policy and principles by reference to which the PRA performs functions under FSMA. The SCO does not require the PRA to act in a manner that is incompatible with its primary objectives. The FCA must act in a way that is compatible with its strategic objective and advances one or more of its operational objectives. The strategic objective is to ensure relevant markets function well and insurance is one of those markets. The FCA’s operational objectives are to protect consumers, enhance market integrity and promote effective competition in the interests of consumers. The mandates and coordination arrangements between U.K. financial regulators are discussed further below in relation to ICPs 1 and 2.



24. This assessment occurs at a time when the objectives, powers, and responsibilities of the PRA and FCA are subject to possible change due to the U.K. Government’s consultation on the Future Regulatory Framework Review (FRF). The assessment does not formally take into account these proposals as the assessment is based on current laws and policies. However, the mission does make recommendations for the U.K. Government to bear in mind as it finalizes the FRF Review.

25. Other significant changes are occurring in the U.K. insurance sector as well as to the way in which the U.K. insurance sector is regulated. Currently, the Solvency II Review is underway and this is expanded upon in Box 1 below. The industry has also had to weather the impact of the COVID-19 pandemic, transition from LIBOR and modified business models and regulatory environment for international business due to Brexit. Equally, EEA insurers operating in the United Kingdom face a transition to a new domestic regulatory approach in the United Kingdom.

26. The PRA undertook a strategic review over 1 year and the report was finalized during the FSAP mission. Implementation of the report comprises the PRA’s 2026 strategy with implementation of refinements to the supervisory approach through to 2022 and organizational transformation through to 2026. As such, any changes because of the strategic review are not in the scope of this assessment.

27. The FCA is undergoing a significant strategic move towards becoming an increasingly data driven regulator. It is working on a transition to cloud technology, and this will enable increased automation and data analysis. However, as that is a process currently underway, the mission understands this will impact on the FCA’s resources and future approach to regulation. However, the mission was only able to consider systems and processes currently in place in the assessment of the ICPs.

28. A significant emerging issue in insurance supervision around the world is how to incorporate climate risk into supervision in order to ensure insurers are appropriately taking climate risk into account in their risk management practices. U.K. Authorities have been thought leaders with respect to this emerging issue of concern for global regulatory authorities and Box 2 details the developments that have occurred in the United Kingdom since 2015.

Box 1. Solvency II Review

The U.K. Government is currently reviewing the Solvency II framework, coinciding with a review being conducted in the EU. The review in the United Kingdom is underpinned by three objectives:

- to spur a vibrant, innovative, and internationally competitive insurance sector
- to protect policyholders and ensure the safety and soundness of firms
- to support insurers to provide long-term capital to support growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the U.K. Government's climate change objectives.

A first call for evidence was launched by HMT in October 2020 with ten major areas for review, including the risk margin, the matching adjustment, and the calculation of the SCR.¹

Respondents were strongly supportive of the Solvency II regime.² Respondents considered that Solvency II had improved standards of risk management and reporting in the insurance sector as well as the overall standard of prudential regulation. No respondents argued that Solvency II should be replaced by a different regime.

Based on the responses, the U.K. Government:

- sees evidence that many aspects of Solvency II are overly rigid and rules-based, and it
- wants to see a prudential regulatory regime that is more proportionate and flexible so that it works more effectively, and outcomes can be delivered more efficiently.
- believes such a regime would include a better mix of judgement and rules so that it can be better applied by the PRA, as well as by insurers.
- sees consensus in the responses that the risk margin is currently too high and too volatile in the current low interest rate environment.
- believes a reduction in the size and sensitivity of the risk margin to interest rates would diminish the incentive to reinsure longevity risk outside the United Kingdom.
- agrees with the responses that there is a strong case to reform the risk margin which could free up resource on, and reduce the volatility of, insurers' balance sheets.
- agrees that reform would contribute to a dynamic, prosperous, and internationally competitive insurance sector.
- thinks that the application process for the matching adjustment needs to be proportionate to the benefits and risks for insurers so that they can move flexibly and quickly to invest in eligible assets.

¹ Other areas include: calculation of the consolidated group SCR using multiple internal models; calculation of the TMTP; reporting requirements; branch capital requirements for foreign insurers; thresholds for regulation by the PRA under Solvency II; mobilization of new insurers; transition from LIBOR to Overnight Indexed swap rates.

²https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/998396/Solvency_II_Call_for_Evidence_Response.pdf

Box 1. Solvency II Review (concluded)

- thinks, equally to the point above, that potential amendments to the matching adjustment need to be informed by the credit and other long-term risks insurers are exposed to, including through growing concentrations in illiquid, internally rated assets.
- agrees that the requirements in Solvency II do not place disproportionate burdens on insurers, either in relation to the calculation of the SCR or model application processes.

The objectives for the Solvency II review align closely with the remit letter issued to the PRC on March 23, 2021. The remit letters issued by HMT pursuant to Section 30B of the Bank of England Act 1998 do not cause concern on their own as these are recommendations to which the PRC should have regard when considering how to advance the objectives of the PRA and the application of regulatory principles under FSMA. In this way, HMT's recommendations must be considered in the context of the primacy of the PRA's single general objective, its insurance objective, and its SCO. However, in the case of the Solvency II review, some aspects of the remit letter are elevated to objectives that the Solvency II review must meet. If the PRA was able to exercise its rule making powers under FSMA to make prudential policy for the insurance sector, including the technical aspects of Solvency II, these objectives would not have such primacy in decision making. The structure of the legislation, combined with the U.K. Government's approach to the Solvency II review appear to constrain the independence of the PRA in its rule making power, transferring ultimate decision making to the ministerial level with objectives that do not align with the primacy of the PRA's general objectives.

The PRA and HMT are working closely on the Solvency II review. HMT draws on the PRA for technical and supervisory expertise. This can be seen in the PRA conducting a Quantitative Impact Study (QIS) between July and October 2021 to support the Solvency II review. However, it is important to note that the scenarios specified in the QIS do not in themselves represent reform proposals. The data collection focused mainly on areas where different options would show an impact on insurers' balance sheets, particularly (i) the calculation of the matching adjustment; (ii) the risk margin; and (iii) the Transitional Measure on Technical Provisions (TMTP). Participation in the QIS was on a voluntary basis. The QIS also contained qualitative questions to gather information to support the development of some areas of Solvency II reform that are less straightforward to assess quantitatively.

During the FSAP mission, it became clear through industry discussions and through reviewing news reports that the life insurance industry was critical of the PRA's approach based on the calibration of the options for the matching adjustment. They used HMT's objectives as a frame of reference to criticize the PRA's approach which they took to be indicative of the policy options being considered by the PRA, despite the specific statements by the PRA that this was not the case

Sources: HMT and PRA.

Box 2. Supervision and Regulation of Climate Risk

Since Governor Mark Carney's landmark speech at Lloyd's of London in September 2015, U.K. financial regulators have been at the forefront of developments in introducing consideration of climate risk in supervision of insurers and banks. The speech coincided with the release of a report "The impact of climate change on the U.K. insurance sector: A Climate Change Adaptation Report by the Prudential Regulation Authority". This report set out the well-known analytical framework for considering climate change risk, defining physical risk, transition risks and liability risks. The PRA has continued to work domestically and with international counterparts to advance the agenda on incorporating climate risks into supervision and promoting identification and management of climate risks in the supervised financial sector.

The next landmark in incorporating climate risks into prudential supervision occurred with the publication of Supervisory Statement 3/19: Enhancing banks and insurers' approaches to managing the financial risks from climate change. In this supervisory statement, the PRA set out its expectations regarding the strategic approach expected of banks and insurers in managing climate risk.

This Scenario analysis was then incorporated as part of the PRA's 2019 Insurance Stress Test. On July 1, 2020, the PRA followed up with a 'Dear CEO' letter, providing industry-wide feedback regarding the PRA's review of firms' SS3/19 plans and to further clarify expectations which included an expectation that firms would fully embed their approaches to managing climate-related financial risks by the end of 2021.

The FCA and PRA established the Climate Financial Risk Forum (CFRF) in March 2019 to build capacity and share best practice across industry and financial regulators to advance the sector's responses to the financial risks from climate change. The CFRF has membership of senior representatives from banks, insurers and asset managers and has observers from trade bodies. The CFRF established four technical working groups on disclosure, scenario analysis, risk management and innovation. The CFRF published a guide on June 29, 2020, that included a summary produced by the PRA and FCA along with four industry-produced chapters covering risk management, scenario analysis, disclosures, and innovation.

Subsequently, on October 21, 2021, the CFRF published its second round of guides adding detail to the previously released guides. Insurers are on a journey of moving from incorporating climate risk considerations in their risk management and governance processes at a rather basic level towards more sophisticated approaches and techniques and tools available are evolving with firms also facing significant challenges in terms of data availability.

The BoE has launched a comprehensive climate risk stress test in June 2021, underlining its pioneering role in analyzing the impact of climate change on the financial sector. The Climate Biennial Exploratory Study (CBES) aims to explore the impact of three different climate scenarios on the balance sheet of banks and insurers. In particular, the exercise assesses the risks arising from structural changes economies around the world are undergoing to achieve net zero emissions—transition risks—and risks associated with higher global temperatures—physical risks. The scenarios of early, late and no action built on a subset of the Network for Greening the Financial System (NGFS) scenarios and have a time horizon of thirty years, reflecting the longer-term nature of those risks.

The CBES is an exploratory exercise. Hence the focus is not on pass/fail, but on understanding business model challenges and contributing to improvements in risk management in the financial sector—a closer engagement of banks and insurers with their largest counterparties on their respective vulnerabilities to climate change is facilitated by this exercise. In December 2021, the FCA confirmed new rules for disclosures aligned with the Task Force on Climate-Related Financial Disclosures (TCFD) which applies to life insurers, assets managers, and FCA-regulated pension providers. This announcement followed a consultation in June 2021.

Box 2. Supervision and Regulation of Climate Risk (concluded)

The rules for life insurers—in respect of assets managed or administered on behalf of clients and consumers in their capacity as asset owners—came into effect for the largest firms on January 1, 2022, and 1-year later for smaller firms (with over £5 billion in assets under management or administration). The disclosures include:

- Entity-level disclosures which require an annual TCFD entity report to be made available in a prominent place on the firm’s website and
- Product-level disclosures which require including a core set of climate-related metrics for the firm’s portfolio and products.

Sources: PRA and FCA.

Industry Structure and Recent Trends

29. The insurance sector in the U.K. is highly developed, particularly in the life sector where penetration and density are considerably above those in peer markets (Table 1).

Globally, the United Kingdom represents the fourth largest insurance market. Gross written premiums amounted to GBP 271bn in 2020. The United Kingdom’s life insurance penetration rate (premiums to GDP) of 8.8 percent ranges considerably above the average for advanced markets (4.2 percent) and the European Union (3.6 percent). Life insurance density (premiums per capita) reached US\$3,574 in 2020. In the general insurance sector, however, both penetration (2.3 percent) and density (US\$949) are below the respective averages for advanced markets and the EU—this might partially be explained by a highly competitive retail general insurance market, lowering costs for policyholders. In terms of balance sheet assets, the size of the insurance sector also exceeds those of most peers in the EU, amounting to 129 percent of the GDP at end-2020, up from 111 percent at end-2016, and comparing against 72 percent for the EU-27 (Figure 2a).

30. The number of licensed insurers has significantly declined since 2016, indicating both a consolidation trend and the status quo of Brexit relocations (Figures 2b and 2c).

At the end of 2016, a total of 465 insurers was authorized in the United Kingdom. This number has declined to 370 insurers by end-2020, of which 126 were life insurers and 221 general insurers. Market consolidation prevails in the life sector, driven inter alia by the low interest rate environment which weighs on profits. Solvency II has also allowed and prompted consolidation of insurance activities, often within the same group. Insurers leaving the market clearly outnumbered new market entries particularly in the general insurance sector where international groups re-organized their operations in Europe. Still, 21 insurers were newly licensed from 2016 to 2020, mostly in the general insurance sector as well as insurance special purpose vehicles. The number of firms, however, is expected to rise again as EU insurers complete the restructuring of their U.K. business, approximately 140 EU insurers which previously undertook business in the United Kingdom through passporting arrangements are expected to apply for U.K. authorization to be able to continue undertaking U.K. business before the cut-off date of December 31, 2022. The PRA and FCA are currently processing these applications.

Table 1. United Kingdom: Insurance Penetration and Density

Life insurance penetration (premiums to GDP) is more than twice the average for advanced markets, but less than half in the general insurance sector.

		Insurance Penetration (2020, in percent of GDP)	Insurance Density (2020, US\$ per capita)
Life	United Kingdom	8.8	3,574
	EU	3.6	1,213
	Advanced markets	4.2	1,994
General	United Kingdom	2.3	949
	EU	3.3	1,122
	Advanced markets	5.7	2,700

Source: Swiss Re Sigma.

31. The concentration in the life insurance sector is moderately high but is very significant in the general insurance sector (Figure 2d). The three largest life insurers account for a market share of 39 percent in terms of assets and the largest ten groups for 75 percent. Concentration in the non-life sector is considerably higher reflecting the significant amounts of international business written in the UK—63 and 81 percent of the market share is held by the three and ten largest companies, respectively. However, the structure of the Society of Lloyds, as explained below, means that is made up of multiple self-directed entities rather than as a single entity.

32. Unit-linked policies are by a wide margin the most important life insurance product, shifting market risks to policyholders (Table 2). Gross written premiums in the life sector amounted to GBP 209bn in 2020, of which 124 bn related to unit-linked products. These policies resemble fund-like savings products, are more capital efficient for insurers, and can offer better returns to policyholders when interest rates are low, while also the downside risks are to a large extent borne by policyholders. Life reinsurance business is another important line with almost GBP 32bn gross written premiums in 2020. With-profit life business generated only GBP 6bn premiums. The most important non-life lines of business comprise property, general liability, and motor insurance with 31, 21 and 19 percent of gross premiums, respectively. In total, the non-life sector generated GBP 62 bn gross written premiums in 2020. Only around 85 percent in life business is retained by the primary insurers, indicating a relatively large share of life risks being transferred. Retention rates in non-life business are typically lower than in life, and amount to around 69 percent in the United Kingdom—particularly the extreme risks of natural disasters are reinsured with foreign insurers.

33. The Society of Lloyd’s (Lloyd’s) dominates the overall non-life insurance sector with its assets representing almost 50 percent of the sector’s assets. The Lloyd’s business is predominantly an international business with only 12 percent of its gross written premiums derived from the U.K. market in 2020.⁶ This makes the role of the U.K. regulators in supervising Lloyd’s one

⁶ Society of Lloyd’s 2020 Solvency and Financial Condition Report

that is not just to promote domestic financial stability and protect policyholders, but it also involves an international role. These comments could equally apply to many London Market insurers as well. Box 3 sets out how Solvency II applies to the unique structure of Lloyd’s.

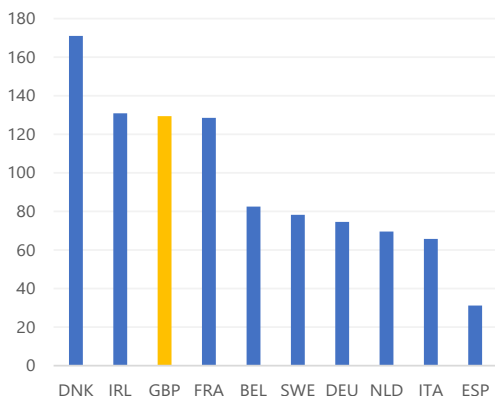
Figure 2. United Kingdom: Size and Structure of the Insurance Sector

Insurers’ balance sheet assets amount to 129 percent of GDP, well above the respective numbers in other larger European markets.

The number of both life and general insurers has significantly declined since 2016, reflecting market consolidation and Brexit relocations.

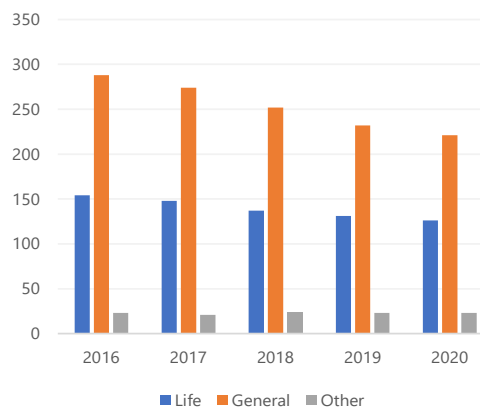
Insurance Sector Assets

(end-2020, in percent of GDP)



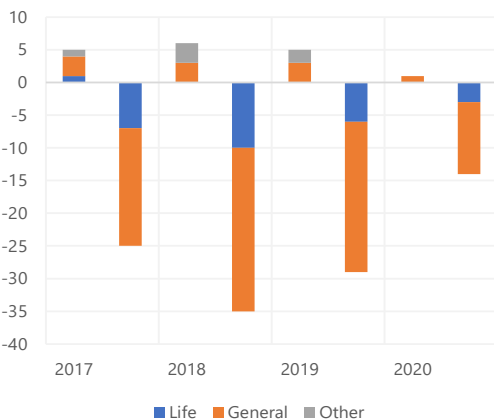
Exits from the market have largely outnumbered new entries since 2016, reflecting both market consolidation and relocations after Brexit.

Number of Insurance Undertakings



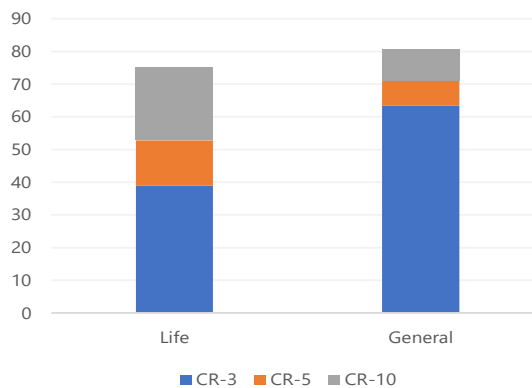
Concentration in the general insurance sector is very high, with the three largest insurers accounting for almost two thirds of the market.

Number of Entries and Exits



Insurance Sector Concentration

(2020, market shares in percent of assets)



Sources: IMF staff calculations based on PRA and EIOPA.

Table 2. United Kingdom: Premium Income

Unit-linked insurance as well as reinsurance are the two dominant business lines in life insurance, while with-profit business records only marginal premiums. In general insurance, fire and other damage to property accounts for 31 percent of all gross premiums.

<i>Premiums - Life business</i> <i>2020, in GBP million</i>	Gross written premiums	Net written premiums
Index-linked and unit-linked insurance	124,025	111,235
Life reinsurance	31,990	31,712
Insurance with profit participation	6,113	6,099
Health insurance	1,913	1,075
Health reinsurance	396	396
Other life insurance	44,670	27,887
Total	209,107	178,404

<i>Premiums - General business</i> <i>2020, in GBP million</i>	Gross written premiums - direct business	Gross written premiums - proportional reinsurance accepted	Gross written premiums - non- proportional reinsurance accepted	Net written premiums
Fire and other damage to property	19,188	6,054	--	16,758
General liability	13,197	2,352	--	10,574
Motor (liability and other)	11,953	2,420	--	10,539
Medical expense	5,131	1,055	--	5,631
Marine, Aviation and Transport	6,148	2,022	--	4,817
Other direct insurance	6,615	940	--	5,613
Non-proportional reinsurance	--	--	9,664	5,967
Total	62,232	14,842	9,664	59,900

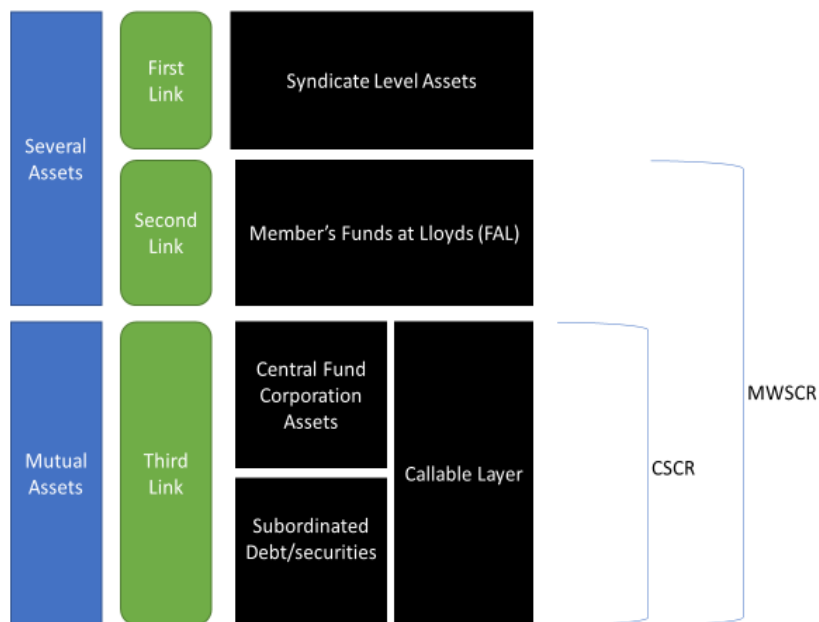
Sources: IMF staff calculations based on PRA.

Box 3. Society of Lloyd's – Overview and Solvency Requirements

The Society of Lloyd's is not an insurance company or a group, it is a statutory corporation incorporated by the Lloyd's Act 1871. The Council of Lloyd's manages and regulates the affairs of the Society. The expression "Lloyd's" is also used to describe the market of Lloyd's Members who undertake insurance business. Members act through insurance syndicates to underwrite insurance and reinsurance cover for policyholders. Syndicates are made up of Members who can be individuals, partnerships, or corporate entities. Syndicates are managed by Managing Agents. Members put up the underwriting capital against their share of insurance or reinsurance risk accepted by the Syndicate and a Member is only liable for their share of the profit or loss of those insurance and reinsurance risks. Syndicates have no separate legal personality from the Members collectively. Members join a Syndicate only for an underwriting year accepting risks incepting in that calendar year. Continued participation in a Syndicate means that a Member must join the subsequent calendar year of that Syndicate. A Syndicate calendar year remains open for three years and at the end of the third year is closed through a Reinsurance to Close (RITC) transaction usually into a subsequent Syndicate year.

The Corporation of Lloyd's oversees the Lloyd's market and provides the market's infrastructure, including services to supporting its operations. The Corporation of Lloyd's sets required standards and expectations against which market participants are regularly assessed. It also approves business plans and capital requirements for each of the Syndicates. Lloyd's risk appetite framework expresses the aggregate level of risk that Lloyd's is prepared to accept to achieve its strategic objectives and the Society of Lloyd's monitors the Market's risk profile against this framework. This market oversight applies to Managing Agents' management of Syndicates and covers underwriting, governance, risk and operations, reinsurance, risk aggregation, reserve adequacy, investment, capital adequacy, model approval, conduct issues and compliance with other regulatory requirements such as monitoring for financial crime. The PRA and FCA engages with Lloyd's on both its approach to and the effectiveness of its market oversight. The PRA and FCA also engages with Lloyd's on oversight of individual Managing Agents. Lloyd's and Managing Agents (as the most important controllers of prudential risk in the market) are authorized entities and as such are regulated by the PRA and FCA. The PRA and FCA regulates Lloyd's and Managing Agents to the same standards as other regulated entities. Given the Society of Lloyd's operates a market, the capital structure is designed to fit that structure and is referred to as the 'chain of security'. The First Link is Syndicate-level assets, and the Second Link is Member's Funds at Lloyd's (FAL) which are referred to as 'Several Assets'. These assets are held in trust for the benefit of policyholders and are used to cover policies written by a particular Member or assumed by the Member through the RITC process. The Third Link is the Mutual Assets which have three components: The Central Fund and Society of Lloyd's Assets, Subordinated Debt and Securities and a Callable Layer. This structure is depicted below.

Box 3. Society of Lloyd’s – Overview and Solvency Requirements (continued)



Syndicate Level Assets are primarily premiums held in trust through a premium trust fund (PTF) which includes all premiums received minus claims and expenses paid. Reserves for future liabilities are subject to independent audit and actuarial review. Where there are insufficient assets to meet liabilities, the Managing Agent makes a cash call on members and a Member’s FAL can be used.

Member’s FAL must be sufficient to support their underwriting at Lloyd’s. The level of FAL required to be held is based on syndicate capital requirement calculations which are allocated to Members based on their share of the Syndicate. The syndicate capital calculations are based on ultimate view of risk rather than the regulatory view of a 1-year time horizon. An uplift, typically 35 percent on this base capital calculation is added to ensure sufficient capital. The FAL is held in trust by the Society of Lloyd’s and is only available to meet the liabilities of that Member. A Member’s FAL is required to be replenished annually in June to meet their underwriting liabilities, a process called ‘coming into line’ but there is flexibility to request recapitalization before the next coming into line date, if necessary.

Requirements of Members to maintain sufficient FAL are requirements of Lloyd’s and are not a regulatory requirement of Solvency II.

The Central Fund is a fund of last resource to safeguard policyholders should a member fail to meet insurance liabilities in full. Access to the Central Fund is at the discretion of the Council of Lloyd’s. Members must contribute annually to the fund and special contributions can be required from time to time. Central Fund assets may be supplemented by a callable layer, up to 3 percent of a member’s overall premium limits in any year.

Box 3. Society of Lloyd's – Overview and Solvency Requirements (continued)

Solvency II requirements apply to both Lloyd's and to Managing Agents. There are specific requirements applicable to Lloyd's also set out in PRA Rulebook, SII Firms, Lloyd's and further elaboration is made in Supervisory Statement SS12/15. Essentially Lloyd's is required to manage each Member's FAL, central assets and central liabilities, conduct supervision of member's insurance business in order to achieve the same effect of conforming with the requirements of any rule when applied to a Solvency II insurer.¹ Managing Agents are required to manage syndicates for each syndicate year to achieve the same effect of conforming with the requirements of any rule when applied to a U.K. Solvency II firm.²

Lloyds has two solvency capital requirements,³ the Market Wide Solvency Capital Requirement (MWSCR) which reflects both the aggregate member losses and the Central Fund losses as well as the Central Solvency Capital Requirement (CSCR) which reflects the Central Fund losses only. Lloyd's must ensure eligible own funds held at Lloyd's meet the MWSCR and this broadly maps to the Second Link and Third Link in the Lloyd's Chain of Security. Centrally, Lloyd's must meet the CSCR, and this broadly maps to the Third Link in the Lloyd's Chain of Security. The PRA requires Lloyd's to meet the CSCR and MWSCR but does not directly regulate Members FAL requirements. However, the way in which these are calculated and overseen by Lloyd's has a direct impact on its own CSCR and MWSCR. The PRA's regulatory focus is on Lloyd's overall but as part of its supervision it will consider the internal Lloyd's process to set Member FAL.

Managing agents must calculate notional SCRs (uSCRs) for each syndicate it manages which is allocated to members to inform members' capital requirements.^{4,5} Lloyd's requires the uSCR is calculated at the 99.5th confidence level on an ultimate basis using an internal model created by the Managing Agent. This process is overseen by the Corporation of Lloyd's. Managing agents sometimes apply capital loadings where models may lead to insufficient uSCRs, and Lloyd's may impose a capital load as part of its supervision process. The PRA oversees the Lloyd's supervision of Managing Agent's calculation of uSCRs. The PRA conducts significant reviews of the syndicate capital process.

A member's capital requirement is determined by Lloyd's based on the sum of their shares in syndicate uSCRs with some diversification allowance where a member participates in multiple syndicates. However, these are not regulatory requirements but are imposed by Lloyd's on Members to ensure adequate funding of liabilities attributable to the Members and contribute to the overall funding of Lloyd's.

¹ PRA Rulebook, SII Firms, Insurance General Application, Section 3.1

² PRA Rulebook, SII Firms, Insurance General Application, Section 3.2

³ PRA Rulebook, SII Firms, Solvency Capital Requirement – General Provisions, Section 7

⁴ PRA Rulebook, SII Firms, Solvency Capital Requirement – General Provisions, Section 8.2

⁵ PRA Rulebook, SII Firms, Solvency Capital Requirement – General Provisions, Section 8.4

Box 3. Society of Lloyd's – Overview and Solvency Requirements (concluded)

The MCWSCR and CSCR is calculated using the Lloyd's Internal Model (LIM) which is subject to the usual supervision by the PRA as described in relation to ICP 17. The LIM simulates losses by class of business, allocates these to syndicate, adds other syndicate risks (market risk, credit risk, operational risk, and additional central fund risk). If simulated syndicate losses exceed PTF, the excess loss is allocated to Members and if Member losses exceed their FAL then that is assumed to be a loss to the central fund. Additional central risks are added (operational, market risk on central assets and pension risk). The MWSCR is the 99.5th percentile member and central losses. The CSCR is the 99.5th percentile of central fund losses. MWSCR and CSCR are subject to Solvency II and PRA reporting requirements (MWSCR quarterly, CSCR is an NST which is currently annual).

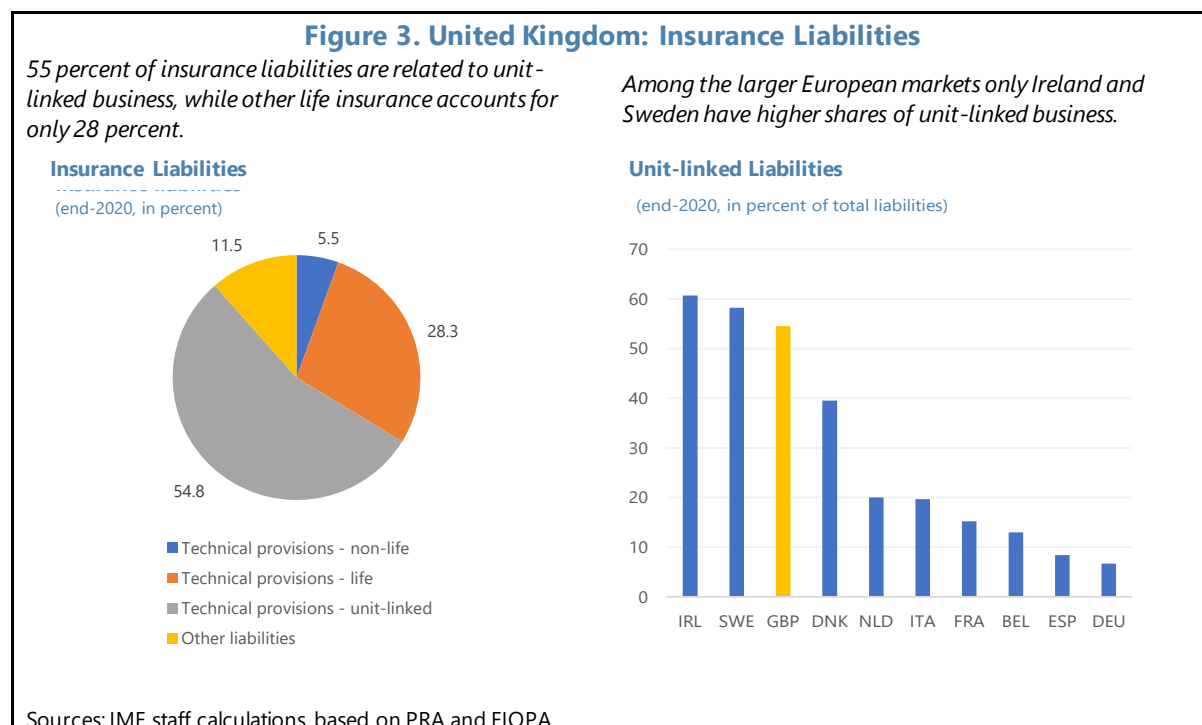
Syndicate PTF and Member FAL are inputs to derive the funds available for a syndicate in the LIM before the LIM simulates losses to the Central Fund. It is important that uSCRs for syndicates are sufficient (therefore ensuring sufficient FAL) as lower levels of FAL would result in a larger CSCR for Lloyd's to meet.

Contingent capital has been a significant source of capital for Lloyd's but is decreasing in importance. Solvency II allows insurers to cover up to 50 percent of their SCR with Tier 2 capital including Ancillary Own Funds (AOF) such as Letters of Credit (LoC). AOF cannot be used to cover the MCR. Use of AOF requires PRA approval. LoCs are used by Members as part of meeting their FAL requirements. Lloyds has introduced an internal requirement that Members cannot have more than 50 percent of their FAL requirements met by LoCs. At year-end 2015, AOF was 40 percent of Available Own Funds, and this has been reduced to 22 percent by year-end 2020. LoCs are standard form instruments which require clean, irrevocable, and unconditional payment if Lloyd's draws down on the LoC and Lloyd's can do this without recourse to the Member. LoCs must have an expiration date of not less than four years. The instruments cannot be amended or canceled without Lloyd's agreement and Lloyd's is obliged to consult with the PRA and FCA if there are any changes to the terms of these instruments. Lloyd's requires counterparties to the LoCs to have at least an A-/A3 rating across all the three major rating agencies; if the counterparty rating falls below that level then the LoC will no longer qualify as FAL. Lloyds has a history of successful draw downs on LoCs including during the 2008 financial crisis.

In 2018, Lloyd's established Lloyd's Insurance Company (LIC) in Belgium for the purposes of maintaining its business in the EU after Brexit. In December 2020, Lloyd's transferred the Members' non-life EU business written since 1993 to LIC by way of a Part VII Transfer. LIC is prudentially supervised by the National Bank of Belgium. As this assessment relates to business transacted in the United Kingdom, the way in which Lloyd's transitioned its business to the LIC platform will not be explored in detail here.

Source: PRA.

34. The structure of insurance sector liabilities illustrates the dominance of unit-linked life insurance products (Figure 3). For the whole insurance sector, technical provisions account for 89 percent of total liabilities. These technical provisions split further into traditional (including with profit) life insurance provisions (28 percent of total liabilities) and unit-linked provisions (55 percent). From 2016 to 2020, unit-linked liabilities increased by 17 percent, and therefore in line with the insurance sector's total liabilities (+16 percent). Non-life technical provisions with their shorter duration account for only 5 percent of total liabilities.



35. The asset allocation of U.K. insurers is characterized by relatively large holdings in government and corporate bonds (Figure 4). With a share of 55 percent, bonds are the dominant asset class when analyzing only the investments which do not back unit-linked liabilities—the share is higher in the general insurance sector (64 percent) than in the life sector (53 percent). Less than 2 percent of bond holdings carry a speculative grade rating, however there is also a large share of unrated fixed-income investments—this includes inter alia equity release mortgages. Generally, over the last years, a trend towards more non-traditional investments can be observed, such as mortgages and loans. Life insurers have also expanded their holdings in equity and participations (+18 percent from 2016 to 2020) and corporate bonds (+19 percent), while general insurers decreased their exposures in both these categories (-22 and -16 percent, respectively).

36. Investments are geographically diverse with only U.K. government bonds being a dominant domestic asset class. Domestic investments in total account for about 56 percent of all investments. Of these, around a quarter are government bonds, which are highly sought after particularly by life insurers who appreciate the long maturities to match their liabilities, as well as the liquid market. The largest single foreign jurisdiction to which U.K. insurers are exposed is the United States (17 percent of total investments), followed by Ireland and Luxembourg with 6 and 15 percent, respectively—these investments comprise mostly mutual funds. Such large investments outside the United Kingdom are also used to match liability exposures in foreign currency—non-life firms and reinsurers have significant USD and EUR liabilities, while the business of life insurers is more concentrated in the home market and hence in GBP.

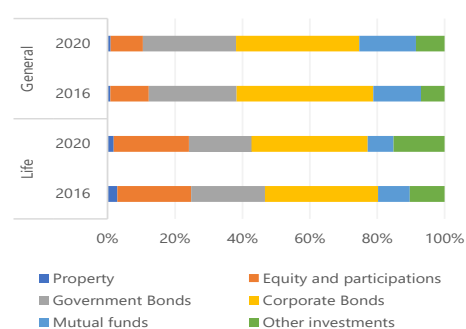
Figure 4. United Kingdom: Insurance Asset Allocation

Since 2016, life insurers have expanded into other investments (alternatives, equity release mortgages), while general insurers went more into equity and funds.

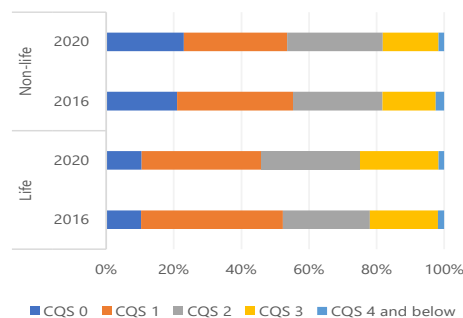
In the life sector, a marginal search for yield can be seen between 2016 and 2020, but speculative grade assets remain very small.

Asset Allocation

(in percent, excl. unit-linked assets)

**Assets: Rating Distribution**

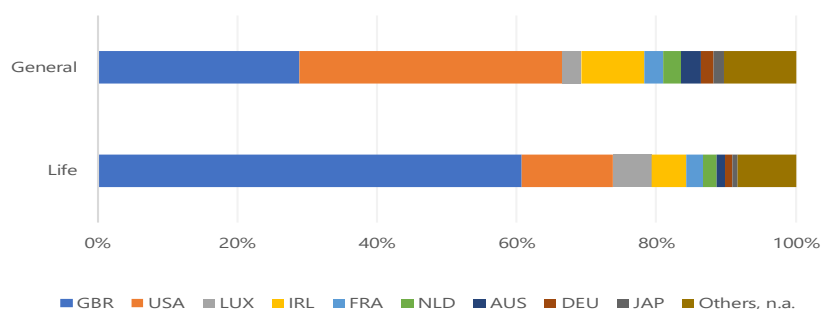
(in percent, excl. unit-linked assets)



Life insurers invest almost 60 percent domestically, while general insurers diversify more, in line with their more global insurance exposures.

Assets: Geographical Distribution

(end-2020, in percent, excl. unit-linked assets)



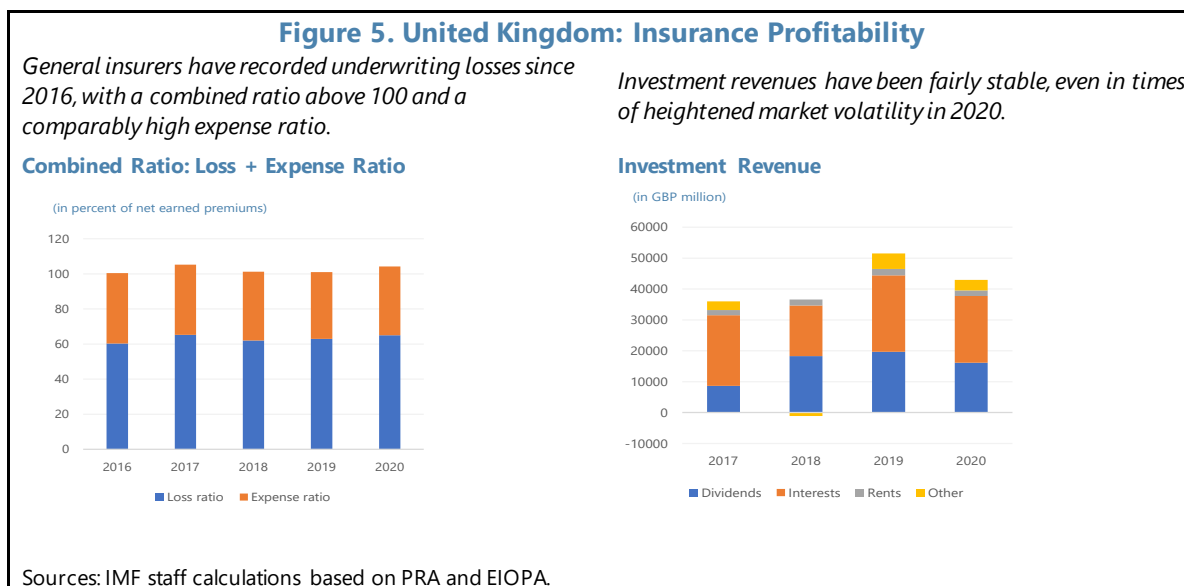
Sources: IMF staff calculations based on PRA and EIOPA.

Notes: Credit quality steps (CQS) can be mapped against rating categories, e.g. CQS 0 = AAA, CQS 1 = AA, etc.

37. Insurance sector growth rates have been muted recently, and premiums have been declining since 2018. Gross written premiums in life insurance grew by only 9 percent from 2016 to 2020 and even fell by 18 percent from a temporary peak in 2018. General insurance premiums declined by 6 percent since 2016. This development can to some extent be attributed to Brexit which led to some relocation of business, especially cross-border business into the EU.

38. Profitability is muted in the general insurance sector, and insurers depend on positive investment returns (Figure 5). General insurers in the United Kingdom are characterized by relatively high expense ratios, particularly due to the London market where the brokerage of reinsurance business is costly, thereby distorting the average for the general insurance sector. Combined ratios—the sum of loss ratios and expense ratios—fluctuate slightly above 100 percent which indicates underwriting losses and the necessity to compensate for these losses with profits stemming from investments. Despite heightened market volatility at the onset of the COVID-19 pandemic in the first quarter of 2020, investment revenues have remained strong, and constant

streams of interest and dividends contribute to, on average, positive returns both in the life and the general sector (Box 4).



39. Solvency ratios of U.K. insurers have been extremely stable since the implementation of Solvency II, well above regulatory thresholds, but consistently lower than those of European peers (Figure 6). While being widely dispersed in both the life and the general sector, the weighted average SCR ratio has been hovering slightly above 150 percent since 2016. The average for the EU life insurers fluctuated between 200 and 250 percent, and EU general insurers recorded SCR ratios around 250 percent. There are several possible explanations for the relatively low SCR ratios, one of them being a risk-free interest rate term structure which is being used to calculate insurance liabilities—this curve is structurally lower for the GBP than for the EUR as it relies more on observed market rates and less on extrapolating rates towards an ‘ultimate forward rate’. The PRA is generally satisfied with the level of SCR coverage of UK insurers and actively monitors SCR ratios to ensure that these remain within risk appetite and above the regulatory minimum.

40. The impact of both the Matching Adjustment (MA) and the Transitional Measure on Technical Provisions (TMTP)—both integral parts of Solvency II—is substantial for the U.K. insurance market. 18 solo entities applied the MA as of end-2020. Without using the MA, the value of technical provisions would be GBP 42bn higher (+3 percent). Even more significant are the capital savings: The SCR would be higher by 44bn (+60 percent), and eligible own funds to meet the SCR would be lower by 37bn (-32 percent). The TMTP, as of end-2020, was used by 22 firms. Without using the TMTP, the value of technical provisions would be GBP 27bn higher (+2 percent). Eligible own funds to meet the SCR would be lower by 21bn (-18 percent), while the SCR would be higher by a rather moderate 3bn (+4 percent).

41. U.K. insurers are, compared to EU peers, significant users of internal models to calculate the required capital (Figure 7). While less than 20 percent of solo entities use either a full or a partial internal model, these insurers represent around 80 percent of the sector in terms of

assets. On average, using an internal model result in a reduction of required capital of around one quarter.

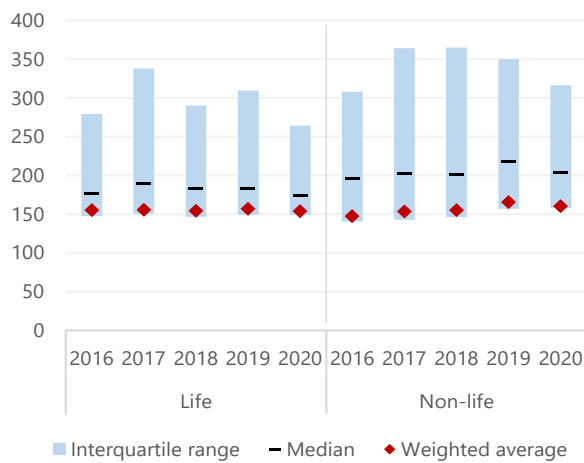
Figure 6. United Kingdom: Insurance Solvency Coverage

Since 2016, SCR ratios have been very stable, slightly above 150 percent in the life sector.

Long-term guarantee measures, especially the matching adjustment, and the transitional on technical provisions have a significant (positive) impact on life insurers solvency.

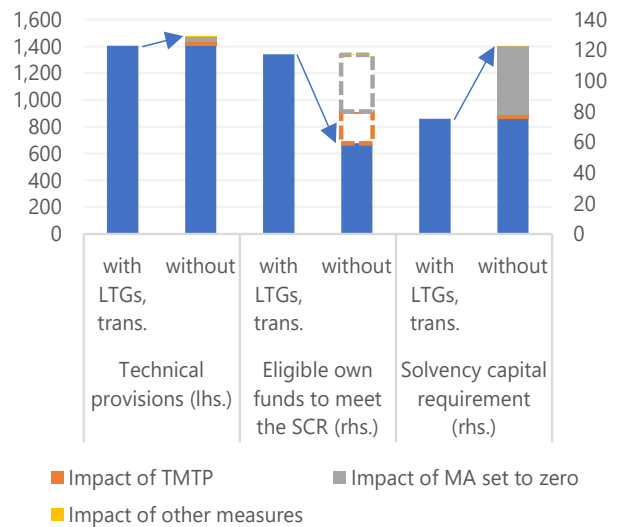
SCR Ratios: Life and Non-life

(in percent)



Long-term Guarantee Measures and Transitionals

(Impact in GBP bn)

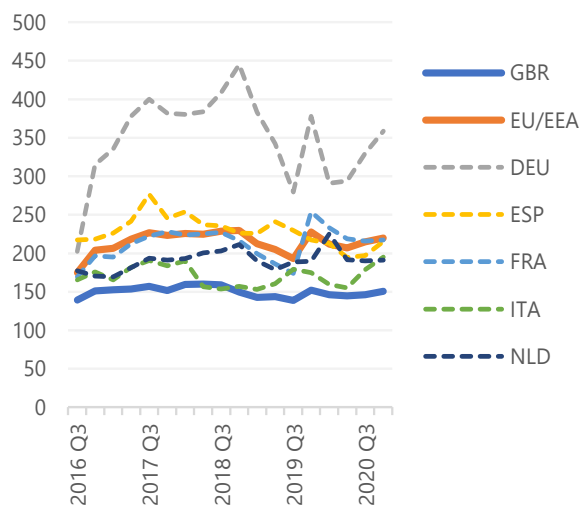


Life insurers have SCR ratios which are below those of European peers, but also considerably less volatile.

Similarly. In the general insurance sector, SCR ratios also lag those of peers.

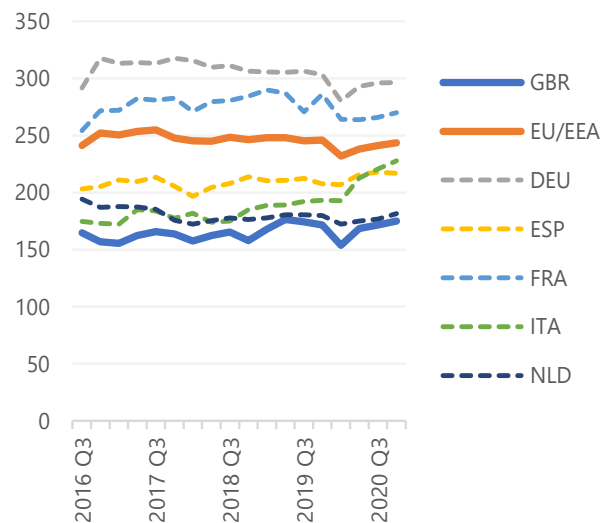
SCR Coverage Ratio-Life

(Ratio of eligible own funds to SCR, in percent)



SCR Coverage Ratio-General

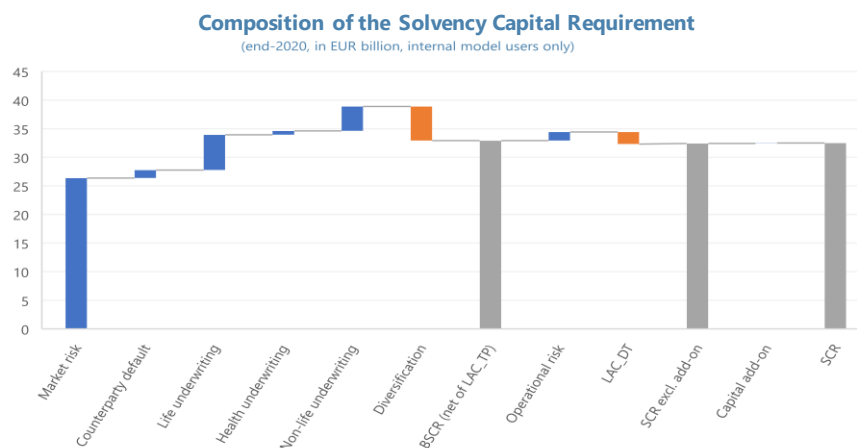
(Ratio of eligible own funds to SCR, in percent)



Sources: IMF staff calculations based on PRA and EIOPA.

Figure 7. United Kingdom: Calculation of the Solvency Capital Requirement

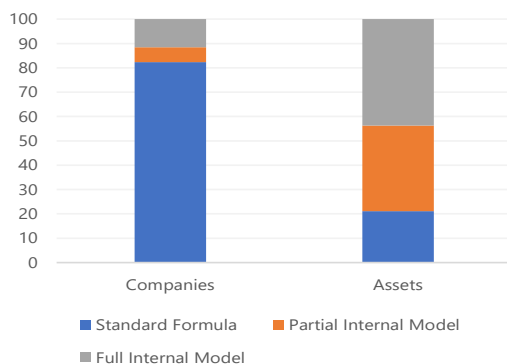
The modular composition of capital requirements reflects the overall risk exposures of the U.K. insurance sector. Market risks contribute most, followed by life underwriting risk—which respectively account for 68 and 16 percent of the undiversified basic solvency capital requirement.



18 percent of insurers use a partial or full internal model for calculating their capital requirement, representing 79 percent of the market.

Method for Calculating the SCR

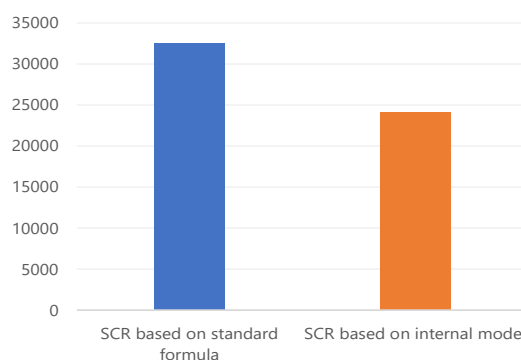
(2020, in percent of companies / total assets)



Internal model users can reduce their capital requirement by around one quarter compared to the standard formula.

Capital Requirements

(end-2020, in GBP million, internal model users only)



Sources: IMF staff calculations based on PRA.

Key Risks and Vulnerabilities⁷

42. A top-down solvency stress test of 14 larger U.K. insurers, run by the FSAP team, showed the sector to be largely resilient, with some vulnerabilities stemming from lower interest rates and from equity price declines, particularly for life insurers. These vulnerabilities emerge even despite recent shifts of market risks to policyholders in unit-linked life insurance. The analysis applied two severe scenarios to insurers’ balance sheets as of end-2020, covering around 70 percent of the market. Insurance companies have a broad range of risk-mitigating mechanisms in place which cannot be fully captured in a top-down stress test. In times of financial stress, insurers

⁷ The TN on Balance Sheet Resilience and Financial Stability provides more details on the results of the insurance stress test.

have several options to restore their capital adequacy and/or their profitability, including changes in underwriting standards, in the reinsurance program or by withholding profits. An even more effective way to improve the solvency position relatively quickly is a de-risking of the balance sheet, e.g., by selling equity or high-yield corporate bonds and buying sovereign bonds instead—this change in the asset allocation can substantially reduce required capital. As the stress test assumed a static balance sheet, these types of management actions were not modeled.

43. In the “scarring” scenario, which assumes a further deterioration of the COVID-19 pandemic, life insurers are considerably more affected than general insurers. While all life insurers would still sufficiently cover their liabilities with assets, the excess of assets over liabilities declines by more than 15 percent for the median firm. Solvency ratios of two firms would drop below the 100 percent threshold, highlighting the need for recovery plans to be ready and effectively executable. The downward interest rate shift of the scenario increases liabilities, but this is partly offset by the MA which rises together with higher credit spreads. Among general insurers, the balance sheet impact is smaller, and solvency ratios remain well above 100 percent. The increase in corporate bond spreads contributes most to the reduction in available capital as it is not mitigated through the MA as is in the life insurance sector.

44. In a scenario of tightening financial conditions, the aggregate impact on both sectors is milder, and most life insurers would even see higher solvency ratios. The sharp increase in interest rates in the scenario generally compensates for losses on investment assets, as the impact weighs larger on liabilities which decline with higher discount rates. For most general insurers, the impact is minor, although interest rate exposures differ across companies—for the median general insurer, the SCR ratio declines marginally. The analysis, however, does not account for the effect of higher claims inflation on the earnings of general insurers, which would be likely according to the narrative of the scenario. Practical difficulties exist, though, in deriving claims inflation from observed consumer price increases, as the disruptions to global supply chains have shown during the course of 2021.

45. Life insurers are largely resilient to variation margin calls in their interest rate swap portfolio, but cash buffers differ markedly at the group level across firms. An analysis of five large life insurers shows that even sizable upward shifts in interest rates would not cause systemic liquidity stress, given existing sufficient buffers of cash and liquid assets.⁸ However, liquidity risks could increase when other derivative stresses besides interest rate swaps are combined with higher outflows following policy surrenders or catastrophe events, or from lower premiums. The PRA’s experience from March 2020 indicated that insurers used the full range of mitigating measures to preserve and increase liquidity. As an example, they stopped investing cash inflows and withheld dividend payments, but widely tried to avoid asset sales—this could be interpreted in a way that the regulatory incentives for buy-and-hold investments, particularly related to the matching adjustment, have worked in practice. To further analyze combined liquidity strains, exacerbated by reduced

⁸ This analysis is, however, limited to margin calls from interest rate swaps, and does not consider effects from currency or other derivatives, due to the availability of data for a top-down analysis.

market liquidity and fungibility of certain assets, more granular data specific to liquidity is needed, particularly for annuity writers and insurers with large derivative holdings. The PRA has plans to obtain specific liquidity data from certain insurers, which would provide an opportunity to close these data gaps.

Box 4. Impact of COVID-19 and Supervisory Response

PRA Firm Engagement

During the COVID-19 pandemic, insurers' balance sheets proved rather stable, with solvency ratios declining only temporarily when markets became more volatile in February/March 2020.

U.K. life insurers benefited from the mitigating mechanics inherent to the Solvency II framework, most notably the matching adjustment which largely offset the impact of higher spreads on sovereign and corporate bonds. Still, earnings of life insurers declined due to lower new sales amid lockdown restrictions and lower consumer confidence. Higher mortality due to the pandemic had a slightly beneficial effect on annuity writers who would typically be substantially exposed to longevity risks. This impact has primarily arisen from experience profits (i.e., annuity payments not having to be paid during the year to policyholders who died, along with a slightly reduced number of in-force annuities at the end of the year), rather than from life insurers weakening their future longevity trend assumptions. In their engagement with firms, the PRA have emphasized the importance of taking a prudent approach to allowing for Covid-19 experience in future longevity assumptions.

General insurers were moderately affected in 2020. Claims increased massively in a few business lines, especially business interruption, event cancellation and travel insurance, but strict lockdown rules and reduced mobility also led to a notable reduction in motor insurance claims. Following the announcement of Government lockdown measures in March 2020 PRA supervisors began to engage with general insurers to assess the exposure from the lines of business likely to be impacted and business interruption claims where there was potential for contractual uncertainty where the FCA had sought to get clarification through the High Court. The PRA asked selected insurers to provide their own stress tests and combined these with other stresses on assets, including reinsurance recoverability and liabilities that may arise during the year to evaluate the resilience of the firms' balance sheets and identify firms where supervision action should be focused.

The PRA maintained close communication with the FCA, and updated estimates were obtained following the High Court judgement in September 2020 and the Supreme Court Judgement in January 2021.

FCA Firm Engagement

At the beginning of March 2020, FCA supervisors began to engage with insurers and large intermediaries to understand the impact of the pandemic on their business model, ability to service customers, product availability and operational resilience. From March to December 2020, the FCA had in place COVID-19 firm engagement plans, under which contact was kept with key insurers and intermediaries on either a weekly or bi-weekly basis, as well as additional ad-hoc engagement with specific firms (for example, relating to business interruption or travel cover) as required. Supervisors' calls with firms focused primarily on operational resilience.

Insurers and intermediaries were generally resilient to the ongoing challenges and changes that COVID-19 brought. Firms saw a significant increase in call volumes relating to some products, though they managed this by reallocating resources from other areas of their business.

Box 4. Impact of COVID-19 and Supervisory Response (concluded)

As well as the U.K. lockdowns, the FCA also engaged with firms to understand the impacts of lockdowns in other countries (e.g., India), where some insurers had call centers or claims processing services.

Alongside the continued firm engagement strategy, the FCA also had regular engagement with sector trade bodies and international regulators and organizations, including IAIS and EIOPA as well as EU regulators, US, Canadian and Australia regulators. Insights were shared, including on the FCA's approach to business interruption and the international reach of Lloyd's and London market.

Business interruption insurance – The FCA sought clarification from the High Court as part of a test case, aimed at resolving the contractual uncertainty around the validity of many BI claims. Following the decision by the High Court in September 2020 and subsequent insurers' and FCA's appeals, the Supreme Court handed down its judgment on 15 January 2021. As a result, many thousands of policyholders had their claims for COVID-19 related business interruption losses paid out. As a result, over 32,000 policyholders have received over £1.25bn in claim payments for Covid-19 related business interruption losses (on 13 January 2022).

Guidance for insurance and premium finance firms – The aim of this guidance was to help customers who hold insurance products and who may be in temporary financial difficulties because of COVID-19. The FCA expected firms to review customers' cover which could result in premium reductions due to changes in risk profile or the sale of an alternative product which would better meet the customer's needs, as well as waiving fees associated with altering cover. Where amendments to the insurance cover do not help alleviate the financial difficulty, firms should grant a payment deferral of between 1 and 3 months, unless it is obviously not in the customer's interests to do so. The guidance was first issued in May 2020, and subsequently updated in August 2020 and October 2020. It continues to remain in place.

Product value and coronavirus – The FCA issued guidance in July 2020, setting out expectations for insurers and insurance intermediaries to consider the value of their products. It highlighted what firms should do to identify any material issues from COVID-19 that affect the value of their products, and their ability to deliver good customer outcomes.

Cancellations and refunds – With an unprecedented number of cancellations of trips, holidays, and other events because of the pandemic, consumers are generally entitled to claim a refund from their travel or service provider. Consumers might also be able to make a claim with their credit or debit card provider, or their travel insurer. The FCA outlined its expectations of firms handling these types of claims and provided guidance for consumers in June 2020. Interventions were designed to ensure that insurance firms, and card providers, handle enquiries and claims from consumers in a way that minimizes inconvenience to the consumer.

Financial resilience survey – Between June and August 2020, the FCA issued the first phase of its COVID-19 impact survey to solo-regulated firms, to help it obtain information about firms' financial resilience because of the pandemic. 3,370 insurance intermediaries responded to the survey in Phase 1. The survey was repeated after a 3-month interval. A small number of insurance intermediaries were at risk of failing with the potential to cause consumer harm.

Dear CEO letter on adequate client assets arrangements – The FCA issued letters to CEOs of relevant firms, requiring them to review the adequacy of their client assets arrangements, in view of the current economic environment. Where deficiencies are identified, firms should take immediate action to rectify them, and notify the FCA of any material concerns.

Sources: PRA and FCA.

D. Preconditions for Effective Insurance Supervision

Sound and Sustainable Macroeconomic and Financial Sector Policies

46. The U.K. Government’s economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential pre-requisites to achieve this objective in all parts of the United Kingdom and sectors of the economy.

47. The Bank of England’s Monetary Policy Committee (MPC) sets monetary policy to keep inflation low and stable, which supports growth and jobs. Subject to maintaining price stability, the MPC is also required to support the U.K. Government’s economic policy. The U.K. Government has set the MPC a target for the 12-month increases in the Consumer Prices Index of 2 percent. The Bank of England’s Financial Policy Committee (FPC) identifies, monitors and takes action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the U.K. financial system. The FPC also has a secondary objective to support the economic policy of the U.K. Government.

48. When the IMF Executive Board concluded the 2020 Article IV Consultation with the United Kingdom, Directors commended the enviable track record of the United Kingdom’s policy frameworks.⁹ In the accompanying Staff Report, staff noted that the authorities’ policy response to the COVID-19 pandemic was an excellent example of well-coordinated action. Staff were also supportive of monetary policy actions taken by the MPC.

A Well-Developed Public Infrastructure

49. The United Kingdom provides the financial services industry with a robust and stable legal system, skilled workforce, and well-developed public infrastructure. This includes:

- a well-established insolvency framework
- an efficient and independent judiciary
- comprehensive and well-defined accounting principles and rules
- a system of independent external audits
- secure, efficient and well-regulated payment and clearing systems
- efficient and effective credit bureaus and
- public availability of basic economic, financial and social statistics.

⁹ IMF Executive Board Concludes 2020 Article IV Consultation with United Kingdom, IMF Press Release PR20/379, December 18, 2020

Effective Market Discipline in the Financial Sector

50. The Financial Reporting Council (FRC) promotes transparency and integrity in business. It regulates auditors, accountants and actuaries and sets the United Kingdom's Corporate Governance and Stewardship Codes. High quality corporate governance helps to underpin long-term company performance. The United Kingdom has some of the highest standards of corporate governance in the world, which makes the U.K. market attractive to new investment.

51. In terms of market discipline, the United Kingdom has an extensive presence of institutional investors and high involvement of major rating agencies and analysts. There are well-developed mechanisms that support market discipline, including a system of regular disclosure by public companies. For insurers, that was materially enhanced in 2016 through Solvency II implementation that set requirements for additional annual disclosures based on supervisory reporting (Pillar 3) and covers issues such as board composition and effectiveness, key functions, the role of board committees, risk management, remuneration and relations with shareholders. The PRA has set out expectations regarding external audit of the public disclosure requirement.¹⁰

Mechanisms for Consumer Protection

52. The FSCS is the United Kingdom's compensation fund of last resort for customers of authorized financial services firms. It may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has gone out of business and/or has been declared in default. The FSCS is independent of the U.K. Government and the financial services industry and was set up under FSMA. It became operational on 1 December 2001 (although it still covers claims from before this date which were protected under previous compensation schemes). The FSCS does not charge individual consumers for using the service. The FSCS covers policyholders for business conducted by firms which are authorized by the FCA and the PRA. Customers of European firms (authorized by their home state regulator) that operate in the United Kingdom may also be covered. The Financial Crisis Management MoU sets out the arrangements for dealing with crisis situations, and the COMP sourcebook of the FCA Handbook and the Depositor Protection and Policyholder Protection chapters of the PRA Rulebook set out when compensation can be claimed and relevant procedures. The FSCS currently covers:

- deposits
- insurance policies
- insurance broking (for business on or after 14 January 2005), including connected travel insurance where the policy is sold alongside a holiday or other related travel (e.g. by travel firms and holiday providers) (for business on or after 1 January 2009)
- investment business and

¹⁰ <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-ii-external-audit-of-the-public-disclosure-requirement>

- home finance (for business on or after 31 October 2004).

Financial Markets

The United Kingdom has a large and sophisticated financial services sector which is able to offer a full range of financial instruments to investors (including insurers). The U.K.

Government offers a full range of debt instruments (including index-linked and a spread of maturities). Insurers have access to U.K. and international equity and property markets. Increasingly U.K. insurers are moving into alternative asset categories such as infrastructure and private equity. U.K. insurers make use of derivatives markets for risk management purposes.

Table 3. United Kingdom: Summary of Observance with the ICPs		
Insurance Core Principle	Level	Overall Comments
ICP 1 - Objectives, Powers and Responsibilities of the Supervisor	O	<p>Based on the regulatory framework in place at the time of the mission, the United Kingdom observes ICP 1. In 2020, HMT launched the Financial Services Future Regulatory Framework Review (FRF) setting out proposals for redesigning the regulatory framework within which the financial services regulators operate. The policy making process is still underway and in November 2021 HMT published a second consultation setting out detailed proposed measures (FRF Review 2021 Consultation). Overall, there are beneficial initiatives that will strengthen the United Kingdom’s approach to regulation and supervision of the insurance sector but also other initiatives which, depending on how they are implemented in practice, may constrain the FCA and PRA from focusing on their primary objectives.</p> <p>It is recommended that the U.K. authorities should continue to preserve the primacy of the PRA’s and FCA’s primary objectives. A proliferation of wider policy priorities, objectives and “have-regards” could divert focus from safety and soundness’ financial stability and protection of policyholders. As such, these proposals in the FRF Review 2021 Consultation pose a risk to future observance of ICP 1 unless the proposals are designed and implemented carefully to ensure the FCA and PRA maintain focus on their primary objectives and can retain their operational independence.</p> <p>It is recommended that the legislative framework for insurance supervision be simplified and streamlined, making it easier for firms to navigate.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)

ICP 2 - Supervisor	LO	<p>Overall, there is legal and operational independence of the regulators except as noted in relation to the Solvency II review. There are strong and appropriate accountability processes required by law and these accountability requirements are put into practice by the authorities. There are appeals processes for regulatory decisions and the U.K. regulators are very transparent about their policy development and how they go about supervision. Both the PRA and FCA appear to have adequate resources to undertake their roles as they currently define those roles.</p> <p>The structure of the legislation, combined with the U.K. Government's approach to the Solvency II review appear to constrain the independence of the PRA in its rule making power, transferring ultimate decision making to the ministerial level with objectives that do not align with the primacy of the PRA's general objective. The PRA's advice to HMT is not transparent as they are working closely together. While the PRA may have opportunities through mechanisms such as senior manager speeches and parliamentary scrutiny and accountability procedures to make its views known, there is no formal process to ensure the PRA's final advice and any deviations from that advice in final legislation are clearly laid out. It is acknowledged that the issue with the Solvency II review is likely one of timing with the intention as set out in the FRF Review 2021 Consultation to put prudential rule-making within the control of the PRA.</p> <p>The final positions taken in the Solvency II Review should be consistent with the Insurance Capital Standard (ICS) developed by the IAIS that is currently in the five-year monitoring period ending in 2024.</p> <p>One way forward to address the identified independence issue with the current legislative structure, would be to ensure that requests for advice from the PRA are made transparently by HMT and that the PRA can provide that advice in an independent and transparent way. Any variation in final policy compared to PRA advice would then be clear.</p>
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Table 3. United Kingdom: Summary of Observance with the ICPs (continued)		
ICP 3 - Information Exchange and Confidentiality Requirements	○	<p>The PRA and FCA have a sound legislative basis for sharing information and protecting the confidentiality of information. Internal policies and procedures are in place to support staff in making decisions about when it is appropriate to share information and when issues require internal legal advice. Both the PRA and FCA have an extensive network of MoUs and MMoUs to facilitate exchange of information with other U.K. regulators (including between PRA and FCA) and foreign regulators.</p> <p>The mission was able to observe examples of sharing of information and examples where information was not shared due to appropriate safeguards in the legislative framework and internal policies.</p>
ICP 4 - Licensing	○	<p>There is a clear legislative framework for licensing of insurance activities in the U.K. market. Unregulated insurance activity is monitored and there are powers for the regulators to deal with unregulated activity. Authorization procedures are clear with information packets available for prospective applicants on the PRA website. The Threshold Conditions ensure that authorizations are only granted to suitable applicants. The preapplication process provides a transparent process for applicants leading up to the application.</p> <p>The TPR-related applications for authorization are a concern in terms of a peak load of applications. Teams and processes have been put in place to deal with this peak load through to December 31, 2023. It is recommended that the PRA and FCA teams dealing with TPR-related authorization applications develop contingency resourcing plans.</p>
ICP 5 - Suitability of Persons	○	<p>The Senior Managers & Certification Regime (SM&CR) has improved individual accountability. The 2016 FSAP considered the SM&CR to be a “major and welcome improvement” and “an important step towards bolstering public confidence in the banking system”. After several years of implementation and its extension to the insurance sector, the PRA presented the findings from a review in December 2020. It concluded that the introduction of the SM&CR has contributed to senior managers taking greater responsibility for their actions and has made it easier for both firms and the PRA to hold individuals to account. Stakeholders also commented positively during the review and suggested only minor improvements—specifically more guidance was requested regarding interim appointments, the use of temporary and conditional approvals, and on the link between the SM&CR and remuneration rules.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)

	<p>Sanctions that have been taken to date in the insurance sector have not been based upon breaches of the SM&CR framework. The U.K. financial regulators may incur a reputational risk, should an approved senior manager be involved in severe misconduct. Consequently, it is critical for the PRA to exercise the full range of its formal powers on top of its supervisory interventions. The PRA will use either supervisory intervention or exercise its formal powers dependent on which is most appropriate in each situation. Since the implementation of the SM&CR, the PRA has not yet issued a formal rejection notice for SMF applicants. Instead, it relies more on supervisory intervention and has permitted applications to be withdrawn by firms in line with their rights under FSMA. With respect to enforcement, sanctions that have been taken to date have not been based upon breaches of the SM&CR framework, though enforcement action has been taken against individuals. In any event, formal enforcement actions for individuals' significant failures to comply with regulatory requirements or to discharge their responsibilities is not the only option available to the regulators.</p> <p>It is up to firms to ensure Senior Managers are fit and proper; however, it is possible the U.K. financial regulators may incur a reputational risk, should an approved senior manager be involved in severe misconduct. Consequently, it is critical for the PRA to continue to exercise the full range of its formal powers on top of its supervisory interventions and linked even more often to responsible individual.</p> <p>Board effectiveness reviews are mostly commissioned directly by insurers to meet corporate governance requirements and conducted by external firms. Where the PRA asks for a Board effectiveness review to be undertaken for insurers this is usually done by an external firm. This practice differs from banking supervision, where more reviews are performed by the PRA itself—this, however, can be partially explained by the larger size of supervisory teams in the Banking Supervision Directorate.</p>
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Table 3. United Kingdom: Summary of Observance with the ICPs (continued)		
ICP 6 - Changes in Control and Portfolio Transfers	O	<p>Processes around change in control and portfolio transfers are well-established, and coordination between the PRA, the FCA and the Court appears to be effective.</p> <p>Applications for a change in control do typically not result in a formal rejection. Out of a total of around 60 applications per year, some three to five are withdrawn by the applicant.</p> <p>In the run-up to the Solvency II implementation and during the early stages of the regime, the number of Part VII transfers increased significantly as insurers aimed to raise benefits from better capital management under Solvency II. Another wave of Part VII transfers occurred over the last four years when many of those were related to Brexit (51 out of 64). To manage the workload, resources at the PRA and FCA were expanded—a necessary step as the timeline of each portfolio transfer is driven by the involved insurers and the Court. The PRA engaged early on with the High Court to inform about the expected number of applications, so proceedings were completed without major delays.</p>
ICP 7- Corporate Governance	O	<p>Overall, there are comprehensive rules related to governance as well as a strong focus on governance by both financial regulators.</p> <p>An observation during the conduct of the stress testing work of the mission is that there are data quality concerns with some of the data provided. There are inconsistencies across firms and gaps in the data. In particular, there were gaps and inconsistencies that hampered the liquidity stress testing work. These concerns do not rise to the level of concern that data quality is hampering supervisory decision making but it is an issue that could do with improvement, particularly as the PRA seeks to become more data driven as part of its 2026 Strategy. Data quality will become more important as greater reliance is placed on it. Given that there are clear requirements for submitting quality data to regulators as well as senior management responsibility for that function, it would be worth conducting a thematic review across regulated insurers to review data quality and financial reporting processes to improve the quality of data submitted to the PRA.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)

ICP 8 - Risk Management and Internal Controls	LO	<p>The PRA and FCA have a largely comprehensive set of regulatory requirements covering risk management and internal control. Supervisory processes also extensively address risk management issues.</p> <p>The two gaps relate to new ComFrame requirements for the group-wide actuarial function and the group-wide internal audit function. It is recommended that the PRA develops a supervisory statement on the group-wide actuarial function and the group-wide internal audit function requirements that specifically address ComFrame requirements.</p>
ICP 9 - Supervisory Review and Reporting	LO	<p>Overall, the PRA's approach to supervision is sophisticated, structured and well anchored in its statutory objectives. One area of concern is a lack of on-site supervisory activity targeted at business processes within firms and discussions with front-line staff in firms by PRA staff. Deep dive reviews do not always involve discussions with firm staff who do not hold senior positions. The PRA approach is very much anchored in senior management responsibility at regulated firms. Deep dive reviews may only involve extensive desk review of documentation and discussions with senior management. This is not just a function of the timing of the mission during the COVID-19 pandemic but is the way the PRA carries out its deep dive reviews by design. The COVID-19 pandemic resulted in more virtual meetings and fewer meetings at the premises of firms. Section 166 reviews by skilled persons are undertaken as an alternative to PRA-staffed deep dive reviews.</p> <p>The PRA should consider increasing and deepening its on-site inspection activity and consider bringing in-house some of the deep dive reviews outsourced to skilled persons (cost recovery options for PRA resourced on-site inspections under FSMA should be explored). The Section 166 review is a useful tool in a number of circumstances but the PRA's use does seem to cover the scope covered by other jurisdictions in their own on-site inspections.</p> <p>The PRA's strategic review report notes that considering stretched resources the PRA needs to prepare as an organization for the challenges and opportunities ahead. One of the outcomes of the review is the need to implement more flexible and risk-based resourcing for supervision. The mission supports this action but further consideration should be given to increasing the resources applied to on-site supervision so that the overall envelope of resourcing is increased. Cost recovery mechanisms available in FSMA should be explored and the cost to regulated firms of section 166 skilled person reviews should be considered as part of this overall resource consideration.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)		
		<p>The mission recommends internalizing some of the work carried out by skilled persons which means the PRA will need to consider deploying the necessary resources to replace those section 166 reviews and recovering costs accordingly.</p> <p>Overall, the FCA’s approach to supervision of insurers with an emphasis on portfolio supervision and some dedicated fixed firm supervision appears an appropriate compromise in allocation of resources for a conduct regulator, The FCA should continue to review its approach to fixed and portfolio supervision to ensure effective risk-based approach to supervision in accordance with business needs and industry developments. In doing so, it should consider its recent reduction in fixed firm supervision in preference for more portfolio supervision in the insurance sector. The incremental resource implications of the FCA extending its fixed firm supervision to all PRA Category 1 and 2 firms appears minimal in the overall context of FCA supervision resources. Overall, insurance sector supervision is optimized where PRA and FCA information sharing is amplified for the most significant firms.</p>
ICP 10 - Preventive Measures, Corrective Measures and Sanctions	O	<p>The PRA and FCA have a broad range of legal powers at their disposal to use in the supervision of firms. Those powers include sanctions under the SM&CR, imposing requirements, Threshold Conditions modifications, self-wind downs among others. The PRA and the FCA are also empowered to issue unlimited financial penalties and publicly censure firms and individuals. This follows a transparent approach, with both the PRA and the FCA having issued policy statements or handbooks outlining their approach to enforcement.</p> <p>The PRA has the same enforcement powers over firms operating in the United Kingdom as branches as it has over subsidiaries. It is also legally empowered to take an appropriate range of remedial actions to address problems such as the firm’s failure to satisfy the Threshold Conditions.</p> <p>The PRA and FCA have not hesitated to act against firms and individuals. That said, the PRA and FCA tend to resolve matters informally during the supervisory process. The PRA applies a “comply or explain” supervisory approach and the FCA applies an “assertive supervision” approach alongside more formal sanctions or enforcement measures. Moral suasion by the PRA and FCA has been generally effective in addressing and correcting deficiencies at individual firms.</p> <p>Contested proceedings before the PRA’s Enforcement Decision Making Committee are relatively infrequent.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)

ICP 12 - Exit from the Market and Resolution	PO	<p>The United Kingdom has been able to successfully deal with the need for small firms to exit the market using the range of exit strategies available to market participants under UK statute and the tools available to the PRA. The FSCS has been able to provide support to policyholders for a number of insurers unable to meet their obligations to policyholders.</p> <p>The mission supports the proposal to enhance the PRA's toolkit for dealing with insurers in financial distress by adapting the write-down power in section 377 of FSMA to make it available before insolvency, to improve the process of this power's application and extend FSCS protection to the written-down amounts.</p> <p>PRA owned resolution plans are constrained by the legal entity level of powers available to the PRA and the lack of clear authority for the PRA to remedy impediments to resolvability. Resolution plans would benefit from more focus on the group rather than UK legal entities. Only designation of a resolution authority supported by a formal revision to the insurer resolution regime providing powers at the group level will enable resolution planning as contemplated by the ComFrame standards in ICP 12.</p> <p>There is a less certainty over the United Kingdom's ability to deal with the failure of a significant insurance company, one that the PRA categorizes as a Category 1 insurer. The PRA and HMT have acknowledged the gap created by the lack of a comprehensive insurer resolution regime. The mission recommends that U.K. authorities develop, in line with the current plan, a comprehensive insurer resolution regime and ensure that powers extend to the head of insurance groups and allow for an entire group approach to resolution.</p>
ICP 13 - Reinsurance and Other Forms of Risk Transfer	O	<p>The United Kingdom has a comprehensive set of requirements for insurers to manage their reinsurance arrangements. They cover both qualitative risk management requirements as well as how reinsurance can be taken into account for solvency calculations.</p>

ICP 14 - Valuation	O	<p>The regulatory framework for the valuation of assets and liabilities, set out in the Solvency II framework, is robust and incorporates the standards of ICP 14.</p> <p>The PRA is attentive to the use of the MA and the TMTP and monitors closely the eligibility criteria for assets in the MA portfolios. It also managed the transition from LIBOR to SONIA effectively and should continue doing so for other currencies as well. Going forward, it will be necessary to continue maintaining high standards for the eligibility of assets for the MA and scrutinizing the performance of illiquid assets in stressed markets.</p> <p>The implementation of IFRS 17 requires close attention also by the supervisory authorities. For insurers which apply IFRS, the process involves vast resources from different parts of the company, including accounting, actuarial, IT, risk management and others. It is important that supervisors monitor the implementation progress and ensure that those insurers lagging behind do not excessively pull resources from other critical projects as well as day-to-day risk management and control functions.</p>
ICP 15 - Investment	O	<p>The principles-based requirements applied under Solvency II are appropriate in an advanced market such as the United Kingdom and the PRA has high expectations of firms in applying these principles. The focus on the governance process around investment decisions is appropriate.</p>
ICP 16 - Enterprise Risk Management for Solvency Purposes	LO	<p>There are 16 standards in ICP 16 applicable generally. There are 25 ComFrame standards that add detail in respect of IAIGs. The PRA's regime is anchored in principles, but it puts expectations into guides like supervisory statements or on more topical issues into 'Dear CEO' letters. There is some dissonance between the PRA approach and the detailed requirements in ComFrame. The mission believes that these issues are not significant although they look like they involve a number of ComFrame standards. The PRA's approach broadly addresses the ComFrame requirements but it cannot be said that it observes every aspect of all the ComFrame standards. The standards are often multifaceted with the U.K. requirements often covering two-thirds or more of the detailed requirements with some issues not addressed directly. These issues could be addressed in the development of supervisory statements building on the robust principles already in place.</p> <p>In the Regulatory Initiatives Grid, the PRA has announced plans to require liquidity management plans from certain insurers. The mission supports this initiative and believes all IAIGs should be in-scope for this initiative.</p>

Table 3. United Kingdom: Summary of Observance with the ICPs (continued)		
		With regard to ICP 16.5 which is the only non-ComFrame standard at issue, the PRA should develop regulations or guidance to address the relationship between ALM policies and product development, pricing functions and investment management.
ICP 17 - Capital Adequacy	O	<p>The capital adequacy framework, implemented through Solvency II, is robust and adequate to a complex insurance sector like the one in the United Kingdom.</p> <p>The wide-spread use of internal models is adequately monitored via an extensive set of additional national reporting templates.</p> <p>After the Brexit, the supervisory community in the EU has lost considerable know-how which used to be provided by PRA colleagues since the beginning of the pre-application phase, well before the actual Solvency II implementation date. Going forward, a continued exchange on internal model supervision, both in the colleges and holistically with EIOPA and the IAIS would be mutually beneficial.</p>
ICP 18 - Intermediaries	O	Intermediaries are subject to a comprehensive set of prudential and conduct requirements. FCA supervision which is described in ICP 9 is comprehensive. With respect to intermediaries both fixed firm and flexible firm supervision is applied.
ICP 19 - Conduct of Business	O	The United Kingdom has a robust and comprehensive framework for regulation and supervision of conduct of business by insurers. While the requirements are comprehensive, as set out in the description, the legal framework is an extremely dense and intricate web of requirements that are complex to navigate, leaving open the possibility for significant streamlining in the future.
ICP 20 - Public Disclosure	O	<p>Solvency II has introduced an extensive set of disclosure requirements fully in line with ICP 20, in particular the SFCR which also provides a set of harmonized quantitative reporting templates. In addition, the full range of additional disclosure requirements under the Companies Act or under Listing rules is available, too.</p> <p>It is however noted that the PRA does not systematically monitor the requirement of SFCRs being audited.</p>

ICP 21 - Countering Fraud in Insurance	O	There is a network of legislation, authorities and industry funded bodies working together to address insurance fraud in the U.K. The FCA plays an active role in monitoring the insurance industry's risk management with respect to fraud risk as well as active participation in work carried out by the lead authorities and through its membership of the NECC.
ICP 22 - Anti- Money Laundering and Combating the Financing of Terrorism	O	The United Kingdom's AML/CFT regime has been highly rated by the FATF in the 2018 MER. With respect to key ML/TF risks, the insurance sector posed generally lower ML/TF risk and the resources applied to the insurance sector appear suitable to those identified risks. The mission found an adequate approach to ML/TF risks in the insurance sector, evidence of proactive supervision and significant involvement by the supervised sector in the creation and implementation of regulation.
ICP 23 - Group- wide Supervision	O	The framework for group supervision, which is determined by Solvency II, is robust, and the PRA has set out its expectations on group-related issues in various supervisory statements. Similarly, the identification of IAIGs has been performed in a transparent way and is regularly reviewed.
ICP 24 - Macroprudential Supervision	LO	Macroprudential supervision of the insurance sector could be enhanced through a more structured and regular consideration of macroprudential risk of the insurance sector. While the FPC requests deep dives and analysis of specific activities, the last sectorial deep dive for the insurance sector was undertaken in 2016. Regular reporting should be provided by the PRA Insurance Directorate on broad trends in the insurance sector that may have near-term or long-term consequences for the functioning of the insurance market and other financial sectors. A process, for example, inspired by the IAIS Global Monitoring Exercise (GME) and implemented in a domestic context might be appropriate and the process could be tied to the qualitative input required for the GME. Reflecting the United Kingdom's key role in global insurance markets, the Bank of England should undertake a deep dive review of the role and potential systemic relevance of Lloyd's and the London Market in international markets and do this in cooperation with other supervisors. The review should focus on substitutability and market share given London's preeminent role in insuring specialist risks around the world.
ICP 25 - Supervisory Cooperation and Coordination	LO	Generally, the roles of the PRA as a group supervisor are laid out in detail, and cooperation with foreign supervisors works effectively. The same holds true for the PRA and the FCA in their respective roles as involved supervisors.

Table 3. United Kingdom: Summary of Observance with the ICPs (concluded)

	<p>However, the PRA should finalize the establishment of Crisis Management Groups for all IAIGs (at the time of the mission, this process was expected to be completed during the course of 2022) and ensure an appropriate membership which would include resolution authorities wherever necessary.</p> <p>Furthermore, setting up a platform for supervisory cooperation for Lloyd's (and potentially the London market in general) could improve interactions and the exchange of information with supervisors abroad, irrespective of whether Lloyd's has a regulated entity there or operates without a physical presence.</p>
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Table 4. United Kingdom: Summary of Observance Level

Observed (O):	17
Largely observed (LO):	6
Partly observed (PO):	1
Not observed (NO):	0
Total:	24

E. Recommendations

Table 5. United Kingdom: Recommendations to Improve Observance of the ICPs	
Insurance Core Principle	Recommendations
ICP 1 - Objectives, Powers and Responsibilities of the Supervisor	Ensure the FRF Review preserves the primacy of PRA and FCA's objectives of safety and soundness and market integrity in principle and in practice over any secondary objectives and ad hoc policy priorities
ICP 2 - Supervisor	<p>Ensure that the final accountability and transparency mechanisms adopted under the FRF Review safeguard regulatory independence and pose no constraints for operational and oversight effectiveness</p> <p>Consider overall resourcing needs for PRA and FCA supervision when reviewing IMF recommendations.</p> <p>Simplify and streamline the legislative framework for insurance supervision making it easier for firms to navigate.</p> <p>With respect to the Solvency II review ensure that there is public transparency of PRA advice to HMT and any variation between final adopted legislation and PRA advice is clear. One way for that to occur would be to ensure that requests for advice from the PRA are made transparently by HMT and that the PRA can provide that advice in an independent and transparent way.</p>
ICP 4 - Licensing	Develop contingency resourcing plans for PRA and FCA teams dealing with TPR related license applications.
ICP 5 - Suitability of Persons	Conduct more board effectiveness reviews using PRA/FCA staff.
ICP 7- Corporate Governance	Conduct a thematic review of financial reporting processes to improve the quality of Solvency II data submitted to the PRA.
ICP 8 - Risk Management and Internal Controls	Develop a supervisory statement on group-wide actuarial function and group-wide internal audit function requirements that specifically address ComFrame requirements.
ICP 9 - Supervisory Review and Reporting	<p>The FCA should continue to review its approach to fixed and portfolio supervision to ensure effective risk-based approach to supervision in accordance with business needs and industry developments, taking resourcing into account.</p> <p>Increase PRA on-site inspection activity and therefore supervisory resources available exploring cost recovery options for this exercise under FSMA</p> <p>Expand the supervisory reporting on liquidity, including flow data, and foster consistency and adherence to harmonized definitions.</p>

Table 5. United Kingdom: Recommendations to Improve Observance of the ICPs (continued)

ICP 10 - Preventive Measures, Corrective Measures and Sanctions	Use the whole range of powers provided for by the SMCR and remuneration framework as appropriate to ensure that individuals holding senior manager functions are fully held accountable.
ICP 12 - Exit from the Market and Resolution	<p>Develop, in line with current plans, a comprehensive insurer resolution regime and ensure powers extend to head of insurance groups and allow for an entire group approach to resolution.</p> <p>Finalize development of resolution plans for all IAIGs and consider development of resolution plans for significant insurers that are not IAIGs.</p>
ICP 14 - Valuation	<p>Continue to maintain high standards for the eligibility of assets for the matching adjustment and scrutinize the performance of illiquid assets in stressed markets.</p> <p>Monitor the implementation progress with regard to IFRS 17 and ensure that those insurers lagging behind do not excessively pull resources from other critical projects as well as day-to-day risk management and control functions.</p>
ICP 16 - Enterprise Risk Management for Solvency Purposes	<p>Develop regulations or guidance to address the relationship between ALM policies and product development, pricing functions and investment management.</p> <p>Review regulations and guidance on risk management for IAIGs to ensure ComFrame requirements in ICP 16 are met.</p> <p>Require IAIGs to develop liquidity risk management plans taking into account the requirements of CF16.9d.</p> <p>Provide guidance that a group-wide ORSA for IAIGs must take into account the fungibility of capital and transferability of assets.</p> <p>Finalize development of IAIGs recovery plans and also consider the need for significant non-IAIGs to develop recovery plans.</p>
ICP 17 - Capital Adequacy	Uphold the overall high regulatory standard of Solvency II and base any revisions of calibrations on sufficient evidence and a high-quality impact assessment.
ICP 24 - Macroprudential Supervision	Enhance the structure and the regularity of consideration of macroprudential risks of the insurance sector through not only FPC requests for deep dives and analysis of certain markets but through regular reporting by the PRA Insurance Directorate on broad trends in the industry that may have immediate or long-term consequences for the functioning of the insurance market and other financial sectors.

Table 5. United Kingdom: Recommendations to Improve Observance of the ICPs (concluded)

	Undertake a deep dive review the role and potential systemic relevance of Lloyd's and the London Market in international markets as well as in the United Kingdom and do this in cooperation with other supervisors with the review focusing on market share and substitutability of Lloyd's and London Market insurers in lines of business important to ensuring maintenance of key economic activities in a selection of advanced economies and emerging and developing economies.
ICP 25 - Supervisory Cooperation and Coordination	Finalize the process of putting in place Crisis Management Groups for all IAIGs and ensure an appropriate membership. Set up a platform for supervisory cooperation for Lloyd's to allow interactions with supervisors where Lloyd's operates both regulated operations and without physical operations.

F. Authorities' Responses to the Assessment

41. The U.K. authorities welcome the IMF's comprehensive review of the United Kingdom's insurance supervisory and regulatory framework. The assessment has come at an important time for the U.K. authorities as they continue to develop and transition to the new regulatory structure and supervisory approach following the United Kingdom's exit from the EU.

42. The ambition of the U.K. authorities remains for the U.K. financial services sector to be the best regulated in the world, aligning competitive and innovative markets of unquestioned integrity with the highest standards of conduct.

43. The United Kingdom's approach is centered on forward looking, judgment based prudential and conduct regulation. A key element of the U.K. approach is that it does not seek to operate a 'zero failure' regime. Rather it seeks to ensure that a financial firm which fails does so without significant disruption to the supply of critical financial services or a material negative impact on consumers. Therefore, the U.K. approach continues to be risk based, with resources devoted to those areas where the risk to financial stability and policyholder protection is the greatest. The U.K. authorities believe that the current level of scrutiny given to the supervision of smaller firms is appropriate, proportionate and is in line with their statutory objectives, including ensuring the safety and soundness of the U.K. financial system.

44. Once again, the U.K. authorities wish to express their support for the role of the FSAP in contributing to improvements in supervisory practices and promoting the soundness of the financial systems in member countries. The U.K. authorities look forward to continuing the dialogue with the IMF and other global counterparts to work to improve the stability and effective supervision of the global financial system.

DETAILED ASSESSMENT

A. Detailed Assessment of Observance of the ICPs

ICP 1	<p>Objectives, Powers and Responsibilities of the Supervisor</p> <p>Each authority responsible for insurance supervision, its powers and the objectives of insurance supervision are clearly defined.</p>
Description	<p>The PRA has been given a general objective to promote the safety and soundness of PRA-regulated firms and a secondary objective to facilitate effective competition¹¹. Under FSMA, the PRA's general objective is to promote the safety and soundness of PRA-regulated firms. The PRA's insurance objective is 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'.¹²</p> <p>The PRA has a secondary objective (SCO) to facilitate, insofar as reasonably possible, effective competition in the markets for services provided by PRA-regulated firms in carrying on regulated activities. The PRA's SCO became effective in March 2014. The SCO applies to the PRA's exercise of general functions which are: making rules under FSMA, preparing and issuing codes under FSMA, determining general policy and principles by reference to which the PRA performs functions under FSMA. The SCO does not require the PRA to act in a manner that is incompatible with its primary objectives. While in many instances the PRA's primary and secondary objectives should be fully aligned, cases might exist where, within the range of prudential regulation options available to the PRA, there may be some which would deliver greater benefits to competition and others which would deliver greater benefits to safety and soundness. The existence of the SCO means that the PRA should consider—but is not required to adopt—those options which would deliver greater benefits to competition for a given objective of safety and soundness.</p> <p>The PRA is required to produce an annual competition report setting out how the PRA is delivering against the SCO. A review of these reports since 2016 has shown instances where the SCO has been taken into account in insurance regulation and supervision: the adoption of a proportionate approach to non-Solvency II firms; encouraging applications to use internal models and/or the matching adjustment;¹³ developing a regulatory framework to encourage an insurance-linked securities market in the United Kingdom;¹⁴ policy developments to refine implementation of the Solvency II regime including</p>

¹¹ Part 1A, Chapter 2 of FSMA

¹² Section 2C of FSMA

¹³ Prudential Regulation Authority Annual Competition Report 2016

¹⁴ Prudential Regulation Authority Annual Competition Report 2017

	<p>streamlining the Solvency II major model application processes;¹⁵ the launch of the New Insurer Start-up Unit.¹⁶</p> <p>When exercising its functions, the PRA is also required to have regard to a number of regulatory principles.¹⁷ The regulators' statutory objectives set out their fundamental purpose and the ends they must pursue, while the regulatory principles set out the principles that the regulators should have regard to in pursuit of these objectives. To this end, regulatory principles do not need to be achieved in the same way as objectives, which take precedence and apply broadly to the regulators' activities. The regulators must consider and evaluate specific principles when acting to advance their objectives even though they cannot pursue them as ends in themselves (unlike statutory objectives). The Prudential Regulation Committee (PRC) are also required to have regard to aspects of the U.K. Government's economic policy, as recommended by HMT. Currently this includes competition, growth, competitiveness, innovation, trade, better outcomes for consumers and climate change.</p> <p>The FCA must act in a way that is compatible with its strategic objective and advances one or more of its operational objectives.¹⁸ The strategic objective is to ensure relevant markets function well and insurance is one of those markets. The FCA's operational objectives are to protect consumers, enhance market integrity and promote effective competition in the interests of consumers.</p> <p>The PRA and FCA have a broad range of legal powers to enforce prudential standards Under Part XI of FSMA. Insurers are required to meet the Threshold Conditions set by FSMA¹⁹ and comply with rules made by the PRA and FCA, in order to be authorized and to continue operating. The Threshold Conditions include, in particular, the obligation to have adequate financial resources and the requirement to conduct business in a prudent manner.</p> <p>The PRA and FCA have flexible rule making powers under Part 9A, Chapter 1 of FSMA. They may be used to introduce new rules or amend existing ones to take account of changing circumstances. Both regulators also have the power to alter or revoke rules and to modify or waive rules (Section 138A of FSMA).</p>
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¹⁵ Prudential Regulation Authority Annual Competition Report 2018

¹⁶ Prudential Regulation Authority, Annual Competition report 2019, Prudential Regulation Authority Annual Report 2018-2019

¹⁷ Pursuant to Section 3B of FSMA. Regulatory principles include inter alia: the need to use resources in the most efficient and economical way; the principle that a burden or restriction which is imposed should be proportionate to the benefits which are expected to result from the imposition of that burden or restriction; the desirability of sustainable growth in the economy of the U.K. in the medium to long-term; the principle that the regulators should exercise their functions as transparently as possible.

¹⁸ Part 1A, Chapter 1, Section 1B of FSMA

¹⁹ Schedule 6, Part 1 of FSMA

	<p>The PRA and FCA are required to be transparent in rule making, bringing drafts of proposed rules to the attention of public, accompanied by cost-benefit analysis, an explanation of the purpose of the rules and how these rules would be compatible with the general duties of the proposing regulator under FSMA.</p> <p>The PRA and FCA have strong enforcement powers as set out in the assessment of ICP 10.</p> <p>While HMT is responsible for introducing or making new financial services legislation, both the PRA and FCA have significant interaction with HMT to formulate policy and prepare legislation and regulation. This process was most ably demonstrated in the onshoring EU law and the continued application of that law in the United Kingdom.</p> <p>Post-Brexit, the regulatory framework for insurers and insurance intermediaries is complex and multi-layered. The framework is contained in retained EU law, U.K.-made primary or secondary domestic legislation (primarily FSMA) and requirements set out by the regulators, in the PRA rulebook, Supervisory Statements and the FCA handbook. Expectations for firms are often also communicated via speeches of senior staff. The description of other ICPs in this assessment indicate a complex web of requirements.</p> <p>At the end of the Transition (EUWA 2018), incorporated all directly applicable EU legislation (including regulations) into U.K. law and preserved existing U.K. implementation of EU law as it had effect in U.K. law immediately before the end of the Transition Period. This is referred to as 'retained EU law' (defined in section 7 EUWA 2018). Given the changed relationship between the United Kingdom and the EU, 'conforming changes' were made to retained EU law based on the guiding principle of treating the EEA the same way as the rest of the world. U.K. Ministers were given the power to amend retained law to prevent, remedy or mitigate any failure of retained EU law to operate effectively or correct any other deficiency. U.K. financial regulators, including FCA and PRA were delegated powers by HMT to address deficiencies in EU regulations containing Binding Technical Standards.</p>
Assessment	Observed
Comments	<p>In 2020, HMT launched the Financial Services Future Regulatory Framework Review (FRF) setting out proposals for redesigning the regulation framework redesigning the regulatory framework within which the financial services regulators operate. The policy making process is still underway and in November 2021 HMT published a second consultation setting out detailed proposed measures (FRF Review 2021 Consultation). These more detailed measures were developed after taking into account initial feedback on the consultation in 2020. The FRF 2021 Consultation shows a clear direction of travel for the initiative. Overall, there are beneficial initiatives that will strengthen the United Kingdom's approach to regulation and supervision of the insurance sector, but some proposed changes will need to be designed and implemented carefully to ensure that</p>

	<p>the FCA and PRA maintain focus on their primary objectives and can retain their operational independence.</p> <p>Under the FRF Review²⁰²¹ Consultation, the FCA and PRA would be empowered to set out the regulatory and supervisory requirements that apply to insurers, while being subject to enhanced accountability arrangements. This is a proposal that goes in the right direction. If it had already been implemented it would mitigate concerns about the PRA's independence cited with respect to the Solvency II review in relation to ICP 2.</p> <p>The FRF Review 2021 Consultation proposes to introduce secondary objectives for the FCA and PRA to facilitate the long-term growth and international competitiveness of the U.K. economy. HMT would also have the ability to establish activity specific 'have regards' and obligations which the two regulators would have to consider when exercising powers to make and enforce rules. While the introduction of these new objectives and have regard to considerations may not formally affect the primary objectives assigned to the U.K. financial regulators, it must be carefully designed and implemented to avoid the risk that it could increase the weight assigned by the PRA and FCA to non-prudential considerations in the discharge of their functions.</p> <p>As such, these proposals in the FRF Review 2021 Consultation could pose a risk to future observance of ICP 1 unless the proposals are designed and implemented carefully to ensure the FCA, and PRA maintain focus on their primary objectives and can retain their operational independence. It is recommended that the legislative framework for insurance supervision be simplified and streamlined, making it easier for firms to navigate.</p>
ICP 2	<p>Supervisor</p> <p>The supervisor is operationally independent, accountable, and transparent in the exercise of its responsibilities and powers and has adequate resources to discharge its responsibilities.</p>
Description	<p><i>PRA independence and governance</i></p> <p>The PRA is part of the Bank of England (BoE) which is owned by HMT. The PRA is required by law to operate within the statutory framework set by FSMA, including the statutory and general objectives referred to in the description of ICP 1. If the PRA operated outside that statutory framework, its actions would potentially be subject to challenge before the courts.</p> <p>The Prudential Regulation Committee (PRC) is the body within the BoE responsible for exercising its functions as the PRA.²⁰ The BoE is owned by the U.K. Government with the Court of Directors appointed by the U.K. Government. The BoE has specific responsibilities including regulation of insurance companies and all its responsibilities are carried out</p>

²⁰ The PRC is created by the Bank of England Act 1998 and has responsibility for exercising the BoE's functions as the PRA as set out in the Bank of England Act 1998 and FSMA.

within a framework established by the U.K. Government but structurally free from operational political influence.

The PRC's terms of reference provide for twelve members: five BoE staff, the FCA chief executive and at least six external members appointed by the Chancellor of the Exchequer. As of November 2021, there are eleven members with five external members appointed. One external member position is open after the expiration of the term of one member on August 31, 2021. The PRC is responsible for:

- Reporting annually to the Chancellor on the adequacy of resources allocated to the PRA and the extent to which those functions are independent of the Bank's other functions, making rules
- Making rules under FSMA
- Developing and monitoring PRA strategy
- Setting out the PRA's statutory guidance as to how it intends to advance its objectives in relation to each regulated sector
- Giving and revoking certain statutory directions under FSMA.

At the time of the assessment, the Solvency II review was underway. Solvency II was onshored into U.K. legislation as part of preparations for the United Kingdom's withdrawal from the EU to ensure Solvency II continued to apply in the U.K. after the end of the Brexit transition period from 1 January 2021. Due to the structure of European legislation, many highly technical subjects are codified in legislation, for example the design and calibration of the risk margin (see ICP 14) and the design and application of the matching adjustment (see ICP 14). HMT is leading this consultation and the ultimate decision-making is at the ministerial level. HMT has been quite clear in stating the objectives of the review, only one of which is to protect policyholders and ensure the safety and soundness of firms. The two other objectives are: 'to spur a vibrant, innovative, and internationally competitive insurance sector' and 'to support insurers to provide long-term capital to underpin growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the U.K. Government's climate change objectives.'

The PRA has a clear approach to decision-making with some powers reserved for the PRC but most operational decisions are delegated to the CEO who then delegates further to the Supervision, Risk and Policy Committee and in turn this committee can delegate certain matters to other committees and individuals within the PRA. Importantly the highest impact decisions are taken on Category 1 firms at the PRC level.

FCA independence and governance

The FCA is a company limited by guarantee. Schedule 1ZA (paragraph 2 (1)) of FSMA sets out that the FCA Board is the Governing Body of the FCA as required by Sch. 1ZA (para 2 (1)) of FSMA. Appointments to the FCA Board are made largely by HMT, with the Chair,

	<p>Chief Executive and at least one other member appointed by HMT as well as 2 members appointed jointly by the Secretary of State for Business, Energy and Industrial Strategy and HMT. The other required appointment is the BoE's Deputy Governor for Prudential Regulation. As of November 2021, there are nine FCA Board Members: seven non-executive board members (including the BoE's Deputy Governor for Prudential Regulation), the Chief Executive and the Chair.</p> <p>The FCA is required to submit an Annual Report to HMT addressing the extent to which the FCA's regulatory objectives have been met. It is also required to hold an Annual Public Meeting each year within 3 months after the Annual Report has been issued to HMT. The FCA also publishes an annual regulatory perimeter report where it sets out key elements, including whether there are any issues with the perimeter which might require legislative or other changes.</p> <p>The FCA has a supervisory decision matrix that defines the types/levels of decisions, the decision maker and the level of authority required for the firms it regulates. In descriptions given during the mission of regulatory decisions made, this appears to result in regulatory decision making at levels in the organization that appear appropriate.</p> <p><i>PRA and FCA funding and resources</i></p> <p>Both the PRA and FCA are funded by the industries they regulate, including insurers and, in the case of the FCA, insurance intermediaries. The FCA and PRA can determine their own funding needs and set statutory fees accordingly but there are accountability mechanisms set out in FSMA.</p> <p>FSMA gives the FCA powers to raise fees to cover budgeted Ongoing Regulatory Activity. Total FCA staffing is approximately 3,629 full time equivalent staff with approximately 256 FTE working on supervision of insurers and insurance intermediaries. Turnover of staff is a very reasonable 7.7 percent.</p> <p>In reviewing the FCA's approach to supervision the mission did not detect any concern that the FCA does not have sufficient human resources to meet its objectives for insurer and insurance intermediary supervision. As mentioned in relation to ICP 9, the mix of fixed firm and flexible firm supervision has undergone changes and the impact of this is recommended to be reviewed. However, this does not imply a lack of resources.</p> <p>The PRA consults each year on the allocation of fees among firms. In 2019/20 the PRA received one response to its consultation which did not change its fee proposals. The PRA has flexibility to raise additional funds during the year for material changes. The PRC allocates its financial and non-financial resources to advance its objectives. The number of staff working directly in insurance supervision has declined from 313 at the end of 2016 to 278 at the end of 2020. However, this does make some sense as 2016 was the first year of implementation of Solvency II. While findings for ICP 9 indicate that potentially more on-site supervision resources are required, the resources given the current supervision approach appear to be adequate. Some reprioritization was necessary due to the market</p>
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	<p>risks and operating conditions imposed by the COVID-19 pandemic but this reprioritization is similar to the experience of many supervisors around the world. In 2020, the PRA underspent its overall budget (not just related to insurance supervision) and is returning that to supervised firms in the determination of 2020/21 fee rates.</p> <p><i>Appeals processes</i></p> <p>FCA enforcement actions are taken by the Regulatory Decisions Committee which ensures separation of the decisions from FCA staff recommending action and allows representation from firms or persons against which the action is proposed.</p> <p>Section 415 of FSMA enables civil proceedings to be brought against the FCA and PRA. The Upper Tribunal (Tax and Chancery Chamber) can consider appeals against decisions by the FCA concerning the lawfulness rather than the merits of the decision.</p> <p><i>Protection of confidential information</i></p> <p>Section 348 of FSMA restricts disclosure of confidential information by the FCA and PRA and its staff unless the person or firm concerned gives prior consent. Further discussion of circumstances in which information can be released is set out in relation to ICP 3. There are other restrictions on disclosure such as personal data in accordance with the Data Protection Act 2018.</p> <p><i>Transparency</i></p> <p>The FCA and PRA are both bound to principles set out in section 3B of FSMA which includes the exercise of their functions as transparently as possible. Both the PRA and FCA have published their approach to supervision and consult extensively on regulatory policy. Evaluation and reviews are also carried out transparently with publication of evaluation findings such as the Independent Evaluation Office of the BoE's evaluation of the PRA's approach to its SCO.</p> <p><i>Outsourcing</i></p> <p>Both the FCA and PRA can outsource certain supervisory activities to third parties including via s166 and s166A of FSMA. The use of these powers is discussed more in relation to ICP 9.</p> <p><i>Legal protection of supervisory staff</i></p> <p>FSMA provides protection to supervisory staff at the PRA and FCA for acts or omissions in the conduct of their duties except where the act or omission was in bad faith or so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998 (which specifies that it is unlawful for a public authority to act in a way which is incompatible with the European Convention on Human Rights).</p>
Assessment	Largely Observed

Comments	<p>Overall, there is legal and operational independence of the regulators except as noted in relation to the Solvency II review. There are strong and appropriate accountability processes required by law and these accountability requirements are put into practice by the authorities. There are appeals processes for regulatory decisions and the U.K. regulators are very transparent about their policy development and how they go about supervision.</p> <p>Both the PRA and FCA appear to have adequate resources to undertake their roles as they currently define those roles. In relation to ICP 9, the mission finds that more resources could be devoted to on-site supervision at the PRA but that does not impact on the assessment of the adequacy of resources here under ICP 2. It is noted however, that implementation of the recommendation in relation to ICP 9 will likely have resource implications for the PRA but the funding model for the PRA will allow those additional resources to be obtained subject to accountability processes. For the FCA, in relation to ICP 9 it is suggested that the FCA review its division between fixed firm and flexible firm supervision. Any changes in that division may have resource implications in the future.</p> <p>As set out in Box 1, the objectives for the Solvency II review align closely with the remit letter issued to the PRC on March 23, 2021, but the structure of the Solvency II legislation and the way the review is being conducted leads to the 'have regard to' policy priorities of the government being elevated to objectives for the Solvency II review.</p> <p>The PRA and HMT are working closely on the Solvency II review. HMT draws on the PRA for technical and supervisory expertise. This can be seen in the PRA conducting a Quantitative Impact Study (QIS) between July and October 2021 to support the Solvency II review. The PRA's advice to HMT is not transparent as they are working closely together. The PRA has the ability to use speeches of senior staff to set out its views on aspects of the Solvency II review. This has occurred a number of times since the launch of the Solvency II review, most recently a speech by Gareth Truran.²¹ Ultimately, it is not clear how the final policy positions of the Solvency II review will be determined and the role that the PRA and HMT will play. In particular, if the PRA and HMT have differences of views it is not clear how those differences of views will be resolved. Since the PRA is not in a decision-making role for the Solvency II review, it is not clear how it will be able to set out its views on the final policy positions to be taken in the Solvency II review. If its advice is not fully adopted in the final policy positions, it may also find itself in a position of supervising the insurance sector using rules that it does not believe are fully in line with its own objectives.</p> <p>The final positions taken in the Solvency II Review should be consistent with the Insurance Capital Standard (ICS) developed by the IAIS that is currently in the five-year monitoring period ending in 2024.</p>
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²¹ <https://www.bankofengland.co.uk/speech/2021/september/gareth-truran-speech-at-the-bank-of-america-26-financials-ceo-conference>

	<p>It is acknowledged that the issue with the Solvency II review is likely one of timing with the intention as set out in the FRF Review 2021 Consultation to put prudential rule-making within the control of the PRA. One way forward to address the identified independence issue with the current legislative structure, would be to ensure that requests for advice from the PRA are made transparently by HMT and that the PRA can provide that advice in an independent and transparent way. Any variation in final policy compared to PRA advice would then be clear.</p>
ICP 3	<p>Information Sharing and Confidentiality Requirements</p> <p>The supervisor obtains information from, and shares information with, relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p>
Description	<p>Section 348 of FSMA restricts disclosure of information by the PRA and FCA unless there is consent by the firm or person who has provided it or if a disclosure is for the purposes of facilitating the carrying out public functions and there is a gateway for disclosure defined in regulations made by HMT.</p> <p>The PRA and FCA are under a statutory duty to co-operate with U.K. and foreign regulators which have similar functions and with other bodies that have functions relevant to financial stability (PRA) and financial crime (FCA).²² A breach of section 348 by PRA or FCA staff is a criminal offence punishable by fine or imprisonment or both.</p> <p>Both the PRA and FCA have signed Memorandums of Understanding (MoUs) with EEA and non-EEA supervisory authorities.</p> <p>The FCA and PRA also have an MoU for sharing information. During the mission, it was observed that sharing of information and cooperation among PRA and FCA staff was exemplary. There were clear examples of sharing of information about wider group structures and practices as well as a well-coordinated approach to approving senior managers under the Senior Managers Regime (see ICP 5 for further elaboration). Dual regulated insurers provide information to both the PRA and FCA at the same time via monthly Board and other Reports so neither regulator has to request this information from the other. However, during discussions it became clear that from the PRA side it is easier to share information where both the PRA and FCA have dedicated supervision teams for insurers. As such, both FCA and PRA supervision is likely more effective due to the clear, open lines of communication between the FCA and PRA where the FCA maintains a fixed firm supervision team.</p> <p>There are other disclosure regimes which apply to other types of information the FCA has received, for instance information obtained under The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (2017/692) and information obtained when the FCA is carrying out any functions under the</p>

²² S354A and S354B of FSMA

	<p>Competition Act 1998 or the Enterprise Act 2002, by virtue of Part 16A of FSMA.</p> <p>Both the FCA and PRA have comprehensive internal guidelines to guide staff in determining whether they can share information and when to seek internal legal advice in doing so.</p> <p>There was a specific case of information sharing arrangements that needed to be put in place when the U.K. ceased to be a member of the EU and the Brexit transition period expired on 1 January 2021. An MoU between the PRA and EIOPA as well as a Multilateral Memorandum of Understanding (MMoU) covering all EEA insurance regulatory authorities came into force on 1 January 2021. The MMoU and MoU provide for continued engagement and supervisory cooperation between the PRA and EU/EEA authorities. There are both senior level (quarterly meetings between the EIOPA Chair and PRA Insurance Executive Director) and many working-level technical dialogues on as needed basis. There are also necessary bilateral contacts between the PRA and European insurance regulatory authorities.</p> <p>There are also fortnightly platform calls involving the PRA and FCA with EIOPA (Chairing) and number of national European authorities. This was set out in 2017 focusing on Brexit preparations. The need for regular calls is reducing.</p> <p>A key reason for ongoing engagement between U.K. and EU authorities is the approximately 180 EU-based insurers that previously passported into the U.K. that have entered the Temporary Permissions Regime or Supervised Run-Off at the point the U.K. left the European Union. The jurisdiction with most insurers seeking licenses in the U.K. is Ireland and in 2019 the PRA signed a Split of Responsibilities Agreement (SoR) with Central Bank of Ireland. The SoR seeks to minimize duplication of effort and sets out a framework for cooperation including triggers for informing the other party to the agreement of material developments within a firm with a branch in the U.K. The PRA intends to agree similar SoRs with other EEA home state authorities once EIOPA issues guidance in 2022.</p> <p>The PRA has a risk-based approach to establishing MoUs looking at the volume of cross-border financial services activity between the two jurisdictions, the presence of U.K.-regulated firms in the host market and the presence of firms from that jurisdiction in U.K. financial markets. The FCA assesses the need for an MoU to be established after an internal review of the desirability, function and necessity. Under FSMA there is a requirement to undertake a professional secrecy equivalence assessment as a pre-condition to entering into an MoU that applies to both the PRA and FCA.</p> <p>In response to a Freedom of Information Request by <i>Professional Adviser</i>,²³ the FCA admitted to three data breaches where information was accidentally made publicly available. One of these was the accidental publication of information about complaints made to the FCA, of which a small proportion of complaints related to the insurance</p>
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²³ As reported in <https://www.internationalinvestment.net/news/4033320/revealed-fca-admits-breaches-last>

	<p>sector. The mission sought to understand the nature of these breaches and received a written response from the FCA Cyber and Information Resilience Department: “We have well-established processes for responding to data breaches, as part of our overall Cyber Crisis Playbook. These processes adhere to Information Commissioner’s Office (ICO) guidelines and are overseen by our Data Protection Officer. Our response to the breaches cited in the media followed these processes. Where appropriate, we reported the breaches to the ICO, who were satisfied with our handling of them.”</p> <p>This is not an issue that obviously impacts on observance of ICP 3. The FCA and its stakeholders would benefit from a more open approach to disclosure about these breaches.</p> <p>Both the FCA and PRA would notify other supervisors if a disclosure of information they have provided is required through a court proceeding. They would seek consent to disclose the information. Where this consent is not given, both regulators would resist disclosure of information. However, FSMA (Disclosure of Confidential Information) Regulations 2001 provides circumstances where confidential information may be disclosed: in relation to a criminal investigation or certain other specified proceedings, Regulators can request confidential information be heard by the court in private.</p>
Assessment	Observed
Comments	<p>The PRA and FCA have a sound legislative basis for sharing information and protecting the confidentiality of information. Internal policies and procedures are in place to support staff in making decisions about when it is appropriate to share information and when issues require internal legal advice. Both the PRA and FCA have an extensive network of MoUs and MMoUs to facilitate exchange of information with other U.K. regulators (including between PRA and FCA) and foreign regulators.</p> <p>The mission was able to observe examples of sharing of information and examples where information was not shared due to appropriate safeguards in the legislative framework and internal policies.</p>
ICP 4	<p>Licensing</p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p>
Description	<p>Section 19 of FSMA provides that no person may carry on a regulated activity in the U.K., or purport to do so, unless he or she is an authorized person or an exempt person. The regulated activities are defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 with insurance business defined in Chapter III. Section 4B of the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013</p>

	<p>requires that to carry on insurance business, an authorized person must be a body corporate, registered friendly society or member of Lloyd's.</p> <p>Since the EU treaties (which provided rights of establishment and to provide cross-border services) ceased to have effect in the U.K. on 31 December 2020, the parts of Schedule III of FSMA which provided for EEA firms authorized in their home member state to passport into the U.K. have been repealed.</p> <p>However, these rights have been replicated in Section 409 of FSMA (and subordinate legislation made under that power) for Gibraltar-based firms, which can continue to establish or provide services in the U.K. This temporary access regime for Gibraltar firms will be made permanent with the creation of a Gibraltar Authorisation Regime.</p> <p>The perimeter guidance section (PERG) of the FCA Handbook provides guidance to a person who is considering carrying on activities in the United Kingdom which may fall within the scope of the Act.</p> <p>The FCA is primarily responsible for identifying unauthorized regulated activities. However, the PRA or FCA can instigate proceeding against a person conducting unauthorized regulated activities with the possibility, on conviction, of the imposition of a fine or imprisonment.</p> <p>The FCA has a number of ways of identifying unlicensed insurance activities from various sources including complaints data, whistleblowers, the FCA's contact center, assessment of regulatory returns, and intelligence from other regulators and competitor firms. There have been no recent detected cases of unauthorized insurers operating but there have been instances of unauthorized insurance intermediaries. There have been examples of licensed insurers inadvertently undertaking business in a class of business not covered by their license.</p> <p>The FCA has a department that is responsible for identifying firms that are operating illegally within the regulatory perimeter either in error or with intent. This department is called the Unauthorised Business Department.</p> <p>Some insurance activities may be undertaken on a cross-border supply basis. However, to fully access the U.K. markets and to promote their services in the U.K., foreign insurers must establish a commercial presence in the U.K. which requires authorization.</p> <p>Firms that wish to establish a discrete group entity or branch must comply with Part 4A and meet Threshold Conditions. The U.K. has a regime for the establishment of an overseas branch of the home state entity (third country branch).</p> <p>Depending on the regulated activities that a firm will undertake under Part 4A of FSMA, it will either be solo-regulated by the FCA, or dual-regulated by the FCA and the PRA. Solo-regulated activities of most relevance to this assessment are insurance distribution activities. Dual-regulated activities of most relevance to this assessment are insurance business – effecting contracts of insurance and carrying out contracts of insurance.</p>
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The PRA is the single point of contact for the application process for insurers that are regulated by both the FCA and the PRA (dual regulated). Application packs for new insurers are available on the PRA website. The New Insurers Start Up Unit website on the PRA website provides information and support for those thinking of setting up as a new insurer in the U.K. The PRA must obtain the FCA's consent before it can authorize an insurer.

The PRA and FCA provide support to applicant firms by means of pre-application meetings. Pre-application meetings are structured to provide initial guidance on the process and procedures, and to subsequently feedback on anything that may impact the firm's ability to comply with Threshold Conditions.

Firms must meet Threshold Conditions in order to receive a license. For dual-regulated firms, the FCA and PRA have different sets of Threshold Conditions which are complementary. Firms must be able to demonstrate they meet the Threshold Conditions including Legal Status, Location of Offices, prudent conduct of business (including the need to have appropriate financial and non-financial resources), suitability of senior managers and capable of being effectively supervised.

An insurer cannot be given permission to carry on both long-term insurance business and general insurance business unless the long-term insurance business is restricted to reinsurance business. U.K. insurance companies permitted or seeking permission to carry on long-term insurance business are, however, able to apply for permission to carry on general insurance business in the specified categories 'accident' and 'sickness'.

Section 55V of FSMA states that the regulator, has a maximum of 12 months to determine an application but a decision needs to be made within 6 months of an application being deemed complete. An application is considered complete if there are no material gaps in the application. In practice, as observed during the mission, initial applications received from companies are often not complete and require a subsequent submission in order that a complete submission is made to start the 6-month period of time. The pre-application period may also cover an extended period of time as the PRA and FCA work with an applicant to ensure they are in a position to submit a credible license application. The PRA and FCA have an agreed internal service level agreement for concluding an initial review of the application within 6 to 8 weeks and providing feedback to the firm.

In the case of branches of foreign subsidiaries, the PRA will seek a letter of good standing from the home state supervisor stating that they have no concerns over solvency, governance and controls of the firm or group.

In practice, there have been no formal rejections of an application for authorization. If an application is not likely to succeed, the PRA will issue a letter to the applicant stating that the relevant supervision team are minded recommending the refusal of the application to the PRA decision maker. The determination of the proposed decision maker is based on the proposed category of the firm (for description see ICP 9

description) and the significance of the decision in terms of the ability of the firm to carry out its business effectively and/or the impact on the PRA's objectives. In most cases, applications are withdrawn after such correspondence, meaning that the proposed decision maker is not required to make a formal decision. A formal rejection of an application for authorization is a statutory notice decision. The PRA must publish information about a rejection that it considers appropriate unless it is unfair to the applicant or prejudicial to the PRA's objectives. Therefore, firms are dissuaded from moving to this formal decision-making stage after receiving the 'minded recommending refusal' letter. While one way of looking at this process may be that the formal decision-making process is being circumvented, the other way of looking at it is that the process is transparent for the applicant and avoids unnecessary negative publicity for the applicant. Applicants sometimes return with revised applications with issues corrected.

When firms are issued with an authorization letter it contains a scope of permission notice that sets out the classes of life or general insurance business the firm is allowed to undertake. A firm may subsequently request to vary its permission if it seeks to expand its product mix beyond the initially approved classes of business. A list of licensed insurers and scope of permissions is provided on both PRA and FCA websites.

Since 2016, 14 new insurers have been authorized by the PRA and FCA with 4 being the maximum number authorized in any one year. Since 2016, 5 Lloyd's Managing Agents have been authorized.

A specific issue related to authorizations is that a large number of applications are expected from EEA insurers. EEA firms which had valid passports into the U.K. insurance market as of December 31, 2020, and have made a valid notification may continue to access the U.K. insurance market through the Temporary Permissions Regime (TPR). The TPR is operating alongside the Financial Services Contracts Regime which allows for the orderly run-off of U.K. business by EEA firms not seeking authorization. This is achieved through the Supervised Run-Off Regime (SRO) or the Contractual Run-Off Regime (CRO). The SRO allows run-off for up to 15 years and is subject to supervision by the PRA and FCA.

There were approximately 700 insurers that had a passport to write business in the U.K. It is believed the vast majority did not conduct business in the U.K., but the U.K. does not have data on this. This lack of data is an issue that will be addressed by supervising all insurers conducting business in the U.K. However, the lack of data on business undertaken by passporting firms in a jurisdiction is an issue within the EU Solvency II framework that needs to be addressed.

The TPR lasts until December 30, 2023, but all applications for authorization must be submitted no later than December 30, 2022, to remain in the TPR. The period of TPR could be extended by HMT. There are approximately 180 firms that have entered the TPR and the PRA expects 140 firms to apply for a third country branch; the remaining

40 are expected to enter the SRO. The usual 12-month deadline for deciding on applications has been suspended for TPR-related third country branch applications. Any subsidiary applications follow the normal application process.

140 firms applying for licenses over approximately a 2-year period must be considered in light of only 14 new insurers granted authorization since 2016 as well as five Lloyd's Managing agents. The volume of applications is notably large by historic norms. Workflow is being managed by locking firms into submitting an application in a particular quarter. The majority of insurers applying for third country branches are Category 5 insurers. There are twelve Category 2 insurers, ten Category 3 insurance with the remainder in Category 4 and 5.

A mitigating circumstance is that these are firms with operating businesses in the U.K. and so the process is to validate business plans, systems and people already in place and operating in the market. That may reduce the burden of the process of authorization somewhat compared to a new insurer.

The U.K. allows insurers to operate through a third country branch if certain conditions are met and these are set out in Supervisory Statement SS2/18.²⁴ In assessing whether a third country branch is an allowable structure for an insurer to operate in the U.K., the PRA considers whether: the home jurisdiction's prudential supervision regime is broadly equivalent (not a formal equivalence assessment); the firm is capable of being supervised effectively by the home supervisor; the whole firm is able to meet the Threshold Conditions; there is sufficient supervisory cooperation with the home supervisor; U.K. policyholders of the firm will be given the appropriate priority in an insolvency; the firm is able to meet relevant PRA rules, given the scale of U.K. branch activity covered by the Financial Services Compensation Scheme (FSCS), the protected amount covered by the FSCS can be absorbed by insurers liable to contribute to the FSCS and the impact of the failure of a firm with a U.K. branch on the wider U.K. insurance market and financial system would not lead to broader instability. The PRA expects third-country branches to have under £500 million of insurance liabilities covered by the FSCS when operating as a branch. This is not a hard threshold, rather an indicative one and if FSCS relevant liabilities exceed this amount the PRA may consider requiring authorization as a subsidiary.

The process of authorizing firms in the TPR by a team formed specifically to address Brexit issues in the PRA, the Cross Border and Restructuring Team (CBRT). The team considers applications for authorization and also Part VII transfers of business related to Brexit. It receives significant support from PRA Authorisations. The FCA has a similar set up and has created a dedicated insurance team within its Authorisations division to handle Brexit related demand from not only these branch applications but also Part VII transfers of business. There are significantly scaled up resources available to work on

²⁴ <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/international-insurers-pras-approach-to-branch-authorisation-and-supervision-ss>

	<p>the applications. The CBRT is a team of 23 people, about half recruited from existing supervision staff and half new to the PRA. The equivalent FCA team is 20 people with a further increase of 2 people expected in the new year. These staff have not been recruited from insurance supervision teams and have been largely external hires and has been built up over 4 years, Coordination mechanisms between the FCA and PRA are in place. The specific Brexit resourcing is expected to remain until December 31, 2023.</p> <p>There is an informal committee of Heads of Department and Senior advisors at the PRA that the CBRT can refer to obtain a steer on some applications and on resourcing needs. On resourcing needs, there is no clear contingency plan in place for additional resourcing of the CBRT if applications turn out to be more complicated and time consuming than expected.</p> <p>Firms in TPR which do not proceed to an application for a third country branch may move either from TPR to CRO or to CRO via SRO. The process for this to occur was still being developed at the time of the mission. If a firm withdraws its application before a decision is made by the PRA, then it may exit the TPR (or a firm may submit a new application). This is likely to mean the willingness of TPR firms to withdraw applications if 'minded refusing' letters are sent will be less, leading to more formal decisions. Another way firms may exit the TPR is if they complete a Part VII transfer of their liabilities.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>There is a clear legislative framework for licensing of insurance activities in the U.K. market. Unregulated insurance activity is monitored and there are powers for the regulators to deal with unregulated activity.</p> <p>Authorization procedures are clear with information packets available for prospective applicants on the PRA website. The Threshold Conditions ensure that authorizations are only granted to applicants that can demonstrate sound business planning, fit and proper senior management and significant owners, appropriate governance and risk management frameworks and necessary capital.</p> <p>The preapplication process provides a transparent process for applicants leading up to the application and means that applications can be processed within the required 12 month period. Formal decision making on applications is largely avoided via the 'minded refusing' letters and voluntary withdrawal of applications. That appears to be a pragmatic way to interact with applicants but it does mean those in formal decision making position do not exercise that formal decision-making power.</p> <p>The TPR-related applications for authorization are a concern in terms of a peak load of applications. Teams and processes have been put in place to deal with this peak load through to December 31, 2023. It is recommended that the PRA and FCA teams dealing with TPR-related authorization applications develop contingency resourcing plans.</p>

ICP 5	<p>Suitability of Persons</p> <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p>
Description	<p><i>The Senior Managers & Certification Regime</i></p> <p>The Senior Managers & Certification Regime (SM&CR) was established to address shortcomings identified by the Parliamentary Commission on Banking Standards in 2013, in particular that in the years around the global financial crisis, senior bankers had avoided accountability ‘for failings on their watch by claiming ignorance or hiding behind collective decision-making’. It therefore recommended that regulators establish an individual accountability regime directed to the decisions and competence of ‘Senior Persons’. Subsequently, the PRA and FCA, together with HMT, developed the SM&CR which was rolled out to banks in March 2016 and was extended to insurers in December 2018, replacing the previous Senior Insurance Managers regime. For insurance intermediaries, it came into effect in December 2019 with extension to reporting requirements in March 2021.</p> <p>The SM&CR sets out (a) the functions for which individuals are required to be approved by regulators, (b) certain prescribed responsibilities that firms are expected to allocate to appropriately capable senior individuals, and (c) conduct rules that all Senior Managers are expected to follow. It also sets out the details of the certification regime applied to individuals not deemed to be Senior Managers but whose function is significant enough that it carries a potentially significant risk of harm to the firm or its customers.</p> <p>The SM&CR, in Section 59 of FSMA, sets out that authorized firms are required to ensure that individuals seeking to perform certain functions specified by the PRA and FCA seek approval and meet suitability requirements before taking up their position. These senior decision-makers must be assessed as fit and proper by the institution and the PRA/FCA and receive formal regulatory approval to perform a Senior Management Function (SMF) before taking up their roles.</p> <p>Under the SM&CR, SMFs are designated as either PRA or FCA led functions. The majority of SMFs are considered PRA-led functions like the Chief Executive Officer, Chief Finance Officer, Chief Risk Officer, Chief Actuary, and Head of Internal Audit. FCA-led functions include, e.g., the Head of Compliance, Money Laundering Reporting Officer and the Chair of the Remuneration Committee. There are also SMFs, covering non-executive directors of the board with responsibilities, such as the Chair, the Senior Independent Director and the chairs of the audit, nominations, remuneration and risk committees.</p> <p>The PRA cannot approve a PRA-led SMF without the consent of the FCA. As such, a single administrative process is operated to facilitate the assessment of PRA-led SMFs. Communications with applicant firms are generally channeled through the PRA as lead regulator, and where both regulators seek to conduct an interview as part of the</p>

	<p>assessment, it is conducted jointly.</p> <p>Authorized firms are required to satisfy themselves that an individual for whom they seek the regulator’s approval to hold a function is fit and proper and, assuming approval, that the individual continues to be fit and proper for the duration that the function is held. The SM&CR regime requires firms appointing a senior manager to secure regulatory references for a period of at least six years. Authorized firms are required to provide regulatory references to prospective new employers, this includes details of any disciplinary action taken due to breaches of the Conduct Rules and any findings that the person was not fit and proper.</p> <p>The assessment for fitness and propriety is done on a desk-based and, where appropriate, interview basis. Whether a candidate is interviewed is determined on a risk-based basis, taking into account the category and soundness of the firm (proportionality), the proximity of the position to the key risks faced by the firm, and the extent to which the regulators are familiar with the individual.</p> <p>The Fit & Proper test consists of three parts: (1) Honesty, integrity and reputation; (2) Competence and Capability; and (3) Financial Soundness.</p> <p>In 2020, the PRA published an evaluation of the SM&CR. This set out that in the year to September 2020, across all PRA-regulated firms there were 1,360 applications for approval, while 1,146 applications were approved, and 98 applications were withdrawn. Firms can withdraw applications before a decision is taken. To date the PRA has not provided a formal rejection notice.</p> <p><i>Certification Regime</i></p> <p>The PRA and FCA’s Certification Regime applies to significant risk-taking individuals, outside the group identified as senior managers, who are potentially capable of causing significant harm to the firm or its customers. The PRA has specified that certification functions include the functions performed by Key Function holders (as described above). In addition, for ‘large firms’, certification functions also include functions performed by ‘material risk-takers’, i.e. those staff whose professional activities have a material impact on a firm’s risk profile.</p> <p>Employees subject to the Certification Regime do not require approval by the PRA or FCA, but the Certification Regime requires firms to assess annually and certify the fitness and propriety of these employees. This certification must be reviewed annually and maintain a record of every employee. Section 63E of FSMA requires authorized persons to ensure that no employee performs a specified function unless certified by the firm.</p> <p>The PRA’s Statement of Policy on Conditions, time limits and variations of approval also sets out further details on how the PRA exercises its powers in this area.</p> <p><i>Conditions</i></p> <p>The SM&CR provides the option of the FCA and the PRA approving an individual’s</p>
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application to hold a particular function either on a time-limited basis or subject to certain conditions. SUP 10C.12 of the FCA's Handbook sets out guidance as to the likely circumstances whereby a time-limit or conditions may be appropriate. For example, the FCA may decide to impose a time-limit on the approval of an individual who is or potentially could be implicated in a current FCA enforcement investigation. Whilst there may be insufficient grounds on which to base a refusal at the point of application, a time-limit allows the FCA the opportunity to consider the outcome of any enforcement investigation in the context of an individual's fitness and propriety. A further example of the use of a time-limit is where the nature or scale of a role is likely to materially change in future. In such circumstances, the FCA may consider an individual fit and proper to discharge a function at the current time but not necessarily for the role as its nature changes.

Conduct Standards

To help ensure the ongoing fitness and propriety of senior individuals, the PRA and FCA require senior individuals to abide by a number of minimum conduct standards requiring that they: (i) act with integrity; (ii) demonstrate due skill, care, and diligence; and (iii) are open and cooperative with the FCA, the PRA, and other regulators. There are additional conduct rules that are applicable to SMF holders, such as taking reasonable steps to ensure the business of the firm for which they are responsible is controlled effectively and complies with the relevant regulatory requirements. Moreover, they must take reasonable steps when delegating their responsibilities, and should disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

In SS35/15, the PRA sets out that firms and groups should have suitable procedures for monitoring the conduct of senior individuals, including their adherence to the Conduct Standards. Moreover, where a firm or group identifies any matter which might be relevant to an assessment of whether an individual who is performing such a function is fit and proper, including a potential failure to observe a Conduct Standard, it should promptly and fully investigate the position and take appropriate action, including complying with any obligation to notify the PRA.

The key facts that should result in a notification to the PRA are set out in section 64C of the FSMA, and are clear: the regulators must be notified where 'disciplinary action' has been taken against an individual, evidenced by any of the following:

- the issuing of a formal written warning
- the suspension or dismissal of the person or
- the reduction or recovery of any of the person's remuneration.

Supervisors also consider the ongoing fitness and propriety of senior individuals as part of their regular engagement with the firm throughout the continuous assessment process, including as part of the regular cycle of meetings with senior individuals.

	<p><i>Controllers</i></p> <p>Section 422 of FSMA provides a definition of controller (significant owner) for the purposes of calculating shares and/or voting power for proposed holding. The fitness and propriety and competence/capability of individuals who exercise control over a regulated firm are assessed either when a firm applies for authorization, via an assessment against Threshold Conditions, or when there is an application for a change in control of an authorized firm. Such individuals may be both owners and directors of an applicant firm (often in the case of insurance intermediaries). Assessments are judgement based and depend on supporting evidence provided by the applicant and/or driven by information received through intelligence checks undertaken on such individuals.</p> <p>The PRA Controllers Regime (Part XII of FSMA) requires persons to seek approval via a section 178 notice from the PRA before gaining or increasing control over a firm that is authorized by the PRA. It is a criminal offence if a person fails to seek and obtain such approval before making the acquisition in question.</p> <p>For significant owners (deemed Controllers under the U.K. regulatory system) suitability is assessed on a more reactive basis. Controllers are required to notify the PRA as soon as the controller becomes aware of any of the following matters:</p> <ul style="list-style-type: none"> • if a controller, or any entity subject to their control, is or has been the subject of any legal action or investigation which might put into question the integrity of the controller • if there is a significant deterioration in the financial position of a controller • if a corporate controller undergoes a substantial change in its governing body. <p>Similarly Rule 4.1 in the Change in Control part of the PRA rulebook requires that a firm must notify the PRA as soon as it becomes aware of any of the above-mentioned matters in respect of one or more of its controllers.</p> <p><i>Board Members Collective Fitness and Propriety</i></p> <p>Article 258(2c) of the on-shored Solvency II Delegated Regulation requires insurers to ensure that the members of the administrative, management or supervisory body collectively possess the necessary qualifications, competency, skills and professional experience in the relevant areas of the business in order to effectively manage and oversee the undertaking in a professional manner.</p> <p>The PRA's expectations for collective competence are expanded upon in SS5/16 – Corporate Governance: Board Responsibility. This states that firms must be run by people who are competent to fill their roles, and have appropriate expertise and experience, and (in the case of non-executive directors) give sufficient time to fulfil their obligations to a high standard. Boards are also required to possess adequate collective knowledge, skills and experience to be able to understand the institution's activities, including the main risks. As a firm grows and changes, and as the challenges it faces change, it may need</p>
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different board members and management.

In addition, SS5/16 sets out further expectations on the collective competence and experience of the board. The PRA note that between them the non-executive directors need to have sufficient current and relevant knowledge and experience, including sector experience, to understand the key activities and risks involved in the business model and to provide effective challenge across the major business lines of the firm. The PRA expects to see evidence of effective challenge, particularly in relation to key strategic decisions. It is the role of the chair to ensure that all views are heard and that the executives do not control the board discussion.

The competence and integrity of board members is considered during the regular cycle of supervisory meetings with key individuals and throughout the continuous assessment activities. Deep-dive Board effectiveness reviews provide supervisors with insights and evidence of the collective fitness and propriety of the board.

Information sharing

There is adequate information sharing between the two regulators including sharing of intelligence received by one or the other. The FCA and PRA are also a member of the Shared Intelligence Service, through which different regulators and other organizations can share information about firms and individuals, thereby providing input to the risk-based assessment of the fitness and propriety of individuals.

Where an individual has been active in other jurisdictions, and where intelligence suggests potential concerns as to the individual's conduct, the authorities have a number of MoUs established with global regulators which facilitate the sharing of information (see ICP 3). The aim of dialogue with other regulatory bodies is to substantiate any concerns arisen from the intelligence mentioned so that the full facts may be considered in any assessment of fitness and propriety.

Enforcement

For the PRA, the SM&CR acts principally as a supervisory tool. Therefore, as part of its ongoing supervision of firms' governance as part of the continuous assessment process, the PRA considers the overall composition and effectiveness of boards as well as the ongoing fitness and propriety of key individuals. Where there are concerns around an individual's competence, the supervisor would look to raise these early with the firm, as well as at the point when they no longer meet suitability requirements. This would be raised with the firm as part of ongoing supervisory dialogue, or at the point of a governance effectiveness review – whichever is timelier. As stated in SS35/15 the PRA expects that supervisors and firms will discuss succession planning for key individuals and any proposed changes to the insurer's board.

While the PRA's preference is to encourage firms to take the initiative or agree to remediation voluntarily in the first instance with the option to use statutory powers as set out in FSMA, to secure remedial action, it also has a set of enforcement powers which it

	<p>will use retrospectively if necessary. The PRA has enforcement powers over certain individuals at insurers²⁵ and is empowered to use these where an individual fails to comply with its Conduct Rules or has been knowingly involved in a contravention by their firm of a requirement imposed by the PRA. The powers enable the PRA, among other sanctions, to impose penalties to censure an individual publicly, to suspend an individual's approval, to withdraw approval from individuals holding SMFs, and to prohibit individuals from holding SMFs in the future.</p> <p>In assessing whether to take enforcement action the PRA considers a variety of factors, including:</p> <ul style="list-style-type: none"> • the impact the individual's behavior has had, or is having, on advancing PRA objectives, including the behavior of other persons in the insurer over whom the individual should exercise control, and thus whether that behavior calls into question the person's fitness and propriety (be it an isolated incident or a course of conduct) • whether taking action will serve to deter the person who committed the breach, and others who are subject to the PRA's requirements, from committing similar or other breaches and • the individual's behavior towards the PRA, including the level of co-operation and openness, and the appropriateness of the individual's actions in response to concerns raised. <p>In addition to the enforcement powers set out above, the PRA and FCA also have powers under Sections 61, 63ZA and 63ZB of FSMA, to impose time limits, conditions and variations on the approval of Senior Managers.</p> <p>The PRA and FCA may use powers under Part 4A of FSMA to vary permission, impose requirements or change individuals' approvals where it appears that individuals may be in contravention of, or are not meeting, relevant standards.</p> <p>The Decision Procedure and Penalties manual (DEPP) of the FCA Handbook sets out the FCA's policy with respect to its power to impose a suspension, restriction, condition limitation or disciplinary prohibition under sections 88A, 89Q and 206A of FSMA 2000. This power is a disciplinary measure which the FCA may use in addition to, or instead of, imposing a financial penalty or issuing a public censure. DEPP 8 sets out the FCA's statement of policy on the exercise of its power under Section 63ZB of FSMA 2000 to vary, on its own initiative, an approval given by the FCA or the PRA for the performance of a designated senior management function in relation to the carrying on of a regulated activity by a SM&CR firm. The FCA may also issue a prohibition order to an individual SMF holder under Section 56 of FSMA.</p>
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²⁵ including those approved by it to perform an SMF or an equivalent function by the FCA (e.g. as a member of the governing body), employees who are a key function holder or fall under the individuals under the certification regime, non-executive directors

	<p><i>ComFrame</i></p> <p>In the context of an IAIG, the SM&CR focuses on the fitness and propriety of individuals that are either employees of the U.K.-regulated entity or those who are employees of the wider group that have a significant influence over the operation of the U.K. regulated entity by proxy of their wider group role.</p> <p>There are two ways in which group individuals can exert influence over a U.K. regulated entity:</p> <ul style="list-style-type: none"> • In some instances, senior managers from within a group take up a shareholder non-executive position on the Board of the U.K. regulated entity. In most instances, these individuals do not chair the board or board sub-committees of the U.K. regulated entity and therefore do not hold SMFs. Neither the FCA nor the PRA conduct a fitness and propriety assessment of these individuals, but the regulators are simply notified of the appointment. • The SM&CR also provides specifically for the situation whereby an individual employed in the wider group exerts significant influence over the U.K. regulated entity by proxy of the wider group role through the Group Senior Manager—this might include the chair of the group board, and the chair of a key group board committee where that committee has direct responsibility for oversight of the affairs of the insurer. This function is commonplace within the governance frameworks of U.K.-regulated entities that are part of large multinational groups (including IAIGs). In such cases, a full fitness and propriety assessment is conducted. <p>For an IAIG, the competence of the board, both individually and collectively, would need to be commensurate to the complexity and international nature of the IAIG, the features of where it operates and the risks to which it is exposed.</p>
Assessment	Observed
Comments	<p>The SM&CR has improved individual accountability. The 2016 FSAP considered the SM&CR to be a “major and welcome improvement” and “an important step towards bolstering public confidence in the banking system”. After several years of implementation and its extension to the insurance sector, the PRA presented the findings from a review in December 2020. It concluded that the introduction of the SM&CR has contributed to senior managers taking greater responsibility for their actions and has made it easier for both firms and the PRA to hold individuals to account. Stakeholders also commented positively during the review and suggested only minor improvements—specifically more guidance was requested regarding interim appointments, the use of temporary and conditional approvals, and on the link between the SM&CR and remuneration rules.</p> <p>Sanctions that have been taken to date in the insurance sector have not been based upon breaches of the SM&CR framework. The U.K. financial regulators may incur a reputational</p>

	<p>risk, should an approved senior manager be involved in severe misconduct. Consequently, it is critical for the PRA to exercise the full range of its formal powers on top of its supervisory interventions. The PRA will use either supervisory intervention or exercise its formal powers dependent on which is most appropriate in each situation. Since the implementation of the SM&CR, the PRA has not yet issued a formal rejection notice for SMF applicants. Instead, it relies more on supervisory intervention and has permitted applications to be withdrawn by firms in line with their rights under FSMA. With respect to enforcement, sanctions that have been taken to date have not been based upon breaches of the SM&CR framework, though enforcement action has been taken against individuals. In any event, formal enforcement actions for individuals' significant failures to comply with regulatory requirements or to discharge their responsibilities is not the only option available to the regulators.</p> <p>It is up to firms to ensure Senior Managers are fit and proper; however, it is possible the U.K. financial regulators may incur a reputational risk, should an approved senior manager be involved in severe misconduct. Consequently, it is critical for the PRA to exercise the full range of its formal powers on top of its supervisory interventions. The PRA will use either supervisory intervention or exercise its formal powers dependent on which is most appropriate in a given situation. Since the implementation of the SM&CR, the PRA has not yet issued a formal rejection notice for SMF applicants. Instead, it relies more on supervisory intervention and has permitted applications to be withdrawn by firms in line with their rights under FSMA. With respect to enforcement, sanctions that have been taken to date have not been based upon breaches of the SM&CR framework, though enforcement action has been taken against individuals. In any event, formal enforcement actions for individuals' significant failures to comply with regulatory requirements or to discharge their responsibilities is not the only option available to the regulators.</p> <p>It is up to firms to ensure Senior Managers are fit and proper; however, it is possible the U.K. financial regulators may incur a reputational risk, should an approved senior manager be involved in severe misconduct. Consequently, it is critical for the PRA to exercise the full range of its formal powers on top of its supervisory interventions.</p> <p>Board effectiveness reviews are mostly commissioned directly by insurers to meet corporate governance requirements and conducted by external firms. Where the PRA asks for a Board effectiveness review to be undertaken for insurers this is usually done by an external firm. This practice differs from banking supervision, where more reviews are performed by the PRA itself—this, however, can be partially explained by the larger size of supervisory teams in the Banking Supervision Directorate.</p>
<p>ICP 6</p>	<p>Changes of Control and Portfolio Transfers</p> <p>The supervisor assesses and decides on proposals:</p> <ul style="list-style-type: none"> • to acquire significant ownership of, or an interest in, an insurer that results in a person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer; and • for portfolio transfers.

Description	<p><i>Definition of controller</i></p> <p>The Acquisitions Directive (Directive 2007/44/EC) was implemented into U.K. law in March 2009. Part XII of the FSMA (Control Over Authorized Persons) places an obligation on the controllers and proposed controllers of those U.K. authorized firms to notify the regulator of changes in control, including acquiring, increasing or reducing control or ceasing to have control over a firm. Failure to notify is an offence under Section 191F of FSMA. However, a retrospective notification can be made, and the suitability of the controller must still be assessed even though the change has already taken place. The appropriate regulator for an insurer is the PRA in consultation with the FCA.</p> <p>Section 422 of FSMA provides a full definition of controller and for the purposes of calculating shares and/or voting power in relation to the relative proposed holdings, the definitions of "shares" and "voting power". In general, a person or firm if they are proposing to acquire:</p> <ul style="list-style-type: none"> • 10 percent or more of the shares or voting power in a U.K. authorized firm or in a parent undertaking of the U.K. authorized firm; or • shares or voting power in a U.K. authorized firm or in a parent undertaking of the U.K. authorized firm as a result of which a person can exercise significant influence over the management of the firm. <p>For insurance intermediaries, the appropriate regulator is the FCA only and requirements come from the FSMA (Controllers) (Exemption) Order 2009, which says that persons should notify the FCA when they have decided to acquire, increase, or cease control. This includes acquiring:</p> <ul style="list-style-type: none"> • 20 percent or more of the shares or voting power in a U.K. authorized firm • 20 percent or more of the share or voting power in a U.K. authorized firm or in a parent undertaking of the U.K. authorized firm or • shares or voting power in the directive firm or its parent undertaking so that the person will be able to exercise significant influence in a U.K. authorized firm or in a parent undertaking of the U.K. authorized firm. <p><i>Change in control</i></p> <p>Section 185 of FSMA provides that where a notification of a proposed change in control has been received, the PRA and the FCA must determine whether to approve the acquisition, approve the acquisition subject to conditions, or object to the acquisition. The regulators may only object to the acquisition if there are reasonable grounds for doing so based on the criteria set out in Section 186 of FSMA:</p> <ul style="list-style-type: none"> • the reputation of the section 178 notice-giver • the reputation and experience of any person who will direct the business of the U.K. authorized person as a result of the proposed acquisition
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- the financial soundness of the section 178 notice-giver, in particular in relation to the type of business that the U.K. authorized person pursues or envisages pursuing
- whether the U.K. authorized person will be able to comply with its prudential requirements (including the Threshold Conditions in relation to all of the regulated activities for which it has or will have permission)
- if the U.K. authorized person is to become part of a group as a result of the acquisition, whether that group has a structure which makes it possible to exercise effective supervision, exchange information among regulators, and determine the allocation of responsibility among regulators and
- whether there are reasonable grounds to suspect that in connection with the proposed acquisition money-laundering or terrorist financing is being or has been committed or attempted, or the risk of such activity could increase.

The regulators have 60 working days from acknowledging a complete notification to make a determination (with a possibility to 'stop the clock' to request missing information).

Where the subject of acquisition or an increase in control is an insurer (i.e. a firm jointly authorized by the PRA and the FCA), the PRA will determine whether to approve the notification in consultation with the FCA. The FCA also performs an independent assessment and may make representations to the PRA, which could include requiring the PRA to object to or impose conditions on the notification in relation to Section 186(f) of FSMA under Section 187A(3) of FSMA.

Mutuals

There is no definition of "mutual" in U.K. law. "Company" is generally defined as referring to an entity registered under the Companies Act 2006, whereas other legal structures are available, such as Friendly Societies, which are not companies but owned by and providing services to its members.

"Friendly societies", under either the Friendly Societies Act 1974 or Friendly Societies Act 1992, are generally regarded as mutuals. The Friendly Societies Act 1992 contains provisions dealing specifically with conversions or transfers to stock companies (Part VIII and Schedule 15). As well as putting in place requirements around member agreement, the legislation also contains provision requiring the Supervisory Authority to confirm the transfer/conversion before it can proceed (Schedule 15, Part II), with a registering authority subsequently responsible for registration of the conversion/transfer to give it effect.

There are a smaller number of insurers registered under the Co-operative and Community Benefit Societies Act 2014, generally also regarded as mutuals. This legislation does not contain express requirement for Supervisory Authority approval/confirmation before any transfer or conversion to a stock company (though it does involve registration of either

change by a registering authority). Where a transfer of engagements is involved, the provisions of FSMA applicable to all other types of firms, apply here. Where the change involves a conversion to a stock company, there is no express provision in FSMA requiring regulatory approval from a Supervisory Authority, but the transaction is still subject to the requirements of FSMA and the firm is still required to continue to meet the relevant Threshold Conditions.

Where a mutual insurer is registered under the Companies Act 2006 (such as a company limited by guarantee), then any change to a different type of legal entity is subject to the provisions of FSMA (involving either Part VII transfer, new authorization, or a 'change of legal status' process), and subsequent registration by a registering authority.

Portfolio transfer

Part VII of FSMA and the Friendly Societies Act 1992, set out the rules under which an insurer or Friendly Society can transfer or amalgamate all or part of its business portfolio to another insurer (Part VII Transfer) or in the case of a Friendly Society to an insurer or another Friendly Society (Part VIII Transfer).

The Part VII process involves a High Court process. No insurance business transfer scheme has effect unless an order to sanction the transfer has been made by the Court (s. 104 of FSMA). By virtue of section 110 of FSMA, both the PRA and the FCA are entitled to be heard in the proceedings and may provide the court with written representations setting out their views on the proposed transfer scheme, against their respective statutory objectives.

The PRA will lead the process for insurance business transfers and will be responsible for specific regulatory functions connected with Part VII applications. This role includes approving the independent expert (IE) and the form of scheme report, after having consulted with the FCA.

The views the FCA give to the High Court are based on its assessment of the Part VII Transfer against its statutory objectives, which are to secure an appropriate degree of protection for consumers, to protect and enhance the integrity of the U.K. financial system, and to promote effective competition in the interests of consumers. The FCA has regard to the PRA's prudential evaluation of a Part VII Transfer, for examples as (a) the expected impact of the Part VII Transfer on the financial soundness of the firms concerned; and (b) the consequent impact (if any) on the security of the affected policyholders' contractual benefit. However, consistent with its role as conduct regulator and the need to use the resources of each regulator in the most efficient and economical way, the FCA does not replicate for itself the prudential evaluation undertaken by the PRA.

The FCA expects firms to demonstrate that they have adequately considered what may be changing as a result of the transfer and have sufficiently analyzed how and to what extent there may be an adverse impact on policyholders, in particular:

- The applicants have considered whether there are sufficient protections in the

	<p>transfer documentation or proposals to mitigate against possible adverse impacts on policyholders, including, where relevant, compensation</p> <ul style="list-style-type: none"> • The IE has considered the relevant information and the analysis identified above. The FCA would also consider whether they have considered appropriate protections and proposed mitigation and considered what mitigations should have been proposed to allow the IE to be satisfied with sufficient confidence • The policyholder communications describe all areas of potential change which may have an adverse impact, and any mitigating or compensation proposals • The applicants have adequately explained and justified where they wish to depend on arguments of non-materiality or proportionality • The description of the scheme is sufficiently clear and fair, contains enough detail and is sufficiently prominent. <p>As policyholders of the firms involved in the transfer have the right to make representations to the Court on the transfer proposals, the FCA considers in detail:</p> <ul style="list-style-type: none"> • Objections raised by policyholders, along with the applicants’ and IE’s substantive response to, and consideration of, those objections • How the applicants have categorized policyholders who continue to object • How the applicants have addressed the initial concerns of those policyholders who no longer wish to object • How the applicants propose to set out for the Court the representations of policyholders who believe that they may be adversely affected.
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>Processes around change in control and portfolio transfers are well-established, and coordination between the PRA, the FCA and the Court appears to be effective.</p> <p>Applications for a change in control do typically not result in a formal rejection. Out of a total of around 60 applications per year, some three to five are withdrawn by the applicant.</p> <p>In the run-up to the Solvency II implementation and during the early stages of the regime, the number of Part VII transfers increased significantly as insurers aimed to raise benefits from better capital management under Solvency II. Another wave of Part VII transfers occurred over the last four years when many of those were related to Brexit (51 out of 64). To manage the workload, resources at the PRA and FCA were expanded—a necessary step as the timeline of each portfolio transfer is driven by the involved insurers and the Court. The PRA engaged early on with the High Court to inform about the expected number of applications, so proceedings were completed without major delays.</p>

<p>ICP 7</p>	<p>Corporate Governance</p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p>
<p>Description</p>	<p>The SM&CR detailed in relation to ICP 5 provides the framework for Corporate Governance and these requirements are administered by both the PRA and the FCA. PRA supervision involves many discussions with the insurer's Board and senior management as part of the continuous assessment process.</p> <p>The SM&CR sets out prescribed responsibilities as well as additional overall responsibilities. The Management Responsibilities Map (MRM) should include sufficient information to enable the supervisor to form a clear understanding of how the management and governance arrangements of the firm work, including Statements of Responsibilities for each of the firm's SMF holders. The MRM must also include detail on reporting lines and the system of governance.</p> <p>The FCA's Handbook also contains COCON 2.1 Individual conduct rules and COCON 2.2 Senior Manager Conduct rules. These rules apply to all holders of a senior management function so only non-executive directors who do not chair a relevant Board Committee are exempt from these requirements. Under SMCR and SYSC 27.2 of the FCA Handbook, firms are required to annually assess the fitness and propriety of senior managers and certified staff. Any breach of these conduct rules resulting in disciplinary action has to be notified to the FCA.</p> <p>The PRA Rulebook also contains the Insurance – Conduct Standards. In SS35/15, the PRA sets out that firms and groups should have suitable procedures for monitoring the conduct of senior individuals, including their adherence to the Conduct Standards and where necessary should notify the PRA where there is a potential failure to observe a conduct standard.</p> <p>There are also the complementary duties of directors set out in sections 171 to 177 of the U.K. Companies Act 2006.</p> <p>In addition, Article 258 of the on-shored Solvency II Delegated Regulation requires that insurers establish, implement and maintain effective decision-making procedures and an organizational structure which clearly specifies reporting lines, allocates functions and responsibilities, and takes into account the nature, scale and complexity of the risks inherent in that undertaking's business. There is scope to simplify the corporate governance requirements once the Solvency II requirements are included in delegated law under FSMA, if the 2021 FRF Review Consultation proposals are enacted. Overall, the U.K. should seek to streamline rules and laws that ostensibly cover similar subject matter to make navigating and complying with the law less onerous. This is a specific instance of an issue raised in relation to ICP 1.</p>

	<p>There is some proportionality built into the requirements; for large insurers the Chair of the Governing Body function (SMF9) and the Chief Executive Officer (SMF1) roles may not be combined (see SMF13) however these roles may be combined for smaller insurers. A group executive of a large insurance group may not take on the role of a Non-Executive Director for a U.K.-based subsidiary.</p> <p>Solvency II rules and the SM&CR do not prevent some roles from being combined but the PRA and FCA may not allow those roles to be combined if there could be a conflict of interest or if the person applying for the combined roles does not have the necessary qualifications or experience to perform the combined role.</p> <p>The PRA's expectations for the board are contained in SS5/16 'Corporate Governance: Board Responsibilities' (SS5/16). Paragraph 6.1 sets out the expectation that Non-Executive directors' responsibilities require them to both support and oversee executive management.</p> <p>The PRA's supervision does focus significantly on senior management accountability. As such, Statements of Responsibilities and Management Responsibilities Maps support on-going discussions between the firm and supervisors regarding individual accountability, including when there are concerns about the appropriate separation between oversight and executive roles. In cases where the supervisor considers that remedial actions are required, it is expected that these are clearly allocated and documented in the relevant SMF's Statements of Responsibilities.</p> <p>If the PRA has material concerns about the functioning of the firm's corporate governance, it can choose to undertake a specific management and governance review that will focus on whether the firm meets the PRA's expectations in this area. This type of review may involve desk-based reviews of Board governance frameworks and supporting documentation as well as board meeting agendas, packs and minutes as well as in person observations of meetings and interviews with Board Members. External board effectiveness reviews are also undertaken through section 166 of FSMA or by the insurer but with PRA input as to the scope of the review.</p> <p><i>Risk committees</i></p> <p>Under SYSC 21.1.1 of the FCA Handbook, the FCA has issued guidance that insurers would be expected to establish a Risk Committee if they are included on the FTSE 100, and that smaller firms should also consider doing so by virtue of their risk profile. In practice, the majority of U.K. insurers have dedicated Risk Committees. However, for the minority of firms without Risk Committees the FCA expect that the Board establish procedures to oversee risk management and internal controls, relying on the guidance issued on the operation of the Board in COND 2.5 Where appropriate the supervisor can also utilize the U.K. Corporate Governance Code, and specifically Principal O and Provision 25.</p> <p>The requirement for the insurer's Board to provide oversight in respect of the design and implementation of risk management and internal controls is set out in a combination of</p>
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rules and expectations with respect to PRA supervision. Rule 2.4 of the Conditions Governing Business part of the PRA Rulebook requires that a firm has in place written policies in relation to risk management and internal control and that these policies are subject to the prior approval of the board. Guideline 6 of the EIOPA Guidelines on the System of Governance²⁶ requires that the Board should determine the scope and frequency of the internal reviews of the system of governance, which includes the risk management and internal controls, taking into account the nature, scale and complexity of the business both at individual and at group level, as well as the structure of the group. Guideline 17 of the EIOPA Guidelines on the System of Governance requires the board to be ultimately responsible for ensuring the effectiveness of the risk management system, setting the undertaking's risk appetite and overall risk tolerance limits, as well as approving the main risk management strategies and policies. Para 4.2 – 4.3 of SS5/16 sets out that the PRA will expect to see evidence that the board and its relevant sub-committees exercise effective oversight of risk management and controls, supported with meaningful and well-targeted management information used to inform board discussions.

Review of supervisory files shows that the PRA does put particular focus on the governance of risk management as risk management is one of the key risk elements assessed in its supervisory risk assessment (see ICP 9).

The chair of the Risk Committee is required to be approved for SMF 10 and is therefore subject to an assessment of their Fitness and Propriety before being permitted to carry out the role.

Remuneration requirements

There are comprehensive remuneration requirements set out in Article 258(1) and Article 275(1) of the on-shored Solvency II Delegated Regulation. The PRA has set out its expectations in SS10/16 Solvency II Remuneration Requirements and Chapter 11 of SS5/16 Corporate Governance. Further requirements are set out in the Financial Reporting Council's Corporate Governance code which applies to listed insurers.

Financial and Supervisory Reporting

Rule 3.1 of the Conditions Governing Business part of the PRA Rulebook requires that a firm must have in place as part of its risk management system, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies.

Rule 2.5 in the Reporting part of the Rulebook further requires that a firm must have in place appropriate reporting systems and structures as well as a written policy approved by its board ensuring the ongoing appropriateness of the information submitted by the firm

²⁶ EIOPA Guidelines on the System of Governance and other Guidelines continue to be relevant as stated by the PRA in *Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the U.K.'s withdrawal from the EU*, December 2020 (updated December 2021).

	<p>to the PRA.</p> <p>Clearly defined responsibilities for the reporting process are also a component of the SM&CR, which requires a senior manager (usually the CFO) to hold a prescribed responsibility for the production and integrity of the firm's financial information and its regulatory reporting.</p> <p><i>Governance and oversight of the external audit process</i></p> <p>There is an Audit Committee part of the PRA Rulebook that sets out the PRA's expectations for the governance and oversight of the external audit process. The Financial Reporting Council's Code sets out requirements for listed insurers. Under the SM&CR, the Chair of the Audit Committee (SMF11) is responsible for overseeing the internal and external audit process.</p> <p>PRA supervision processes requires at least annual discussions with the lead partner of audit firms in relation to at least Category 1 and 2 insurers.</p> <p><i>Dealing with regulators</i></p> <p>PRIN 2.1 of the FCA Handbook requires firms to deal with regulators in an open and cooperative way and disclose anything to the FCA for which the FCA would reasonably expect notice. There are further detailed requirements in the FCA Handbook. Fundamental Rule 7 of the PRA Rulebook has a similar requirement.</p> <p><i>ComFrame</i></p> <p>While there are no specific governance requirements for IAIGs, it is clear that the governance requirements as described above apply to IAIGs as many of the requirements apply at both the solo and group level. The detailed requirements set out in the ComFrame standards are all addressed either specifically or are clearly covered in more generally applicable rules. In addition, the PRA focus on governance in its supervisory processes clearly addresses the Head of the IAIG as appropriate.</p> <p>Rule 19.1 of the Group Supervision part of the PRA rulebook requires that a firm disclose publicly, at the level of the group, on an annual basis, the legal structure and the governance and organizational structure, including a description of all subsidiaries, material related undertakings, and significant branches belonging to the group.</p> <p>In addition, Article 372 of the on-shored Solvency II Delegated Regulation requires the insurer to submit as part of the Solvency and Financial Condition Report (SFCR) among other things, a list of all subsidiaries, related undertakings and branches and a description of the contribution of each subsidiary to the achievement of the group strategy.</p> <p>The PRA ensures that there are clear and appropriate reporting lines between subsidiaries and the group through the application of the SMF7 Group Entity Senior Management Function (see ICP 5). This function should capture any individual within the group (e.g., a group CEO) whose decisions and actions must be regularly taken into account by the</p>
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	<p>governing body of the firm.</p> <p>The FCA has requirements for firms that are part of a group. SYSC 12 of the FCA Handbook sets out how the systems and control requirements apply where a firm is part of a group.</p>
Assessment	Observed
Comments	<p>Overall, there are comprehensive rules related to governance as well as a strong focus on governance by both financial regulators.</p> <p>An observation during the conduct of the stress testing work of the mission is that there are data quality concerns with some of the data provided. There are inconsistencies across firms and gaps in the data. In particular, there were gaps and inconsistencies that hampered the liquidity stress testing work. These concerns do not rise to the level of concern that data quality is hampering supervisory decision making but it is an issue that could do with improvement, particularly as the PRA seeks to become more data driven as part of its 2026 Strategy. Data quality will become more important as greater reliance is placed on it. Given that there are clear requirements for submitting quality data to regulators as well as senior management responsibility for that function, it would be worth conducting a thematic review across regulated insurers to review data quality and financial reporting processes to improve the quality of data submitted to the PRA.</p>
ICP 8	<p>Risk Management and Internal Controls</p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.</p>
Description	<p>PRA</p> <p>Rules 2.5 and 3 of the Conditions Governing Business part of the PRA Rulebook, require insurers to have in place a written policy on risk management and an effective and documented risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies. The risk-management system must be effective and well-integrated into the organizational structure and decision-making processes of the firm (with proper consideration of the persons who have key functions) including subject to prior approval by the governing body, reviewed annually and adapted to significant changes (Rule 2.4).</p> <p>The SM&CR sets out requirements for senior management roles responsible for control functions and underpins the promotion of effective risk culture. Under the SM&CR, there are two prescribed responsibilities for culture - leading the development of the firm's</p>

	<p>culture by the governing body as a whole (PR I) and overseeing the adoption of the firm's culture in the day-to-day management of the firm (PR H). There are specific SM&CR roles related to the control functions required by ICP 8.</p> <p>The Conditions Covering Business part of the Rulebook sets out requirements for all of the control functions set out in ICP 8:</p> <ul style="list-style-type: none"> • Rule 3.5 sets out that a firm must provide for a risk management function that is structured in such a way as to facilitate the implementation of an effective risk-management system. • Rule 4.1 requires that a firm must have in place an effective internal control system. • Rule 4.2 requires that a firm must have in place an effective internal control system, which includes a compliance function. • Rule 6.1 requires that a firm must provide for an effective actuarial function. • Rule 5.1 requires that a firm must provide for an effective internal audit function. • Rule 7.1 requires that if a firm outsources a function or any insurance or reinsurance activity, it remains fully responsible for discharging all of its obligations. <p>Articles of the Solvency II Commission Delegated Regulation (EU) 2015/35 (CDR) also address ICP 8 requirements:</p> <ul style="list-style-type: none"> • Article 258 requires that there must be a policy on risk management that clearly sets out the relevant responsibilities, objectives, processes and reporting procedures to be applied consistent with the undertaking's overall business strategy. • Article 259 requires that as part of the risk management system the insurer must have a clearly defined risk management strategy, which is consistent with the undertaking's overall business strategy. • Article 266 requires that an insurer has a system of internal controls that ensure compliance with applicable laws, regulations and administrative provisions and the effectiveness and the efficiency of the undertaking's operations. • Article 268 requires that firms incorporate the control functions and the associated reporting lines into the organizational structure in a way which ensures that each function is free from influences that may compromise the function's ability to undertake its duties in an objective, fair and independent manner. • Article 270 requires that the compliance function shall establish a compliance policy and a compliance plan which defines the responsibilities, competencies and reporting duties of the compliance function. • Article 271 sets out requirements concerning the internal audit function and its tasks. • Article 272 sets out the details of activities that should be performed by the actuarial function.
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- Article 274 sets out details on the necessary oversight of and accountability for any material outsourcing arrangements.

Further expectations regarding the system of internal controls are set out in Section 7 of the EIOPA Guidelines on the System of Governance.

As part of the supervisory process, supervisors receive management information from firms, which can include committee packs from the risk committees. Supervisors can use this management information to form an opinion on the effectiveness of the risk function. In addition, to enhance their understanding of the effectiveness of the risk function, as part of the regular schedule of meetings with key senior managers, supervisors meet at least annually with the chief risk officer.

Supervisors can also choose to undertake a deep dive review of the risk management function if they have particular concerns. The mission saw evidence of PRA supervisors undertaking such deep dives and raising concerns on risk management with senior management of insurers. Risk management and governance is one of the key risk elements PRA supervisors assess to ensure that firms are operating within the PRA's risk tolerance.

FCA

While ICP 8 requirements are largely met by the PRA's requirements, the FCA does also have requirements and supervisory processes relevant to ICP 8. The FCA's focus is determined by its objectives which as outlined in relation to ICP 1 are different from those of the PRA. This means two regulators are looking at risk management processes through different lens based in different objectives.

Regulated firms have a fundamental obligation to adhere to the FCA Handbook's Principles for Businesses one of which is Principle 3, 'Management and control'. Chapter 3 Senior management arrangement, systems and controls (SYSC) source book contains more detailed requirements covering the firm's risk management strategy, risk, systems and controls.

In assessing appointees under the SM&CR with the PRA, the FCA considers their suitability for the role from a conduct perspective. For example, the FCA is concerned to ensure that every actuary appointed by a firm under PRA rules has the necessary skill and experience to provide the firm with appropriate actuarial advice from a conduct perspective.

The FCA also has its own rules regarding outsourcing which are set out in SYSC 8. The mission observed the FCA has conducted assessments of outsourcing arrangements, even visiting key vendors used by insurers in other countries.

A key FCA supervisory focus is the assessment of whether a firm has a strategy in place to manage and mitigate risks. Both the firm assessment model and the portfolio assessment model specifically make judgements on how effective the firm's systems and controls are

in reducing the potential harm arising from the firm's business model. The thematic review of pricing practices in the general insurance sector was an example of a supervisory activity related to risk management.

ComFrame

There are extensive and detailed ComFrame standards within ICP 8.

The PRA rules, Articles within the on-shored Solvency II Delegated Regulations apply at the group level, some of the SM&CR roles specified are related to group roles and some solo roles can be filled by group executives. The regulatory framework set out above contains detailed requirements which mostly address the very detailed requirements set out in the ComFrame Standards within ICP 8. So this section sets out general rules that apply and comments, by exception, where the detailed requirements are not met.

PRA Rules 2.5 and 3 of the Conditions Governing Business part of the PRA Rulebook, which apply at the group level, require groups to have in place an effective and documented risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies. The EIOPA System of Governance Guidelines which remain relevant include group-level requirements related to risk management and that the risk management system should cover risks at both individual and group levels. Interdependencies including reputational risk arising from group transactions, interdependence between risks due to conducting business in different jurisdictions, risks arising from third country entities and risks arising from non-regulated entities.

ComFrame Standards 8.6a and 8.6b contain detailed requirements for the group-wide actuarial function of an IAIG as well as coordination between the group-wide and legal entity actuarial functions. The PRA's requirements for the actuarial function are set out in Article 272 of the Solvency II Delegated. Chapter 6 of the Conditions Governing Business Part of the PRA Rulebook and Rule 3.1 (7) of the Allocation of Responsibilities Part, which requires the firm to allocate to a relevant SMF (usually the Chief Actuarial Function or CRO) a prescribed responsibility for the performance of the ORSA. These do not include all aspects required in ComFrame as they focus on actuarial work with respect to technical provisions, the overall underwriting policy, the adequacy of reinsurance arrangements and the effective implementation of the risk management system, including in particular the ORSA.

CF8.6a requires the group-wide actuarial function performs an overview of the group-wide actuarial activities, functions and risks emanating from insurance legal entities within the IAIG. The group-wide actuarial function is also required to opine on risk management and internal controls relevant to its function and to consider the overall financial condition of the IAIG including its solvency position and prospective solvency position. These requirements are not addressed the PRA's rules or expectations. It could be suggested that to some extent these requirements in ComFrame are met by the ORSA and SFCR

	<p>requirements. However, ComFrame is clear about these being roles for the group-wide actuarial function. The ORSA and SFCR is not necessarily a product of the group-wide actuarial function under the PRA's rules although the group-wide actuarial function would contribute to these products.</p> <p>ComFrame Standard 8.7a contains detailed requirements for group-wide internal audit functions. In accordance with Article 271 of the Solvency II Delegated Regulation, the PRA requires the internal audit function to take a risk-based approach in deciding its priorities. The following requirements are not established in U.K. regulations. Independent assessment and assurance to the IAIG board by the group-wide internal audit function of:</p> <ul style="list-style-type: none"> • overall means by which the IAIG preserves its assets, and those of policyholders, and seeks to prevent fraud, misappropriation or misapplication of such assets • reliability, integrity and completeness of the accounting, financial, management, information technology systems and risk reporting information.
Assessment	Largely Observed
Comments	<p>The PRA and FCA have a largely comprehensive set of regulatory requirements covering risk management and internal control. Supervisory processes also extensively address risk management issues.</p> <p>The two gaps relate to new ComFrame requirements for the group-wide actuarial function and the group-wide internal audit function. It is recommended that the PRA develops a supervisory statement on the group-wide actuarial function and the group-wide internal audit function requirements for IAIGs that specifically address ComFrame requirements.</p> <p>As with other parts of the U.K. regulatory framework for insurance supervision, there appears to be plenty of scope to streamline the risk management and internal control requirements to clarify and make them easier to navigate.</p>
ICP 9	<p>Supervisory Review and Reporting</p> <p>The supervisor uses off-site monitoring and on-site inspections to examine the business of each insurer; evaluate its financial condition, conduct of business, corporate governance framework and overall risk profile; and assess its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p>
Description	<p>Both the FCA and PRA are transparent about their approach to supervision with both regulators clearly setting out their approach to supervision in public documents.</p> <p>PRA</p>

	<p>The PRA's approach to supervision is anchored in its primary objectives and SCO as set out in relation to ICP 1. The PRA supervisory approach is based on four key principles: 1) judgement-based; 2) forward-looking; 3) risk-based; and 4) proportionate.</p> <p>The PRA does not seek to completely avoid firm failure but to ensure any failure occurs in an orderly way so as not to disrupt the availability of financial services in the U.K. and to ensure policyholder protection.</p> <p>Threshold Conditions are set out in The Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013 that insurers must meet at all times. For dual regulated insurers, there are some Threshold Conditions for which the PRA is responsible²⁷ and some for which the FCA is responsible – see below.</p> <p>There are Fundamental Rules which express the objective of promoting safety and soundness of regulated firms in a more detailed form. These are set out in the PRA Rulebook. There are 8 fundamental rules:</p> <ol style="list-style-type: none"> 1. A firm must conduct its business with integrity 2. A firm must conduct its business with due, skill, care and diligence 3. A firm must act in a prudent manner 4. A firm must always maintains adequate financial resources 5. A firm must have effective risk strategies and risk management systems 6. A firm must organize and control its affairs responsibly and effectively 7. A firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice 8. A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services. <p>The PRA divides insurers into five categories based on a potential impact assessment – the potential to adversely affect the PRA's objectives by failing, coming under operational or financial stress or because of the way in which it carries out its business. Category 1 insurers are: "Insurers whose size (including number of policyholders) and type of business mean that there is very significant capacity to cause disruption to the interests of a substantial number of policyholders". For Category 2 insurers the term 'very significant capacity' is change to 'significant capacity'. For category 3 insurers they have a 'minor capacity' to cause disruption. Category 4 insurers have 'very little capacity' to cause disruption and Category 5 insurers have 'almost no capacity' to cause disruption. Potential impact is currently a quantitative calculation with a potential qualitative override. The methodology for assignment to risk categories was undergoing changes at the time of</p>
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²⁷ Part 1D, The Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013

the mission which is part of the PRA Strategic Review but the new methodology was not implemented and so was not assessed at the time of the mission.

The PRA's risk assessment framework considers gross risk of a firm and then considers mitigating factors. Gross risk is based on the potential impact as outlined in the category description above but also taking into account the external context and business risk it faces – the risk context- and how this might affect the firm's viability. Mitigating factors include the operational mitigation from management and governance as well as risk management and controls; financial mitigation from capital and liquidity; and structural mitigation from a firm's resolvability.

The intensity of the PRA's supervisory activity varies across firms. The level of supervision principally reflects the PRA's judgement of a firm's potential impact on the stability of the financial system, its proximity to failure (as encapsulated in the Proactive Intervention Framework), its resolvability, and the PRA's statutory obligations. Other factors that play a part include the type of business carried out by the firm, and the complexity of the firm's business and organization. The PRA are not formulaic about the supervisory activity they perform, since the focus on key risks means that this activity depends inevitably on a firm's particular circumstances.

The PRA take a structured approach when forming their judgements. The PRA publish 'Supervisory Approach' documents for banking and insurance. Each year the PRC set the PRA strategy and business plan. These are based on the PRA's approach to supervision, the PRA's operating model, and its risk tolerance, all agreed by PRC.

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A regular review of a firm formally considers the risks posed by the firm and sets the supervisory strategy for the coming period. This involves an annual internal meeting held by the PRA called a Periodic Summary Meeting (PSM) to discuss the major risks the firm faces, the supervisory strategy, and proposed remedial actions, including guidance about the adequacy of a firm's financial mitigation. There is senior level involvement in these assessments, such that major judgements are made by the PRA's most senior and experienced individuals. These formal assessments are also subject to rigorous review by those not directly involved in day-to-day supervision, including risk specialists, independent advisers and relevant participants from the rest of the Bank, such as the Resolution Directorate. There is a clear and direct link between the risks that the PRA perceive and the actions the PRA expect from firms in consequence.

	<p>To determine the intensity of supervisory activity in a supervisory plan for a firm, the PRA applies its Proactive Intervention Framework which is based on supervisory judgement about the firm's proximity to failure. This is based on the risk assessment framework described in the above paragraph. There are 5 PIF stages: Stage 1 Low risk to the viability of the insurer; Stage 2 Moderate risk to the viability of the insurer; Stage 3 Risk to viability absent action by the insurer; Stage 4 Imminent risk to viability of the insurer and Stage 5 Insurer in resolution or being actively wound up. Assessment against the 8 risk elements and PIF status are subject to continuous review over the supervisory cycle in light of new developments.</p> <p>If an insurer starts to move up through the PIF stages, it will experience more intense supervisory scrutiny in relation to weaknesses found that may threaten its viability. For example, if risk management issues are found, deep dives into risk management processes may be undertaken and senior managers in relevant positions will be subject to enhanced scrutiny. The firm will be asked to present a plan to address any out of tolerance risk elements even if it is in PIF Stage 1.</p> <p>PIF Stage and Impact Category combine to determine the intensity of supervision and the types of supervisory actions that should be taken. Category 1 and 2 insurers are subject to the most intense normal supervisory activity while in PIF Stage 1 and PIF Stage 2 and are subject to the continuous assessment process. All Category 1 firms are required to have 2 deep dive reviews per year and Category 1 firms are required to have at least 1 deep dive review per year.</p> <p>Threshold Conditions assessment, PIF Stage, Potential Impact Category, risk scores on risk elements, supervisory strategy and work plan, key messages to the board and senior management are all agreed at a Periodic Summary Meeting (PSM). Actions agreed at the last PSM and whether these actions have occurred are also reported with emphasis on such reporting for Category 1 firms. It is noted that an internal audit report on Category 2 to 4 general insurers supervision found that supervisors did not adequately record or report on prior year's supervisory activity at the PSM. This issue is being addressed by the PRA and the PSM documentation reviewed by the mission showed reporting on progress of issues identified in the prior PSM.</p> <p>The purpose of the PSM is for an appropriately senior panel of supervisors with a mix of skills and expertise who are independent of the day-to-day supervision of the firm to challenge assessments and supervisory plans. The FCA may be represented on the PSM for higher category firms. The PSM occurs every 12 months for all insurers. After the PSM, a PSM letter is sent to a firm reflecting the key messages agreed at the PSM and actions the PRA expects the firm to take to mitigate key risks. In addition to PSM, for Category 1 firms there are mid-point reviews.</p> <p>Supervisory strategies and work plans include meetings with firm directors, executives and lead audit partners. A minimum number of deep dive reviews are required each year for</p>
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Category 1 and 2 firms. Deep dive reviews can be either at the U.K. firm level or at the group level depending on where the activity is carried out.

There are minimum requirements for meetings with Non-Executive Directors and Executives annually as well as meetings with the lead external audit partner for Category 1 and 2 firms. In addition, it is typical for meetings to occur with the Chairman, Chairs of the Risk Committee and Audit Committee, CEO, heads of key functions to be invited to meetings each year. This results in a number of meetings with senior management per month for Category 1 and 2 firms. So, frequent contact is made and this is supplemented through ad hoc communications as required.

Deep dive

Deep dive reviews have a specified targeted scope, interviews with key individuals, verification of senior management claims and a report outlining the findings and actions. There are standardized deep-dive reviews on key financial risk topics which may be specified as deep dive reviews and specialist resources are available to supervision teams to conduct these types of deep-dive reviews. Over the period 2017 to 2020 there were approximately 100 deep dive reviews conducted for insurers. Skilled person reviews under s166 of FSMA are also a tool available to supervisors and such a review may be considered a deep dive review, meeting the requirements for the minimum number of deep dive reviews without these being carried out by PRA staff. These appear to be used quite frequently as an alternative to PRA staffed deep dive reviews. From 2017 to the latest report available during the mission, Q2 2021/22 there have been 34 section 166 skilled person reviews for insurers. Internal guidance indicates that s166 reviews can be used for a variety of purposes including diagnostic purposes, monitoring purposes, preventative actions and remedial actions. Reasons for the use of s166 skilled person reviews include where an independent review of views held by supervision is needed, where there is insufficient capacity at the PRA to perform the work or lack of necessary specialist skills, and the firm being unable to tackle a regulatory issue without the help of an external party. Costs for s166 reviews are paid directly by firms. Costs should be proportionate to the benefits derived from the review by the firm or the PRA. Supervision teams maintain contact with the external contracted skilled persons throughout the review and receive a report at the end of the review.

Solvency II firms are required to submit annual and quarterly quantitative reporting templates, alongside additional reporting specific to the PRA. This includes national specific templates. Firms with approved internal models have additional reporting requirements. With reporting requirements still based in EU Solvency II requirements, the PRA has issued guidance to make reporting requirements after Brexit clear.²⁸ U.K. IAIGs are providing the PRA with necessary information for the ICS Monitoring phase. Analysis of regulatory reporting and management information received is prompted and tracked

²⁸ https://www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-insurance-sector#harmonised_reporting

through the PRA's internal system Risk and Work Manager.

The PRA and FCA conducted a joint outsourcing review for life insurers in 2019. This covered contracts and contingency plans for critical policy administration outsourcing arrangements. One key finding was that there was a heavy concentration of policy administration outsourcing to two providers. This review fed into the development of the PRA's Supervisory Statement SS2/21 Outsourcing and third-party risk management which sets out PRA expectations related to outsourcing and third-party risk management. This is effective from March 31, 2022. There was evidence seen in the review of supervisory documents that the PRA did look into outsourced business functions where appropriate as part of its supervisory processes.

ComFrame standards are met through supervisory processes clearly occurring at the Head of the IAIG as well as at the authorized insurer level.

FCA

The FCA supervision is anchored in its mission and identifying the harms set out in that mission. The five harms set out in the mission are:

- Confidence and participation threatened by unacceptable conduct such as market abuse, unreliable performance or by disorderly failure
- Buying unsuitable or mis-sold products; customer service/treatment
- Important consumer needs are not met because of gaps in the existing range of products, consumer exclusion, lack of market resilience
- Prices too high or quality too low
- Risk of significant harmful side-effects on wider markets, the U.K. economy and wider society, e.g. crime/terrorism.

Firms need to continually meet the Threshold Conditions set out in Schedule 6 of FSMA. One role of supervision is to assess whether firms meet these Threshold Conditions. Supervision also considers the risk of harm in the firm's business model or culture and seeks to mitigate risk of harm to consumers.

Thematic reviews, multi-firm work and market studies

In the FCA's annual business plan it sets out its key priorities, which are often addressed by conducting thematic reviews and market studies. There is a framework for including firms in these studies to ensure a representative sample of firms. A number of thematic reviews in the insurance sector have been undertaken by the FCA in the last 3 years with some successful outcomes. The two most notable examples are detailed below.

A general insurance pricing practices market study was undertaken beginning in 2018, which resulted in consultation on reforms in September 2020 with final rules issued in May 2021. A piece of multi-firm works and a thematic review found that differential pricing leads to some groups of consumers paying significantly higher prices than other

similar consumers. A Dear CEO letter was sent articulating the FCA's expectations of general insurers in their pricing activities. A market study was launched in October 2018 to consider pricing practices in the home and motor insurance markets and whether they support effective competition and lead to good consumer outcomes. The final report in September 2020 found the markets were not working well with 6 million policyholders collectively paying an excess of £1.2 billion in premium. This resulted in revised rules released in May 2021 covering pricing rules (renewal prices not greater than new business prices), product governance, premium finance, auto-renewal cancellation process, reporting and attestation of pricing practices. The new rules become effective on 1 October 2021 and 1 January 2022.

Another high-profile piece of multi-firm work was the business interruption insurance (BI) test case. The FCA looked to achieve clarity for insurers and policyholders; the court was asked for an interpretation of a representative sample of policy wordings. Following the court's judgement the FCA issued a Dear CEO letter outlining the FCA's expectations of insurers and provided guidance to policyholders to help them identify if their BI policy may cover pandemic related business interruption losses based on the court ruling.

The FCA maintains two frameworks for supervision that are applicable to individual insurers and insurance intermediaries. Whole firm supervision applies to 'fixed firms' and portfolio supervision applies to smaller 'flexible firms'.

Fixed firm supervision

Fixed firms have dedicated supervision teams and are determined based on the greatest potential impact on consumers and markets. In 2017 there was a significant reduction in the number of fixed firms that reflects an FCA-wide change in approach to supervision with a greater focus on portfolio supervision.

Supervisors use the Firm Assessment Model to consider the risk of harm to consumers from the firm's business model and strategy and then assesses how effective the firm's culture is in reducing that potential harm. This results in an overall assessment of the potential harm that the firm may cause and then a strategy of supervisory activities and actions is set out to reduce or prevent it.

Fixed firm supervision takes into account the whole group including all sectors it operates in. The Lead Supervisor is accountable for risk identification and the work program across the entire firm or group. Where fixed firms operate in more than one sector, as is the case with some major insurers, the supervisory group is broken into Material Business Units (MBUs). A Group Assessment is carried out that takes into account conduct risks at each of the MBU levels. Where a group operates in only one sector, a firm assessment is created and legal entities are attached to this. Therefore, FCA supervision of fixed firms is arranged at the group level.

Fixed firm supervision is coordinated by a Lead Supervisor. The Lead Supervisor maintains a relationship with the firm and is the go-to person within the FCA for matters relating to

that firm. Lead supervisors of fixed firms sit within its home sector based on the entity or business unit that is most important to the firm, generally where it makes most of its profits.

The Lead Supervisor is accountable for the overall work strategy. This supervisory strategy is agreed via a 'Firm Evaluation' meeting, chaired by a Director or Executive Director of the FCA and this meeting must take place at least every two years. Required aspects of the supervisory strategy include the schedule of proactive engagement meetings with the firm's senior management, a list of management information to be requested for review and the plan for 'deep dive' on-site reviews and any other supervisory work. There is an annual strategy meeting with the CEO of the firm and heads of major business lines. Outside of these formal supervisory meetings, supervisors keep an open line of communication with the firm through regular calls, usually with the compliance team at the firm. Firms are also required to notify the FCA of matters with serious regulatory impact.

Flexible firm supervision

Most firms supervised by the FCA are supervised as members of a portfolio of firms that share a common business model.

Portfolio	Number of firms in 2020
Personal and Commercial Lines Insurers	573
Personal and Commercial Lines Intermediaries	4,446
Price Comparison Websites	16
Lloyd's and London Market Insurers	228
Lloyd's and London Market Intermediaries	359
Life Insurers	167
Source: FCA	

In philosophy, flexible firm supervision is similar to fixed firm supervision but rather than being addressed individually, portfolios of firms that share a common business model are assessed as a group using the Portfolio Assessment Model in a Portfolio Strategy Forum and a common portfolio strategy is set.

The FCA identifies key risks of consumer harm in each portfolio and individual outlier firms which may present heightened risk of harm and warrant direct supervisory engagement. Portfolio letters are issued annually communicating expectations, priorities, and key messages to firms and other stakeholders.

As detailed in relation to ICP 3, PRA and FCA coordination appears to be at its best where the FCA designates a firm as a fixed firm as there are open lines of communication between dedicated supervision teams for those firms at the PRA and FCA.

Reactive firm supervision

Both fixed and portfolio firms are subject to reactive supervision, responding to regulatory issues identified by the FCA. The FCA assesses intelligence it receives and determines the appropriate course of action based on prioritized risk of harm. The FCA analyzes data provided to it as part of regulatory returns or other reporting requirements and this may lead to supervisory activities or actions. The FCA receives intelligence from the general public via the FCA's call center and also referral of issues from the Financial Ombudsman Service. Members of Parliament also write to the FCA to highlight issues affecting their constituents. Regulated firms sometimes identify issues with their own operations or provide intelligence about other firms operating in their markets. Whistleblowers tell the FCA about poor practices within the firm for which they work. The FCA also maintains a Consumer Panel, Practitioner Panels and Markets Panels which can be a source of intelligence about industry wide trends and issues as well as issues about particular firms. The FCA also shares intelligence with other regulators as detailed in the description of ICP 3.

Where analysis of regulatory data and information or externally provided intelligence is assessed as being of adequate quality and there is sufficient scale and severity of the potential harm, the FCA will investigate the root causes of the issues. The senior manager (see ICP 5) responsible for the relevant business area will be contacted and asked to explain the steps they have taken to reduce or prevent the harm or potential harm identified. Where concerns of serious misconduct or a risk that a firm no longer meets the Threshold Conditions are identified then an enforcement investigation may be commenced (see ICP 10 for a description).

Supervision of outsourced activities

The FCA makes it clear that firms cannot contract out their regulatory obligations and need to supervise outsourced functions. Firms are required to notify the FCA when they enter into material outsourcing arrangements.²⁹ Outsourcing is explicitly included as part of the Firm Assessment Model, requiring the individual supervisor to consider it in the development and approval of the supervisory strategy. The FCA's 2019/2020 Business Plan highlighted outsourcing and third-party services providers as a priority area for the FCA. A multi-firm review was conducted on outsourced service providers (OSPs) in the life insurance sector. These OSPs conduct activities such as annuities payroll administration and claims processing. The FCA notes there is potential for widespread harm if an OSP fails. The FCA review focused on exit planning, business continuity planning and

²⁹ FCA Handbook SYSC 13.9.2

	<p>governance, systems and controls of insurers with respect to OSP arrangements. Some material OSPs are regulated entities in their own right under fixed firm supervision.</p> <p><i>Regulatory reporting to the FCA</i></p> <p>Principle 11 of the FCA Handbook requires that firms inform the FCA of any matter that the FCA would reasonably expect to be notified about. Sup 15.3 of the FCA Handbook provides more detail on this requirement to notify the FCA. In addition, there are regular reporting requirements as set out in Sup 16 of the FCA Handbook and firms are expected to take reasonable steps to ensure the information is accurate and complete (Sup 15.6 of the FCA Handbook).</p> <p>Fixed Firms are required to provide Management Information (MI). A schedule of MI to be provided is agreed as part of the supervisory strategy. Such MI includes Board packs, Risk Committee Packs, Compliance Plan, Internal Audit Plan and Annual Strategy Papers.</p> <p><i>On-site inspections</i></p> <p>On-site inspection of fixed firms is regularly carried out. This is not mandated in the supervisory framework but is a feature of supervisory strategies. Deep Dive Reviews are often a feature of supervisory strategies and typically include an on-site element.</p> <p>The FCA also uses section 166 skilled person reviews to obtain a report on a specific topic. It is common that these skilled person reviews contain an on-site component. The mission found that these skilled person reviews were used in an investigation or enforcement context and also after a thematic or multi-firm review that identified issues that required further investigation at individual firms. The use of section 166 skilled person reviews appears appropriate in the context of the FCA’s model of supervision and appears to mainly be used in a reactive capacity to issues or potential issues identified and complements the existing on-site work of FCA staff.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>PRA</p> <p>Overall, the PRA’s approach to supervision is sophisticated, structured and well anchored in its statutory objectives but one area of concern is a lack of on-site supervisory activity targeted at business processes within firms and discussions with front-line staff in firms by PRA staff. Deep dive reviews do not always involve discussions with firm staff who do not hold senior positions. The PRA approach is very much anchored in senior management responsibility at regulated firms. Deep dive reviews may only involve extensive desk review of documentation and discussions with senior management. This is not just a function of the timing of the mission during the COVID-19 pandemic but is the way the PRA carries out its deep dive reviews by design. The COVID-19 pandemic resulted in more virtual meetings and fewer meetings at the premises of firms. However, section 166 reviews by skilled persons are undertaken as</p>

an alternative to PRA-staffed deep dive reviews. This is clearly set out in internal PRA documentation. It is notable that there was a reduction in section 166 reviews due to the COVID-19 pandemic.

One downside of a section 166 skilled-person review is the knowledge of the supervised institution's internal processes remains with the skilled persons rather than being maintained within the supervisory authority. Actual on-site experience cannot be replaced by communication with the skilled persons. The important aspect of any on-site work, whether carried out by supervisors or skilled person is to verify the implementation of documentation and information provided to the supervisor and that reported data can be relied upon. There are benefits to supervisors undertaking these reviews. Supervisors who are familiar with how a firm operates are often in a better place to spot anomalies in documentation they must review off-site and anomalies in statements made by senior management and board directors.

With respect to deep dive reviews conducted by the PRA, more observations of business processes and discussions with front-line staff would be appropriate in order to challenge the statements made by senior managers and assess the real world implementation of a firm's documented policies and procedures. Interviews with senior management are not of sufficient depth to truly be considered on-site supervision.

It is clear that the PRA's approach does not meet the expectations of ICP 9 with respect to on-site reviews and therefore the assessment of Largely Observed is appropriate.

The PRA's strategic review report notes that considering stretched resources the PRA needs to prepare as an organization for the challenges and opportunities ahead. One of the outcomes of the review is the need to implement more flexible and risk-based resourcing for supervision. The mission supports this action but further consideration should be given to increasing the resources applied to on-site supervision so that the overall envelope of resourcing is increased. Cost recovery mechanisms available in FSMA should be explored and the cost to regulated firms of section 166 skilled person reviews should be considered as part of this overall resource consideration. The mission recommends internalizing some of the work carried out by skilled persons which means the PRA will need to consider deploying the necessary resources to replace those section 166 reviews and recovering costs accordingly.

FCA

Overall, the FCA's approach to supervision of insurers with an emphasis on portfolio supervision and some dedicated fixed firm supervision appears an appropriate compromise in allocation of resources for a conduct regulator. The FCA should continue to review its approach to fixed and portfolio supervision to ensure effective risk-based approach to supervision in accordance with business needs and industry developments. In doing so, it should consider its recent reduction in fixed firm supervision in preference for more portfolio supervision in the insurance sector. The incremental resource implications of the FCA extending its fixed firm supervision to all PRA Category 1 and 2 firms appears

	minimal in the overall context of FCA supervision resources. Overall, insurance sector supervision is optimized where PRA and FCA information sharing is amplified for the most significant firms.
ICP 10	<p>Preventive Measures, Corrective Measures and Sanctions</p> <p>The supervisor:</p> <ul style="list-style-type: none"> • requires and enforces preventive and corrective measures; and • imposes sanctions • which are timely, necessary to achieve the objectives of insurance supervision, and based on clear, objective, consistent, and publicly disclosed general criteria.
Description	<p><i>Conducting insurance activities without the necessary license</i></p> <p>Carrying on a regulated activity in the U.K., such as effecting and carrying out contracts of insurance, without authorization or the benefit of an applicable exemption, is a criminal offence for which the PRA or FCA can instigate proceedings and for which, on conviction, a fine or imprisonment can be imposed under section 23 of FSMA. Notwithstanding the illegality of the unauthorized insurance contract in question, FSMA provides that the contract (although unenforceable by the insurer) is enforceable by the insured insofar as the insured can nevertheless recover sums paid under the policy.</p> <p>To identify unlicensed insurance activity, the FCA uses intelligence from a broad set of sources. This includes complaints data, whistleblowers, its firm and consumer contact center, regulatory returns, other regulators and competitor firms.</p> <p>The FCA's Unauthorised Business Department (UBD) takes enforcement action against firms and individuals not authorized or exempt under FSMA or subsequent legislation (such as the Payment Services Regulations and the Electronic Money Regulations), and who carry on regulated activities in breach of the general prohibition and/or contravene restrictions on financial promotions.</p> <p>UBD's primary aim is to protect the interests of consumers by reducing the harm they suffer because of unauthorized business. UBD aims to detect, deter, disrupt and prosecute firms and individuals conducting unauthorized business. Whilst doing so they also aim to alert, inform and educate members of the public about the dangers of dealing with unauthorized entities.</p> <p>UBD works closely with other organizations such as the police and U.K. Government agencies or departments to mitigate the risks posed by unauthorized business. Where UBD takes enforcement action, that action can involve taking civil, criminal and insolvency proceedings against firms and individuals. Where UBD does not take formal action, it may still seek to obtain a positive outcome by engaging with the firm or individual and seeking their cooperation in applying for authorization, undertaking to cease the unauthorized</p>

activity and/or offering redress to consumers. In appropriate cases, typically involving unauthorized persons, the FCA can also seek to remedy misconduct through criminal, civil and insolvency orders. It can also require compensation to redress the consequences of misconduct.

Tackling scams by unlicensed firms is a priority for the FCA. The FCA also publishes the list of known firms running scams or operating without authorization on its ScamSmart warning-list, Consumers' page and ScamSmart page. The FCA also regularly publishes warnings of firms identified as not authorized on this page.

Preventive and corrective measures

The PRA has power under section 137G (The PRA's general rules) of FSMA to make general rules that apply to authorized persons, including insurers and reinsurers. In particular, it can:

- require authorized persons to provide information
- appoint skilled persons (e.g. accountants or lawyers) to undertake investigations of authorized persons
- conduct investigations of authorized persons
- enter premises under warrant and obtain documents.

In addition, under sections 55M (Imposition of requirements) and 55P (Prohibitions and restrictions) of FSMA, the PRA may impose a requirement on an undertaking if it appears to the PRA that it is desirable to exercise the power in order to advance any of the PRA's objectives.

FSMA grants the PRA an extensive range of disciplinary, criminal and civil powers to take action against regulated firms. In relation to (re)insurers, examples of those powers include the PRA being able to:

- withdraw a firm's authorization or vary the activities that it is permitted to carry out
- suspend a firm's permission to carry on regulated activities
- censure firms through public statements
- impose financial penalties
- seek injunctions and
- seek restitution orders.

The PRA also has the ability to take enforcement action against individuals within financial institutions.

The Proactive Intervention Framework (PIF) is designed to identify and respond to emerging risks at an early stage. There are five PIF stages, each denoting a different proximity to failure, and every firm sits in a particular stage at each point in time. When a

firm moves to a higher PIF stage (i.e. as the PRA determines the firm's viability has deteriorated), supervisors will review their supervisory actions accordingly. Senior management of firms will be expected to ensure that they take appropriate remedial action to reduce the likelihood of failure and the authorities will ensure appropriate preparedness for resolution.

Firms are required to set their capital risk appetites and maintain solvency coverage within this. The PRA would expect a firm to take action to repair its capital position where its SCR level fell beneath its stated coverage ratios. In practice, therefore, supervisors will intervene at a firm in advance of its capital position deteriorating to a position where it might fail to meet capital requirements. However, where a firm actually does breach SCR then the PRA will formally take steps to require the firm to repair the breach. If it is unable to do so within the required timeframe then the PRA will ask the firm to give up its permission to write new business and if the firm refuses to do so will remove the permission on its own initiative.

The PRA also has powers under section 66 (Disciplinary powers) of FSMA to take action against certain individuals within an undertaking (including those approved to perform senior management functions), who appears to the regulator to be guilty of misconduct and where the regulator is satisfied that it is appropriate to take such action. Such powers include (among others) imposing a financial penalty on the person, suspending the person's approval to perform a function or publishing a statement of the person's misconduct.

To assist with its risk assessment, the PRA may at times use its statutory powers, in particular, its information gathering power and its powers to commission reports by Skilled Persons on specific areas of interest (under sections 165, 165A, 166 and 166A of FSMA). Such reviews can be undertaken where the PRA seeks additional information, an assessment, further analysis, expert advice and recommendations, or assurance around a particular subject.

Under s.55L of FSMA, the FCA can use its own initiative powers to impose a new requirement, vary an existing requirement or cancel a requirement to a firm's permissions where:

- a firm is failing, or is likely to fail, to satisfy the Threshold Conditions for which the FCA is responsible
- a firm has failed, during a period of at least 12 months, to carry on a regulated activity to which the Part 4A permission relates, or
- it is desirable to exercise the power in order to advance any of the FCA's operational objectives.

The FCA seeks to obtain redress for affected customers – it may put this right itself by requiring a redress scheme, or by engaging directly with the firm, or by working with

other authorities such as the Financial Ombudsman Service.

Risk Mitigation Programmes (RMP) can be applied as an action for a firm's senior management to carry out assessment work to identify and/or measure a risk mitigation, work to mitigate a risk, or remedial action to address risk. RMPs are only used if the authorities consider a firm's senior management to be capable to carry out the action effectively and within a reasonable timescale, taking into consideration the corporate governance structure, management culture, senior management's relationship with the FCA, and the success of previous actions the FCA has set for senior management.

Section 166 - Skilled Persons Reviews might be used, e.g., where the firm has a history of similar issues, or when there is a lack of confidence in the firm's ability to deliver an objective report or complete an RMP. The skilled person can assess failings within a firm and provide recommendations for improvements.

Where a firm is considered to pose a significant risk of harm to the FCA's statutory objectives, a firm can be added to the FCA Watchlist. This is an internal process that escalates awareness of these issues to the FCA's Senior Leadership team, ensuring increased oversight of firms posing the greatest risk of harm and monitoring the firm's progress against a time-bound action plan to mitigate the risks. An action plan is set for the firm (which is made aware that it is on the Watchlist) to address the root causes of the matters causing the significant risk of harm. This Watchlist is shared with the PRA and HMT.

Enforcement procedures

Once a PRA investigation has established a breach, the investigation team will consider which, if any of the disciplinary sanctions should be applied. If a financial penalty is considered the most appropriate sanction, it will be calculated taking into account (i) disgorgement (depriving the firm/individual of the economic benefit of their misconduct), (ii) seriousness (determine a starting point for the financial penalty by taking a relevant metric, often a firm's turnover or an individual's remuneration for one year, and applying a percentage depending on the seriousness of the misconduct), (iii) adjustment for aggravating/mitigating factors, (iv) adjustment for deterrence, and (v) reductions for settlement discount and/or serious financial hardship.

Once a sanction, if any, has been determined it will be considered if it is an appropriate case for settlement. The investigation team will then put its recommended disciplinary sanction to a panel of Settlement Decision Makers who will consider the findings of the investigation including the proposed sanction, and whether to open settlement discussions.

The Settlement Decision Makers will be convened according to the PRA's settlement decision-making procedure and policy for the determination of the number of penalties and the period of suspensions or restrictions in settled cases. In the event no settlement is reached, or this is considered a matter where settlement is not appropriate, the matter will

be referred to the PRA's Enforcement Decision Making Committee, which is responsible for decisions relating to contested (not settled) enforcement matters. It is operationally independent from the PRA, and its members are external appointments.

Where the FCA's diagnostic work raises suspicions of serious misconduct, or that a firm no longer meets the Threshold Conditions, or if a firm failed to take appropriate corrective action, an enforcement investigation may be appropriate. The FCA's Approach to Enforcement document, chapter 2, sets out how it assesses misconduct. Not all breaches of its rules or requirements constitute serious misconduct. Many breaches can be addressed and remedied (and the FCA expect them to be) without the need for enforcement action, especially where the breach is technical or minor. Where the FCA has reason to believe serious misconduct may have taken place, it will start an investigation.

The FCA uses a wide range of enforcement powers – criminal, civil and regulatory – to protect consumers and to act against firms and individuals that do not meet its standards. These actions include:

- withdrawing a firm's authorization
- prohibiting individuals from carrying on regulated activities
- suspending firms and individuals from undertaking regulated activities
- issuing fines against firms and individuals who breach rules or commit market abuse
- issuing fines against firms breaching competition laws
- making a public announcement when the FCA begins disciplinary action and publishing details of warning, decision and final notices
- applying to the courts for injunctions, restitution orders, winding-up and other insolvency orders
- bringing criminal prosecutions to tackle financial crime, such as insider dealing, unauthorized business and false claims to be FCA authorized
- issuing warnings and alerts about unauthorized firms and individuals and requesting that web hosts deactivate associated websites.

Proportionality

The purpose of imposing a sanction is to hold the firm and/or relevant individuals to account for any contravention, and to deter others from engaging in similar misconduct. The sanction should be proportionate to the contravention and the harm caused. The FCA aims to make sure the sanction is sufficient to deter the firm or individual from re-offending and deter others from offending. Where it takes disciplinary action against a firm or an individual, it will consider all its sanction and redress and restitution powers.

When it assesses the nature of the sanction, the FCA takes into account all relevant circumstances. This includes what steps the firm or individual has taken to address the

harm and to cooperate, including, where relevant, in cooperating with any variation of permission or with the imposition of a requirement e.g. under Part 4A of FSMA. If firms and individuals fully account for any harm caused, including putting it right where there are reasonable grounds to do so, the FCA will consider this when applying sanctions. In extraordinary cases, it may determine whether a sanction is required at all. If a firm or individual fail to take steps to address harm or refuse to cooperate fully, this will be taken into account and may justify heavier sanctions.

The FCA will publish the results of its decisions, whether agreed or contested, in a Final Notice in accordance with sections 391 and 391A of FSMA. The Final Notice will make clear the basis for its findings, including the facts and reasons for concluding there has been serious misconduct. The FCA often publishes a press release accompanying an enforcement outcome including criminal cases.

ComFrame requirements

There are a number of provisions in FSMA under which the PRA is expressly empowered to cooperate with other authorities/bodies, which would include EIOPA and EEA national competent authorities, in respect of enforcement and associated matters:

- Section 55Q (Exercise of power in support of overseas regulator): this allows the PRA to exercise its own-initiative variation and requirement powers (in sections 55J and 55M of FSMA) in respect of an authorized person at the request of, or for the purpose of assisting, an overseas regulator. This is subject to the overseas regulator making such contribution towards the associated costs as the PRA considers appropriate.
- Section 169 (Investigations etc. in support of overseas regulator): this allows the PRA, at the request of an overseas regulator, to exercise its power to require information from an authorized person (in section 165). This is subject to similar limitations and considerations as section 55Q.

The FCA cooperates with other international regulators, many of whom it engages with bilaterally (often as facilitated by formal cooperation agreements) or through its membership of international supervisory 'colleges'. The intelligence it receives from these other bodies is used to identify emerging harm and inform its sector views, and it engages regularly with them to improve the quality of data it holds and shares.

With regard to enforcement activities, the FCA works closely and collaboratively with other regulators and law enforcement agencies both in the U.K. and overseas. For example, working with law enforcement agencies investigating crime can help the FCA identify how criminal proceeds might be laundered through the financial markets. The FCA also works closely with other international regulators, sharing information, intelligence and know-how as well as detecting and acting to tackle cross-border misconduct.

The FCA follows a proportionate and risk-based approach to supervising firms and would therefore not require the Head of IAIG to have additional preventive measures if there are

	already preventive measures set by another regulator that would mitigate the harm.
Assessment	Observed
Comments	<p>The PRA and FCA have a broad range of legal powers at their disposal to use in the supervision of firms. Those powers include sanctions under the SM&CR, imposing requirements, Threshold Conditions modifications, self-wind downs among others. The PRA and the FCA are also empowered to issue unlimited financial penalties and publicly censure firms and individuals. This follows a transparent approach, with both the PRA and the FCA having issued policy statements or handbooks outlining their approach to enforcement.</p> <p>The PRA has the same enforcement powers over firms operating in the U.K. as branches as it has over subsidiaries. It is also legally empowered to take an appropriate range of remedial actions to address problems such as the firm's failure to satisfy the Threshold Conditions.</p> <p>The PRA and FCA have not hesitated to act against firms and individuals. That said, the PRA and FCA tend to resolve matters informally during the supervisory process—one reason for that might be that the SM&CR with its respective sanctioning powers is still a rather new framework which could be used more often in the future. The PRA applies a “comply or explain” supervisory approach and the FCA applies an “assertive supervision” approach alongside more formal sanctions or enforcement measures. Moral suasion by the PRA and FCA has been generally effective in addressing and correcting deficiencies at individual firms.</p> <p>Contested proceedings before the PRA's Enforcement Decision Making Committee are relatively infrequent.</p>
ICP 12	<p>Exit from the Market and Resolution</p> <p>Legislation provides requirements for:</p> <ul style="list-style-type: none"> • the voluntary exit of insurers from the market; and • the resolution of insurers that are no longer viable or are likely to be no longer viable and have no reasonable prospect of returning to viability.
Description	<p>Insurers have available to them various mechanisms to exit the market in an orderly way, including:</p> <ul style="list-style-type: none"> • Closure to new business, through the revocation of the “effecting” permission (leaving the firm authorized to “carry out” its back book of existing contracts), or a variation of permission to limit the extent or nature of new business written • Portfolio transfer of all or part of its insurance business, under Part VII of FSMA

- Schemes of arrangement under Part 26 and 26A of the Companies Act 2006
- Modified insolvency proceedings, including the use of various powers (including cram-down) under Part XXIV of FSMA.

From 2016 there have been 61 general insurers and 29 life insurers that have exited the market through Part VII transfers. Of these 25 general insurers and 8 life insurers were related to Brexit. 3 general insurers and 4 life insurers have exited the market through schemes of arrangement under Part 26 of the Companies Act. Three general insurers have gone into administration of which 2 are now in insolvent schemes of arrangement. Three general insurers have entered insolvency proceedings.

There is a vibrant market for general insurance run-off portfolios. There are approximately 20 firms in the business of acquiring run-off portfolios with the intention of extracting value from the run-off. Technical provisions of these firms are about GBP 3.5bn. There are 40 firms that have chosen to stop writing new business and are running off their current books expecting to release value at the end, with total technical provisions of GBP 8.5bn and 10 firms in insolvency proceedings with total technical provisions of GBP 3bn. The PRA and FCA have a role in Part VII transfers – they are required to present a report to the court regarding the impact of the transfer.

Similarly, there are acquirer firms that specialize in buying life insurance books of business or entire life insurance companies with the aim of running these portfolios off at a profit. In addition to specialist acquirer firms, other life insurers open for new business do acquire significant portfolios.

The PRA has not initiated court administration or other modified insolvency proceedings for insurers that have entered insolvency since 2016. Insolvencies that have occurred were London Market insurers and only one had unexpired risks. The size and type of insurer meant that there were limited impacts on broader financial stability with a PRA focus on orderly failure and policyholder protection in that process. The PRA's involvement with these insurers were proactive discussions with Boards and senior management as to the most appropriate course of action. Notices were given of requirements restricting disposal of assets, payment of dividends and informing other relevant jurisdictions of the insolvency and actions being taken. The PRA has engaged with the FSCS where required. The PRA has also provided assistance to the court indicating the impact of the insolvency on statutory objectives. The office holder in the insolvency has to be subject to the PRA's Senior Manager Regime and the PRA remains involved in seeking reporting on progress against plans to run-off or transfer insurance contracts.

Firms undertake Part VII Transfers and Schemes of Arrangements for a variety of reasons including business restructuring and the alignment of their balance sheets and future business strategy. They can be used in cases of failure or insolvency, however, historically this has proved to be rare.

Direct insurance policyholders are given a statutory priority over other unsecured

	<p>creditors (including cedants) in the winding-up of an insurer. Regulation 21 of the Insurers (Reorganisation and Winding Up) Regulations 2004 provides as follows:</p> <p>'(2) Subject to paragraph (3), the debts of the insurer must be paid in the following order of priority—</p> <ul style="list-style-type: none"> (a) preferential debts. (b) insurance debts. (c) all other debts. <p>(3) Preferential debts rank equally among themselves and must be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions.</p> <p>(4) Insurance debts rank equally among themselves and must be paid in full, unless the assets available after the payment of preferential debts are insufficient to meet them, in which case they abate in equal proportions.</p> <p>(5) Subject to paragraph (6), so far as the assets of the insurer available for the payment of unsecured creditors are insufficient to meet the preferential debts, those debts (and only those debts) have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the insurer, and must be paid accordingly out of any property comprised in or subject to that charge.'</p> <p>Section 377 of FSMA provides a power for the court to reduce the value of one or more of the insurer's contracts. This can only be exercised when an insurer has been proved to be unable to pay its debts, and only as an alternative to making a winding up order (which if made, would move the insolvent company into compulsory liquidation). Any reduction is to be on such terms and subject to such conditions (if any) as the court thinks fit. There are proposals to amend section 377 to include (among other proposals) a stay on certain life insurance redemptions and a moratorium on termination of outwards reinsurance (as well as preventing outwards reinsurers from discounting recoverables) during a court-ordered write-down. However, these changes are not yet in place at the time of the mission.</p> <p>Firms are required to make prospective judgments themselves and to plan accordingly for the event of their resolution. Fundamental Rule 8 of the PRA Rulebook states that:</p> <p>'A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.'</p> <p>Rule 2.6 of the Conditions Governing Business part of the PRA Rulebook provides as follows:</p> <p>'A firm must take reasonable steps to ensure continuity and regularity in the performance of its activities, including the development of contingency plans. To that end, the firm must employ appropriate and proportionate systems, resources and procedures.'</p>
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This is supplemented by EIOPA Guideline 8 on systems of governance, which is observed in the U.K. and carried forward as a domestic expectation on firms following the U.K.'s departure from the EU. It requires that:

'The undertaking should identify material risks to be addressed by contingency plans covering the areas where it considers itself to be vulnerable, and it should review, update and test these contingency plans on a regular basis.'

The PRA under FSMA has a selection of legal tools available to support insurers' exit from the market. Section 55J (*Variation or cancellation on initiative of regulator*) of FSMA gives the PRA the power to vary the permission of an insurer if the undertaking is failing, or likely to fail, to satisfy the Threshold Conditions for which the PRA is responsible, or if it is desirable to exercise the power in order to advance any of the PRA's objectives. This gives the PRA the power to vary the permission of an insurer such that it no longer has permission to effect contracts of insurance. The firm would need to retain its permission to carry out contracts of insurance in order to carry out an orderly, and supervised, run-off.

If an insurer has failed to comply with MCR and has not provided a credible plan to restore MCR compliance within 3 months, then under Part 7B of Section 55J, the PRA must use its power to remove the insurer's permission to undertake insurance business. The PRA can also suspend permission to carry on regulated activities under section 206A of FSMA.

Section 55M enables the PRA to impose requirements on a PRA-authorized person if it appears to the PRA that it is:

- Failing, or likely to fail, to satisfy Threshold Conditions for which the PRA is responsible
- Has failed, during a period of at least 12 months, to carry on a regulated activity; or
- it is desirable to exercise the power in order to advance any of the PRA's objectives.

The PRA's power under this subsection is a power—

- a) to impose a new requirement,
- b) to vary a requirement imposed by the PRA under this section, or
- c) to cancel such a requirement.

Section 55M enables the PRA to impose requirements such as a capital add-on which would have the effect of increasing a firm's SCR. This power is exercisable where the undertaking's risk profile deviates significantly from the assumptions underlying the SCR whether calculated by standard formula or internal model. This would have the impact of earlier triggering of the ladder of intervention set out in Solvency II and described in relation to ICP 17. In addition, non-compliance with the SCR is a trigger event for principal loss absorbency mechanisms in certain types of Tier 1 own funds, effecting a write-down

	<p>of these debts. This is only useful for those insurers that have these forms of Tier 1 own funds.</p> <p>The Solvency II ladder of intervention as described in ICP 17, provides for the PRA to be able to intervene prior to MCR breach, i.e. after SCR breach has occurred. Such an event would trigger the PRA's Proactive Intervention Framework and an insurer failing SCR or subsequently MCR would be put in the highest PIF stage.</p> <p>Section 55P of FSMA enables the PRA to impose prohibitions and restrictions such as prohibitions on disposing of assets.</p> <p>Section 192C of FSMA, provides a 'Power to direct a qualifying parent undertaking' Under Section 192C, the PRA can:</p> <ul style="list-style-type: none"> • direct the Group to seek a compromise with debtholders (e.g., debt/equity swap or 'bail-in') • block dividends from the Group to shareholders • direct that the group disposes of subsidiaries (fully or partially); and • direct the group to support the U.K. subsidiary. <p>Section 192D of FSMA provides that a requirement may be imposed which may require a parent undertaking to take a specific action or refrain from a taking a specific action, This power may be imposed on its group or other members of its group.</p> <p>Prior to a review in 2014, the FSCS provides protection for policyholders of insolvent insurers generally up to 90 percent of the claim due or where there is no claim, 90 percent of the value of premiums paid under the contract of insurance. Where insurance is mandatory, protection rises to 100 percent of the claim. Other lines of business protection increased to 100 percent as a result of the 2014 review- long-term insurance, professional indemnity insurance, claims arising from death or incapacity due to injury, sickness or infirmity of the policyholder. Buildings guarantee policies are also covered up to 100 percent due to consequences for policyholders and the housing market if a lower level of compensation was provided.</p> <p>The FSCS is currently dealing with 39 general insurers in default and two life insurer defaults.³⁰ The failures date back as far as 1980 and are still live cases for the FSCS. Since the beginning of 2016, the policyholders of five general insurers have required FSCS support.</p> <p>The U.K. currently does not have a resolution regime for insurers. Assessment of the population of life insurers and general insurers is underway for resolution planning. Resolution plans are being put in place for all U.K. IAIGs but at the time of the mission these plans were not yet all in place. The relevant standard in ComFrame, CF12.3a does allow discretion for supervisors to put in place resolution plans for IAIGs. However, the</p>
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³⁰ <https://www.fscs.org.uk/what-we-cover/insurance/insurance-insolvencies/> accessed on November 15, 2021

PRA has identified the need to have resolution plans in place for all IAIGs, it just has not completed it for all IAIGs, citing reprioritization due to the COVID-19 pandemic. It has not consulted with crisis management groups regarding the need for resolution plans.

There is evidence that the PRA has had some success in IAIGs voluntarily making changes to improve resolvability of the U.K. businesses of IAIGs. However, this required voluntary agreement and is not clearly supported by legislation.

The PRA is unable to take a group-wide approach to resolution. This legal entity focus of powers means that many of the powers contemplated by CF12.7a are not directly and clearly available to the PRA. Other than Section 192C and Section 192D of FSMA, most powers of resolution available to the PRA are on a legal entity level. CF12.7a contains a detailed list of powers the supervisor or resolution authority may exercise. While there is the word 'may' here, this is taken as a best practice list of powers. The absence of any particular power is not necessarily a cause for concern with respect to observance, but taken in totality, gaps that are evident may be taken into account in determining whether the standard is met. The lack of powers at the group level is a major issue for U.K. observance of CF12.7a. However other gaps are noted (most equally applicable at holding company or legal entity level):

- The power to prohibit payment of variable remuneration and to allow recovering of variable remuneration does not appear to be conferred explicitly on U.K. authorities. Although there is no specific power addressing this issue, it could be argued that wide ranging powers such as that in section 55M of FSMA might cover this issue, there is no evidence the U.K. has contemplated the use of such a power
- No U.K. authority has the power to sell or transfer the shares of an IAIG to a third party
- Writing down of liabilities is currently only allowed once insolvency is established, an issue to be addressed in legislative change
- Powers to override of rights of shareholders of the IAIG in resolution are not conferred on U.K. authorities
- Powers to terminate, continue or transfer certain types of contracts, including insurance contracts and reinsurance contracts are not conferred on U.K. authorities as they have no power over parties to contracts that are not regulated entities
- Powers to restrict or suspend policyholder rights of withdrawing their insurance contracts are not conferred currently on U.K. authorities although this is contemplated in legislative change
- No U.K. authority has the ability to stay the rights of reinsurers of a ceding insurer in relation to terminate, not reinstate, coverage relating to periods after the commencement of the resolution

	<ul style="list-style-type: none"> • There are no explicit powers to impose a temporary suspension of payments to unsecured creditors or impose a stay on creditor actions to attach assets or otherwise collect money or property from an IAIG • There is no ability to establish a bridge institution • There is no clear authority to take steps to provide continuity of essential services (such as annuity payments) and functions and • There is no clear authority to stay early termination rights associated with derivatives and securities financing transactions.
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>The U.K. has been able to successfully deal with the need for small firms to exit the market where necessary using the range of exit strategies available to market participants under UK statute and the tools available to the PRA. The FSCS has been able to provide support to policyholders for a number of insurers unable to meet their obligations to policyholders.</p> <p>Under the current section 377 of FSMA, the court is currently unable to reduce the value of one or more of the insurer’s contracts before an insurer is insolvent. This removes the possibility of a write down in insurer contract value which could be preferable to an insolvent winding-up of the insurer. HMT has proposed amendments in a consultation paper on May 20, 2021. The proposal would apply to U.K. insurers but not the Society of Lloyd’s. The proposals include enhancement to the PRA’s toolkit for dealing with insurers in financial distress by adapting the write-down power in section 377 of FSMA to make it available before insolvency, to improve the process of this power’s application and extend FSCS protection to the written-down amounts. This will achieve a solvency run-off where continuity of cover with FSCS support is provided for protected policyholders. The power will only be used where policyholders are not worse off than under the alternative of an insolvency. The mission encourages HMT and the PRA to proceed with these proposals.</p> <p>PRA-owned resolution plans are constrained by the legal entity level of powers available to the PRA and the lack of clear authority for the PRA to remedy impediments to resolvability. Resolution planning therefore involves insurers entering into intra-group agreements to ensure that a U.K.-based insurer could continue to operate in the event of a failure of the parent group. Resolution plans would benefit from more focus on the group rather than UK legal entities. Even though resolution plans are being put in place, they are not likely to achieve the goal of the holistic framework requirements set out in the ComFrame standards of ICP 12 as they focus on U.K. insurer resolvability. Only designation of a resolution authority supported by a formal revision to the insurer resolution regime providing powers at the group level will enable resolution planning as contemplated by the ComFrame standards in ICP 12.</p> <p>There is a less certainty over the U.K.’s ability to deal with the failure of a significant</p>

	<p>insurance company, one that the PRA categorizes as a Category 1 insurer. The PRA and HMT have acknowledged the gap created by the lack of a comprehensive insurer resolution regime. The mission recommends that U.K. authorities develop, in line with the current plan, a comprehensive insurer resolution regime and ensure that powers extend to the head of insurance groups and allow for an entire group approach to resolution.</p>
ICP 13	<p>Reinsurance and Other Forms of Risk Transfer</p> <p>The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p>
Description	<p>Firms are required to have in place an effective risk-management system and it must cover (amongst other things), reinsurance and other risk-mitigation techniques. In the PRA Rulebook, SII Firms. Conditions Governing Business, 3.1(2)(c)(vi) sets out requirements for a firm's risk management system, which must cover reinsurance and other risk-mitigation techniques.</p> <p>The on-shored CDR, Article 260(1)(g) requires insurers' risk management systems to cover reinsurance and other risk management techniques.</p> <p>In addition, the Actuarial Function is required to express an opinion on the adequacy of reinsurance arrangements. PRA Rulebook, SII Firms. Conditions Governing Business – Actuarial Function, 6.1(h).</p> <p>Within the technical provisions calculation, insurers must calculate amounts recoverable from reinsurance contracts and U.K. Insurance Special Purpose Vehicles (ISPVs). Firms should take into account the time difference between the amounts becoming recoverable and the actual receipt of those amounts. And firms must adjust the calculation to take into account expected losses due to the default of the counterparty.³¹</p> <p>Further requirements are given in the on-shored CDR, Article 41 (General provisions) and 42 (Counterparty default adjustment).</p> <p>Within the SCR calculation, firms should allow for the counterparty credit risk associated with any reinsurance or risk mitigation. This is covered in:</p> <ul style="list-style-type: none"> • PRA Rulebook, SII Firms, SCR – Internal Models, 11.8, where a firm's internal model must take into account the effect of risk-mitigation techniques if and to the extent that credit risk and other risks arising from the use of risk mitigating techniques are properly reflected in the internal model.

³¹ PRA Rulebook, SII Firms, Technical Provisions –11 Recoverables from Reinsurance Contracts and ISPVs.

	<ul style="list-style-type: none"> • PRA Rulebook, SII Firms, SCR – Standard Formula, 3.12, where the counterparty default risk module must cover risk-mitigating contracts, such as reinsurance arrangements. <p>Where a firm is taking into account the risk-mitigation technique of a reinsurance contract in the calculation of the SCR, the on-shored CDR, Article 211(2) allows three different types of reinsurance counterparty to be reflected:</p> <ul style="list-style-type: none"> • A reinsurer that complies with the SCR in Solvency II • a third-country reinsurer situated in a country where (re)insurance supervision is deemed equivalent or temporarily equivalent • a third-country reinsurer not subject to an equivalence assessment that meets certain credit quality criteria. <p>PRA Supervisory Statement SS20/16 Solvency II: reinsurance – counterparty credit risk³² sets out that the PRA expects boards to:</p> <ul style="list-style-type: none"> • understand the risk transfer taking place • ensure the economic impact of reinsurance is adequately reflected in business planning, capital setting and reserving • appreciate the wider associated risks to which reinsurance placements can give rise. <p>SS20/16 further notes that firms may reinsure to a single or only a few counterparties (or connected counterparties), in which case a firm can be exposed to a significant concentration of counterparty default risk. This can be a situation with intragroup reinsurance. The PRA nonetheless expects firms to prudently manage concentration aspects of reinsurance counterparty default risk under Solvency II. SS20/16 sets out minimum expectations in these circumstances which provides supervisors with soft power to challenge firms that have excessive concentration risk. Additional requirements, including stress testing are imposed.</p> <p>Third country equivalence criteria for the reinsurance activities of firms with their head office in a third country are specified in Article 378 of the on-shored CDR.</p> <p>Paragraph 3.2 of SS5/19 Liquidity risk management for insurers sets an expectation that insurers consider the extent to which reinsurance payments could be used to satisfy liquidity needs, including assessing whether claims might be adjusted downward or where settlement may take longer than expected.</p> <p>The mission was able to observe the consideration of reinsurance arrangements in supervisory activities of the PRA raising issues in PSMs as well as conducting deep dive reviews.</p> <p>A novel initiative was the joint Insurer Stress Tests with the Bermuda Monetary Authority</p>
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³² <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss2016>

	in 2019. This exercise was undertaken due to the significant amount of reinsurance placed by U.K. insurers into the Bermuda market. Further details are contained in the ICP 24 description.
Assessment	Observed
Comments	The U.K. has a comprehensive set of requirements for insurers to manage their reinsurance arrangements. They cover both qualitative risk management requirements as well as how reinsurance can be taken into account for solvency calculations. A comment common across a number of ICPs is the diversity of the sources of requirements for insurers. There is certainly scope for simplifying and streamlining these requirements.
ICP 14	Valuation The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.
Description	<p>Unless otherwise specifically set out in the Commission Delegated Regulation (EU) 2015/35, assets and liability recognition, derecognition and measurement follows IFRS, as long as the measurement is consistent with arm's length market value. The main departure of balance sheet recognition from IFRS is the introduction of additional prudence by the requirement to recognize contingent liabilities on the balance sheet if material. In particular, the requirements on firms regarding recognition, derecognition and measurement of assets and liabilities are detailed in:</p> <ul style="list-style-type: none"> • For assets and liabilities other than technical provisions, CDR, article 9 requires that assets and liabilities are recognized in conformity with the U.K.-adopted international accounting standards and that they are valued according to the same standards to the extent those standards are consistent with the Article 75 of the Directive 2009/138/EC – would it be not the case, firms shall use other valuation methods that are deemed to be consistent with Article 75 of Directive 2009/138/EC. • For technical provisions, <ul style="list-style-type: none"> ○ CDR, article 17 deals with the recognition and derecognition of insurance and reinsurance obligations ○ CDR, article 18 defines the boundary of an insurance or reinsurance contract; and ○ PRA rulebook - Valuation, rule 2.1 which provides that firms must, except where otherwise provided, value: <ol style="list-style-type: none"> (1) assets at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction; and

	<p>(2) liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.</p> <p>The valuation methodology for assets and liabilities other than technical provisions, is set out being the following hierarchy (Art.10 of the CDR):</p> <ul style="list-style-type: none"> • Firstly, quoted market prices in an active market • When not possible, then quoted assets or liabilities for similar assets and liabilities, adjusted to reflect differences • Where neither of these is possible, alternative valuation methods shall be used, but observable inputs should be used as much as possible. <p>This hierarchy of methods should ensure reliable, decision-useful valuations. Article 267 of the CDR requires that firms document their processes and procedures adequately, define roles and responsibilities, provide sufficient resources and have effective checks and balances in place.</p> <p>The requirements relating to technical provisions require that all assumptions are consistent over time, can be explained and justified, validated and documented. Data quality requirements are in place. In the CDR, Articles 19-21 set requirements in term of data quality; Articles 22-26 set requirements in term of Underlying Assumptions; Article 264 on validation; and Article 265 on documentation.</p> <p>Those technical aspects are complemented by robust reporting and disclosure standards such as to address the transparency of the calculation (PRA rulebook reporting 3.1 to 3.3; PRA rulebook reporting 3.5).</p> <p>The value of technical provisions must be equal to the sum of a best estimate and a risk margin. Firms must value the best estimate and the risk margin separately, except where:</p> <ul style="list-style-type: none"> (a) future cash-flows associated with (re)insurance obligations can be replicated reliably; and (b) that replication is provided using financial instruments; and (c) those financial instruments have a reliable market value which is observable. <p>then the value of technical provisions associated with those future cash-flows must be determined on the basis of the market value of those financial instruments (PRA rulebook: Technical provisions rules 2.4-2.5).</p> <p>The best estimate must correspond to the probability-weighted average of future cash-flows, taking into account the time value of money (expected present value of future cash-flows) using the relevant risk-free interest rate term structure. It must be calculated based upon up-to-date and credible information and realistic assumptions; using adequate, applicable and relevant actuarial and statistical methods; and gross, without deduction of the amounts recoverable from reinsurance (PRA rulebook: Technical</p>
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provisions rules 3.1). The cash-flow projection used in the calculation of the best estimate must take into account all the cash in- and out-flows required to settle the (re)insurance obligations over their lifetime (PRA rulebook: Technical provisions rules 3.2).

Where firms value the best estimate and risk margin separately, the risk margin must be an amount equal to the cost that a U.K. Solvency II firm would incur in order to hold eligible own funds to cover the SCR necessary to support the (re)insurance obligations over their lifetime, determined using the cost-of-capital rate (PRA rulebook: Technical provisions rules 4.1). The risk margin is calculated based on a projection of future SCRs in respect of only a subset of risks that the insurer is exposed to (known as the non-hedgeable risks). The risk margin must be such as to ensure that the value of the technical provisions is equivalent to the amount that a U.K. Solvency II firm would be expected to require in order to take over and meet the insurance and reinsurance obligations over their lifetime (PRA rulebook: Technical provisions rules 4.2).

When valuing liabilities, no adjustment must be made to take account of the own credit standing of the firm (PRA rulebook: Valuation 2.1-2.2).

Until December 2020, the end of the Brexit transition period, firms used the risk-free rates published by EIOPA to discount their future cash flows. Since then, the PRA has been publishing the rates and also transitioned the GBP rates to SONIA in July 2021. Work on other currencies is in progress, e.g. the JPY rates are expected to be available by end-2021, and work on the USD is planned for 2022.

When calculating technical provisions, insurers must take account of the value of financial guarantees and any contractual options included in (re)insurance contracts (PRA rulebook: Valuation 9.2).

Long-term guarantee measures and transitionals

Long-term guarantee (LTG) measures and so-called “transitionals” were introduced in Solvency II to better reflect the long-term nature of some business lines, especially life insurance, and to avoid excessive volatility from a valuation relying purely on market prices. The LTG measures need to be understood as part of Solvency II, and as they impact the valuation of liabilities, they ultimately also affect own funds and the solvency coverage ratio. Transitionals were introduced to bridge the capital needs of the life insurance sector during the transition from Solvency I to Solvency II. Such transitionals are temporary in nature and will be gradually phased out by 2032. Supervisors have to assess whether companies are capable of covering their SCR without the transitionals by the end of the transition period.

Insurers may apply a matching adjustment (MA) to the risk-free interest rate when valuing their life insurance obligations if they hold bonds or other assets with similar cash-flow characteristics, immunizing them against the spread risk on those assets. The MA is calculated by each insurer based on the spreads between the interest rate that could be

	<p>earned from the assets in the undertaking's matching portfolio and the risk-free interest rate.</p> <p>Approval for use of the MA is subject to the conditions set out in Regulation 42, including eligibility conditions for the assets and matching liabilities to which the MA is applied. Regulation 42(4)(e) requires that the asset portfolio's expected cash flows replicate each of the expected liability cash flows in the same currency. This implies that overall cash flows from the portfolio are fixed in terms of timing and amount and cannot be changed by the issuers of the assets or any third parties. The PRA does not consider that this requires individual assets being denominated in a particular currency, provided that replication can be demonstrated by considering the cash flows of assets in aggregate. The PRA's view is that the condition in Regulation 42(4)(a) that the portfolio must consist of 'bonds or other assets with similar cash flow characteristics' could also be satisfied by considering relevant pairings or groupings of assets.</p> <p>The PRA considers that the MA has functioned as intended thus far throughout the COVID-19 crisis but noting that its specification is part of the Solvency II review (see Box 1). Nevertheless, the PRA found it useful to remind firms that there is generally no requirement or expectation to sell downgraded assets as long as the MA portfolio continues to comply with Regulation 42 of the Solvency II Regulations and firms' own governance and risk management systems. It furthermore laid out that the use of COVID-19 related payment holidays or loan modifications would not automatically result in a loan being considered in default.</p> <p>Until 2031, insurers may apply the transitional measure on technical provisions (TMTP), a deduction to insurance obligations concluded before the start of Solvency II, based on the difference between technical provisions under Solvency I and technical provisions under Solvency II. Over a period of 16 years the transitional deduction is reduced to zero.</p> <p>The impact of both the MA and the TMTP is substantial for the U.K. insurance market:</p> <ul style="list-style-type: none"> • 18 solo entities applied the MA as of end-2020. Without using the MA, the value of technical provisions would be GBP 42bn higher (+3 percent). Even more significant are the capital savings: the SCR would be higher by 44bn (+60 percent), and eligible own funds to meet the SCR would be lower by 37bn (-32 percent). • The TMTP, as of end-2020, was used by 22 firms. Without using the TMTP, the value of technical provisions would be GBP 27bn higher (+2 percent). Eligible own funds to meet the SCR would be lower by 21bn (-18 percent), while the SCR would be higher by a rather moderate 3bn (+4 percent). <p><i>IFRS 17</i></p> <p>When endorsed for use in the U.K., IFRS 17 will be the new accounting standard for insurance contracts. Effective for annual reporting periods beginning on or after 1 January 2023, it will enhance transparency by introducing consistent principles, and thereby improve international comparability. IFRS 17 combines current measurement of future</p>
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	<p>cash flows with the recognition of profit over the period that services are provided under the contract. It also presents insurance service results separately from insurance finance income or expenses, and finally it requires an entity to make an accounting policy choice of whether to recognize all insurance finance income or expenses in profit or loss or to recognize some of that income or expenses in other comprehensive income. These changes will come along with new and more comprehensive disclosure requirements.</p> <p>The PRA does not have an active role as an authority in the implementation of IFRS 17. Nevertheless, it monitors the developments and engages with insurers and auditors, focusing on operational challenges.</p>
Assessment	Observed
Comments	<p>The regulatory framework for the valuation of assets and liabilities, set out in the Solvency II framework, is robust and incorporates the standards of ICP 14.</p> <p>The PRA is attentive to the use of the MA and the TMTP and monitors closely the eligibility criteria for assets in the MA portfolios. It also managed the transition from LIBOR to SONIA effectively and should continue doing so for other currencies as well. Going forward, it will be necessary to continue maintaining high standards for the eligibility of assets for the MA and scrutinizing the performance of illiquid assets in stressed markets</p> <p>The implementation of IFRS 17 requires close attention also by the supervisory authorities. For insurers which apply IFRS, the process involves vast resources from different parts of the company, including accounting, actuarial, IT, risk management and others. It is important that supervisors monitor the implementation progress and ensure that those insurers lagging behind do not excessively pull resources from other critical projects as well as day-to-day risk management and control functions.</p>
ICP 15	<p>Investments</p> <p>The supervisor establishes regulatory investment requirements for solvency purposes in order for insurers to make appropriate investments taking account of the risks they face.</p>
Description	<p>The PRA's regulatory requirements on the investment activities of an insurer or group are set out in the PRA Rulebook: Solvency II Firms: Investments. This sets out the Prudent Person Principle. The General Principle in 2.1 requires a firm to invest in assets it can properly identify, measure, monitor, manage and report and appropriately take into account in the assessment of its overall solvency needs. All the assets must be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio of assets of the firm as a whole and localized to ensure their availability. In addition, for assets covering technical provisions, 3.1 requires a firm must ensure that assets held to cover technical provisions are appropriate to the nature and duration of the firm's</p>

	<p>(re)insurance liabilities and in the best interests of all policyholders consistent with any disclosed policy objectives.</p> <p>The PRA's Supervisory Statement 1/20 sets out the PRA's expectations regarding the firm's investment strategy, internal governance over the investment function, investments in assets in unregulated markets, and intragroup participations.</p> <p>For investments supporting technical provisions that are not based on unit-linked policies there are additional requirements in Investments chapter of the PRA Rulebook. Derivative usage must be for risk management or efficient portfolio management, investments that are not traded on a regulated market must be kept to prudent levels and assets must be properly diversified.</p> <p>The PRA does not impose any quantitative limits on investments but expects that firms will internally establish investment limits as part of their investment risk management.</p> <p>In its supervisory approach, the PRA seeks to understand how firms are implementing the prudent person principle in their own circumstances. Therefore, PRA supervision is very much focused on the governance of investment decision-making and the documentation evidencing that governance process.</p> <p>ComFrame requirements in ICP 15 are met by virtue of the investment requirements applying at the group level.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>The principles-based requirements applied under Solvency II are appropriate in an advanced market such as the U.K. and the PRA has high expectations of firms in applying these principles. The focus on the governance process around investment decisions is appropriate. One possible question mark comes from the wording of Standard 15.5 which contemplates quantitative requirements on complex and less transparent classes of assets and investments in markets or instruments subject to less governance or regulation. The standard though does include the words 'where appropriate'. In the context of a principles-based approach to investments the mission does not believe that hard quantitative requirements in relation to these higher risk investments are necessary for observance of that particular standard. From review of supervisory files, the mission is confident that the PRA is focusing on higher risk investments and there was ample evidence of focus on these issues with respect to application of the requirements for the matching adjustment portfolios as outlined in the description of ICP 14.</p>

ICP 16	<p>Enterprise Risk Management for Solvency Purposes</p> <p>The supervisor requires the insurer to establish within its risk management system an enterprise risk management (ERM) framework for solvency purposes to identify, measure, report and manage the insurer’s risks in an ongoing and integrated manner.</p>
Description	<p>Conditions Governing Business 3.1 requires insurers to have in place an effective risk-management system to ‘identify, measure, monitor, manage and report on a continuous basis the risks, at an individual and at an aggregated level, to which it is or could be exposed, and their interdependencies’. There are consistent links between risk management and capital management throughout the Solvency II legislation and rules.</p> <p>On-shored CDR Article 259 requires insurers to ‘...establish, implement, and maintain a risk management system...’. This risk management system must include a risk strategy, clearly defined decision-making process, written policies for each category of risk identified along with tolerance limits for each type of risk and reporting procedures and processes. Senior managers have to take into account information reported as part of the risk management system. Insurers are required, where appropriate, to perform stress tests and scenario analysis.</p> <p>The PRA Rulebook’s Solvency II Firms: Conditions Governing Business 3.8-3.11 requires insurers to conduct an ORSA as part of its risk management system. This must include the insurer’s ‘overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the firm.’ An insurer must perform the ORSA ‘regularly and without delay following any significant change in its risk profile.’ On-shored CDR Article 306(c) requires a firm’s ORSA to include information on their overall solvency needs and a comparison between those solvency needs, the regulatory capital requirements and their own funds. The PRA’s Supervisory Statement 19/16 Solvency II: ORSA further expands on the PRA’s expectations. SS19/16 covers expectations for the ORSA supervisory report, a separate ORSA policy that is not part of the supervisory report, Board sign-off and embedding of the ORSA, strong linkages with business strategy, identification of risks, linkages with assessment of regulatory solvency, stress testing based on a sufficiently wide range of plausible stress tests and certification of continued adequacy of internal models (where used for regulatory purposes) to calculate firm solvency. SS19/16 also addresses how ORSA can be implemented for a group with the ability to gain approval for a group ORSA covering multiple entities or alternatively how individual ORSAs link to an overarching group ORSA. Under the SM&CR, responsibility for a firm’s ORSA is a prescribed responsibility.</p> <p>Supervisory Statement 4/18 Financial Management and Planning by Insurers (SS4/18) sets out expectations for an insurer’s risk appetite statement. It should encompass all material risks relevant to the insurer and should be communicated appropriately within the insurer.</p> <p>On-shored CDR Article 260(1)(b) requires insurers to have an ALM policy. EIOPA Guideline 24 sets out expectations for insurers’ ALM policies. These requirements do not include an</p>

	<p>explicit reference in the regulations to the relationship of ALM policies with product development, pricing functions and investment management as required in ICP 16.5.</p> <p>The requirements for investment risk management are set out in relation to ICP 15.</p> <p>On-shored CDR Article 260 (1)(a) details how underwriting policy must include actions to be taken ‘...to assess and manage the risk of loss or of adverse change in the values of insurance and reinsurance liabilities, resulting from inadequate pricing and provisioning assumptions’. EIOPA Guideline 20 on System of Governance makes the link between designing an insurance product and the premium to charge for it and reinsurance and other risk mitigation techniques.</p> <p>Conditions Governing Business in the PRA Rulebook 3.1(2)(c)(iv) requires insurers to have strategies, processes, policies and reporting procedures necessary to manage their liquidity risk. Supervisory Statement 5/19 Liquidity Risk Management for Insurers sets out the PRA's expectations for U.K. insurers which includes that firms have in place scenario analysis and liquidity stress testing programs, maintain a liquidity buffer and develop a liquidity contingency plan. The mission saw that PRA supervisors focused significantly on liquidity risk particularly in 2020 after the liquidity stress events in markets in March 2020.</p> <p>Firms are not required specifically to develop recovery plans but ‘identify and analyze potential management actions, in response to stress scenarios, that are realistic, credible, consistent with regulatory expectations, and achievable and which should be approved by the Boards’ (S4/18 3.7 and PRA’s Approach to Insurance Supervision).</p> <p>The PRA’s supervisory process places significant emphasis on the risk management systems of insurers. This is one of the key risk elements assessed in the supervisory process as set out in the description of ICP 9. One interesting aspect is that over time, less emphasis has been placed on assessing the ORSA supervisory report for the larger firms (Category 1 and 2 firms). Supervisors have very frequent contact with these larger firms and discuss risk management issues throughout the year, so they do not see as much value in the ORSA supervisory report from the perspective of their own supervision needs as they do for the smaller insurers where they have less frequent interactions.</p> <p><i>ComFrame requirements</i></p> <p>The ComFrame standards where observance is in question are:</p> <ul style="list-style-type: none"> • CF16.7a regarding reliability of data – there is no obvious link in legislation and rules addressing data quality in the context of pricing and reinsurance as required by the standard • CF16.7b – group-wide claims management policy – there is no explicit requirement for a feedback mechanism into the group-wide underwriting policy and reinsurance policy from the claims management process • CF16.7c – group-wide strategy for reinsurance – there is no explicit requirement for the interaction of group-wide reinsurance strategies with group-wide capital
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	<p>management strategies (although there is evidence of IAIGs making this connection in their SFCRs and other disclosures), there is no requirement to be explicit about how risk appetite is decided and no requirement to specifically address the autonomy of subsidiaries to enter into their own reinsurance arrangements.</p> <ul style="list-style-type: none"> • CF16.7e – requirements for the group-wide actuarial function to report to the IAIG board on certain matters make no explicit reference to the need to consider non-insurance legal entities or non-regulated legal entities although there are explicit requirements for this to be addressed by the risk management function • CF16.9d – reporting to the supervisor on liquidity risk, there is no requirement for what amounts to a liquidity management plan as set out in the standard, however there is ample evidence of supervisors focusing on liquidity risk and therefore deriving the same information via supervisory processes • CF16.12a and 16.12b – detailed requirements for the IAIG’s group-wide ORSA – there are no requirements for IAIGs to specifically address the fungibility of capital and transferability of assets within the group in their group-wide ORSA, one of a list of 5 detailed requirements in the standard (it could be argued this is addressed in the Prudent Person Principle for investments but there is no direct reference to this issue), no requirement to address aggregate counterparty exposures across the group and apply scenario analysis and stress testing to these aggregate exposures (so 2 out of 7 detailed requirements are not explicitly met).
Assessment	Largely Observed
Comments	<p>There are a large number of ComFrame standards in ICP 16 which add detailed requirements for IAIG supervision to the general requirements set out for supervision of all insurers. There are 16 standards in ICP 16 applicable generally. There are 25 ComFrame standards that add detail in respect of IAIGs. The PRA’s regime is anchored in principles, but it puts expectations into guides like supervisory statements or on more topical issues into ‘Dear CEO’ letters. There is some dissonance between the PRA approach and the detailed requirements in ComFrame as set out above. The mission believes that these issues are not significant although they look like they involve a number of ComFrame standards. The PRA’s approach broadly addresses the ComFrame requirements, but it cannot be said that it observes every aspect of the standards listed above. The standards are often multifaceted with the U.K. requirements often covering two-thirds or more of the detailed requirements with some issues not addressed directly. Furthermore, these issues could be addressed in the development of supervisory statements building on the robust principles already in place.</p> <p>In the Regulatory Initiatives Grid, the PRA has announced plans to require liquidity management plans from certain insurers. The mission supports this initiative and believes all IAIGs should be in-scope for this initiative.</p>

	With regard to ICP 16.5, which is the only non-ComFrame standard at issue, the PRA should develop regulations or guidance to address the relationship between ALM policies and product development, pricing functions and investment management.
ICP 17	<p>Capital Adequacy</p> <p>The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p>
Description	<p>Solvency II follows a total balance sheet approach. The U.K. regime post Brexit is the result of the onshoring of Solvency II rules, comprising:</p> <ul style="list-style-type: none"> • The market valuation of assets and liabilities (Rulebook - Valuation Art. 2.1) • The own funds (Rulebook - Own funds incl. recognition, eligibility, and tiering) • The definition of the Solvency Capital requirement (SCR) (Rulebook - Solvency Capital Requirement General Provisions in particular Art. 3.4 and Art. 3.3). <p>Finally, the above framework is built upon a set of Fundamental Rules (Rulebook – Fundamental rules) for firms that provide that (i) a firm must act in a prudent manner (Rule 3), and (ii) a firm must always maintain adequate financial resources (Rule 4).</p> <p><i>Capital requirements and supervisory ladder of intervention</i></p> <p>Insurers are required to hold eligible own funds to cover:</p> <ul style="list-style-type: none"> • a minimum capital requirement (MCR), which is calibrated to a (value-at-risk) confidence level of 85 percent over a one-year period (PRA Rulebook, SII Firms, Minimum Capital Requirement, sections 2 and 3). • a solvency capital requirement (SCR), which is calibrated to a (value-at-risk) confidence level of 99.5 percent over a one-year period (PRA Rulebook, SII Firms, Solvency Capital Requirement – General Provisions, sections 2 and 3). <p>Additionally, SS4/18 regarding risk appetites sets an expectation for insurers to include the risk appetite for the levels of capital that are to be maintained in reasonably foreseeable market conditions (e.g., as assessed through stress and scenario tests, or through some suitable alternative approach, to provide no more than a 1 in X probability that SCR coverage might fall below 100 percent), i.e., an implicit expectation that capital is held above 100 percent of SCR.</p> <p>The regulatory capital requirements include solvency control levels which trigger different degrees of intervention by the supervisor with an appropriate degree of urgency and requires coherence between the solvency control levels established and the associated corrective action that may be at the disposal of the insurer and/or the supervisor.</p> <p>PRA Rulebook, SII Firms, 'Undertakings in difficulty' sets out the consequences of a breach</p>

of the SCR and the MCR. Upon a breach of its SCR, a firm must:

- immediately inform the PRA as soon as it observes that the SCR is no longer complied with, or where there is a risk of non-compliance within the next three months
- within two months from the observation of non-compliance with the SCR, submit a realistic recovery plan for approval by the PRA and
- take the measures necessary to achieve, within six months (or such longer period as the PRA may determine) from the observation of non-compliance with the SCR, the re-establishment of the level of eligible own funds covering the SCR or the reduction of its risk profile to ensure compliance with the SCR.

The breach of MCR requires even more timely and robust actions. A firm must:

- inform the PRA immediately where it observes that the MCR is no longer complied with or where there is a risk of non-compliance within the next three months; and
- within one month from the observation of non-compliance with the MCR, submit, for approval by the PRA, a short-term realistic finance scheme to restore, within three months of that observation, the reestablishment of eligible own funds at least to the level of the MCR or to reduce its risk profile to ensure compliance with the MCR.

The rules also set out what the recovery plan or finances scheme must at least include.

In the event that a firm does not satisfactorily comply with the actions set out above on breach of MCR, Sections 55J and 55KA of FSMA:

- requires the PRA to withdraw a firm's permission to enter new business; and
- permits the PRA to withdraw a firm's permission to continue to administer existing business if that would be to the benefit of policyholders.

The PRA also has a Proactive Intervention Framework (PIF), which sets out five stages of risk to viability of an insurer and the possible supervisory actions the PRA can take at each stage. The PRA maintains a PIF score for each firm that is reviewed on a regular basis. As part of this review, a firm's solvency coverage is monitored against the stated risk appetite (see SS4/18). Solvency coverage below risk appetite may lead to closer supervisory monitoring depending on the impact of the insurer, magnitude of the divergence from stated risk appetite and duration of the divergence.

Group capital requirements

Each relevant insurance group undertaking must ensure that eligible own funds are available in the group which are always at least equal to the group SCR. Insurance groups also need to have eligible basic own funds to cover at all times the minimum group SCR which is determined as sum of the MCR of the participating Solvency II undertakings and the proportional share of the MCR of the related Solvency II undertakings (PRA Rulebook, SII Firms, Group Supervision – sections 4 to 15).

	<p><i>Calculation of the capital requirements</i></p> <p>Insurers can determine their SCR using either an approved internal model (partial or full) or using a standard formula approach (PRA Rulebook, SII Firms, Solvency Capital Requirement – General provisions, 2.1 and 3.1).</p> <p>Regardless of whether a standard formula or internal model is used:</p> <ul style="list-style-type: none"> • The SCR must be calibrated to ensure all quantifiable risks a firm is exposed to are taken into account, including at least non-life underwriting risk, life underwriting risk, health underwriting risk, market risk, credit risk and operational risk (PRA Rulebook, SII Firms, SCR – General provisions, 3.3). • The SCR must correspond to the value-at-risk of its basic own funds subject to a confidence level of 99.5 percent over a one-year period (PRA Rulebook, SII Firms, SCR – General provisions, 3.4). • Firms must take into account the effect of risk mitigation techniques (reference 3.5) and it should not cover the risk of loss of basic own funds resulting from changes to the volatility adjustment (PRA Rulebook, SII Firms, SCR – General provisions, 3.6). <p>The PRA reviews insurers’ SCRs to ensure that it covers all quantifiable risks a firm is exposed to. Specifically, PRA Rulebook, SII Firms, SCR – General provisions, 3.3 requires firms to cover at least the following risk categories: non-life underwriting risk, life underwriting risk, health underwriting risk, market risk, credit risk and operational risk.</p> <p>With regards to the aggregation of risks, there are separate requirements for internal model and standard formula:</p> <ul style="list-style-type: none"> • For the standard formula, the aggregation approach is based on a variance-covariance aggregation approach with pre-defined correlation parameters (on-shored CDR, Article 87). • For internal models, the Statistical Quality Standards require an insurer’s system for measuring diversification effects to be adequate (PRA Rulebook, SII Firms, SCR – Internal Models, Statistical Quality Standards, 11.8). Furthermore, the on-shored CDR, Article 234 sets out some further technical requirements with regards to the system of measuring diversification effects. <p>The standard formula requirements set out the method to be used to calculate the SCR for each risk module (PRA Rulebook, SII firms, SCR – Standard Formula, and the on-shored CDR s Articles 83-221).</p> <p>Furthermore, insurers using the standard formula have to assess the appropriateness of its use as part of the firm’s ORSA.</p> <p>In order to support consistency, the PRA requires internal model users to provide an estimate of the SCR determined in accordance with the standard formula. In addition, the PRA monitors “model drift” between the standard formula SCR and a firm’s internal model</p>
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SCR (SS15/16).

The PRA can impose a capital add-on if a firm's risk profile deviates significantly from the assumptions underlying the SCR, or if there is a significant deviation from the system of governance requirements. This applies to both firms using an internal model and the standard formula.

The standard formula SCR can also be varied to take into account "undertaking specific parameters". Specifically, insurers can apply to the PRA for approval to use a subset of parameters specific to the undertaking, instead of a subset of parameters of the standard formula.

Eligible own funds

The U.K. regime distinguishes three tiers of capital, based upon the quality of loss absorbency which each offers (SS3/15 - The Quality of Capital instruments; and SS8/14 - Subordinated guarantees and the quality of capital for insurers). The regime also sets out which tiers of quality can be recognized to cover the SCR and MCR, and the proportion of that capital which must be of the highest tier. Where assets on the balance sheet may only be used to absorb losses in a restricted manner, a ring-fenced adjustment is required to Tier 1 capital to reflect this.

The treatment of participations is specifically set out to ensure that no double counting of regulatory capital occurs between entities in different financial regulated sectors (such as banking and insurance).

The group capital regime builds on the solo tiering structure and limits on tiering. However, it also has detailed requirements as to how the group balance sheet shall be calculated, how adjustments to group capital shall be made to reflect such things as minority interests and availability of own funds held in one part of the group to absorb losses elsewhere in the group.

All basic own fund instruments which an insurer intends to be recognized as solo or group own funds must be notified to the PRA 30 days before issuance, unless they are identical except for certain specifics such as issue date, size of issuance or coupon rate. That notification must contain a near final set of terms and conditions.

Ancillary own fund (AOF) items are assessed individually. After an internal governance process, they are formally approved, and the approval published on the PRA's website. Only at that point can an insurer take credit for the AOF in its capital calculations.

For instruments that are intended to be recognized as group own funds as well as solo, a separate check is undertaken to ensure that the proposed instrument complies with the group availability requirements. No AOF can be recognized for group purposes.

Internal models

The internal model criteria to ensure broad consistency among all insurers are set out in the PRA Rulebook, SII Firms, SCR – Internal Models, and in the on-shored CDR, Articles

	<p>222-247:</p> <ul style="list-style-type: none"> • Use test, where firms must demonstrate that the internal model is widely used and plays an important role in its systems of governance. • Statistical Quality Standards, which set out for example the requirements in respect to the methods, assumptions, data used, and risks covered by the model. • Further technical standards on topics such as financial guarantees, policyholder options, diversification effects, risk-mitigation techniques, and future management actions. • Calibration Standards, where a firm may use a different time period or risk measure than the 99.5th percentile value-at-risk over one-year measure. • Profit and Loss Attribution, where firms demonstrate how the internal model can be used to explain the sources of profits and losses. • Validation Standards, which sets out a requirement for firms to have a regular cycle of validation, e.g., to demonstrate the resulting capital requirements are appropriate. • Documentation Standards, which requires firms to document the design and operational details of the internal model. • External Models and Data, which sets out that all the above requirements apply for models or data obtained from a third party. <p>Insurers need to apply for prior regulatory approval for an internal model (either full or partial), as well as major changes to an approved internal model and to an internal model change policy.</p> <p>The overall principle of proportionality applies, where the requirements of the on-shored CDR should be applied taking into account the nature, scale, and complexity of the risks inherent in the business of an insurance or reinsurance undertaking.</p> <p>The Statistical Quality Standards require firms to demonstrate that the methods used (in the calculation of the probability distribution forecast) are:</p> <ul style="list-style-type: none"> • based on adequate, applicable, and relevant actuarial and statistical techniques • based upon current and credible information and realistic assumptions and • consistent with the methods used to calculate technical provisions. <p>Furthermore, firms are required to justify the assumptions underlying their internal models to the PRA.</p> <p>The following data quality standards apply:</p> <ul style="list-style-type: none"> • Data used for the internal model must be accurate, complete, and appropriate
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- A firm must update the data sets used in the calculation of the probability distribution forecast at least annually.

In addition to the above, the PRA has published a number of supervisory statements setting out its expectations in respect of the methodology (amongst other things) of the internal model for certain risks. The motivation behind these supervisory statements is to provide expectations in modelling areas which tend to be more complex or less than straightforward to model. These include:

- SS5/15 – covering the treatment of (occupational) pension scheme risk in internal models.
- SS17/16 – which covers a range of internal model methodology considerations, including the modelling of the premium provision for general insurers, and validation of internal models.
- SS3/17 – covering illiquid unrated assets. Chapter 3 covers the assessment of risks from equity release mortgages. Chapter 4 covers the risk identification and modelling of Income Producing Real Estate loans but is also more broadly relevant to other similar types of assets.
- SS8/18 – covering the modelling of the matching adjustment in internal models. This includes the modelling of credit risk in the context of long-term assets held to back annuity business in firms' matching adjustment portfolios.
- SS9/18 – covering the modelling of the volatility adjustment in internal models.

The PRA would review a firm's calibration as part of the initial internal model application or under a major internal model change. As part of these review processes, firms would still be required to demonstrate the calibration requirements as below:

- An insurer's solvency capital requirement (SCR) is required to be calibrated to a (value-at-risk) confidence level of 99.5 percent over a one-year period. This is set out in PRA Rulebook, SII Firms, Solvency Capital Requirement – General Provisions, sections 2 and 3.
- Furthermore, the Calibration Standards allow a firm to use a different time period or risk measure than the 99.5th percentile value-at-risk over one-year measure (PRA Rulebook, SII Firms, SCR – Internal Models, Calibration Standards). Further requirements are set out in the on-shored CDR, Article 238.

In addition to these requirements, the PRA monitors (and reviews where appropriate) an insurer's internal model calibrations on an annual basis in the following ways:

- SS25/15 which sets out an expectation for insurers to provide "internal model outputs", which capture their internal model calibrations against a standardized set of risks, such as equity risk, credit spread risk, longevity risk etc.

	<ul style="list-style-type: none"> • SS15/16 which sets out an expectation for insurers using approved internal models to provide standard formula SCR reporting, to allow the PRA to monitor “model drift”.³³ <p>Finally, the PRA uses quantitative analysis as part of model approvals. In brief, it uses quantitative tools to satisfy itself that a model meets the internal model tests and standards. This is described in more detail in SS17/16.</p> <p>One of the internal model standards is the use test, where firms must demonstrate that the internal model is widely used and plays an important role in its systems of governance, risk management system and decision-making processes (PRA Rulebook, SII Firms, SCR – Internal Models, Use Test).</p> <p>Further use test requirements are set out in the on-shored CDR, articles 223-227, which cover:</p> <ul style="list-style-type: none"> • Use of the internal model • Fit to the business (essentially that the design of the internal model is aligned with the business’s activities, and that the outputs of the model are sufficiently granular to be useful) • Understanding of the internal model (essentially that the insurer’s senior management understand the structure of the internal model, its scope and purpose, the general methodology, limitations, and diversification effects) • Support decision-making and integration with risk management (the internal model is considered to be widely used and plays an important role in the system of governance if it meets a number of conditions set out in article 226) • Simplified calculation. <p>Firms are also required to ensure that the circumstances under which the internal model does not work effectively are documented, in accordance with the on-shored CDR, Article 245.</p> <p>The Documentation Standards requires firms to document the design and operational details of the internal model. This includes how the firm demonstrates compliance with the Use Test, Statistical Quality Standards, Calibration Standards, Profit and Loss Attribution, and Validation Standards. The Documentation Standards also require firms to provide a detailed outline of the theory, assumptions, and mathematical and empirical bases underlying the internal model. This is in the PRA Rulebook, SII Firms, SCR – Internal Models, Documentation Standards.</p>
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³³ In the general insurance sector (excluding reinsurance), there is no indication of model drift from 2015 to 2019, measured by the ratio of internal model SCR to the standard formula SCR. Some hints of model drift exist in the life sector but can be explained by increasing exposures to illiquid assets which would carry a significantly higher capital charge under the standard formula. A further consideration in this context is required with regards to the transfer of longevity risks which distorts the comparison between internal models and the standard formula over time.

	<p>Finally, the on-shored CDR, Articles 243-246 set out further requirements:</p> <ul style="list-style-type: none"> • The requirement for the documentation to be sufficient for an independent knowledgeable third party to understand the internal model and form a sound judgement as to its compliance with the internal model standards, and covers • The minimum content of the documentation, which specifically sets out a requirement for there to be a description of the policies, controls, and procedures for the management of the internal model. Including responsibilities assigned to staff members of the insurance or reinsurance undertaking, requires all relevant assumptions to be justified and an explanation of the methodology to be given. • The circumstances under which the internal model does not work effectively. • Requirements in respect of changes to the internal model. <p>The Use Test requires firms to ensure the ongoing appropriateness of the design and operations of their internal model, and that the internal model continues to appropriately reflect the risk profile of the firm.</p> <p>There is an internal model change process, where insurers are required to seek approval for major changes. Major model changes are subject review by the PRA and must meet the internal model requirements (PRA Rulebook, SII Firms, SCR – Internal Models, and the relevant internal model articles set out in the on-shored CDR). Firms are also expected to provide a quarterly summary of minor model changes to the PRA.</p> <p>So far, COVID-19 has not resulted in any major calibration changes in the internal models of life insurers. Also, in the general insurance sector, model changes were only minor, mostly related to dependencies between certain risks or the use of reinsurance—taken together, these changes had no major impact on SCR levels.</p> <p>Finally, a firm that has received internal model approval must ensure that its risk management function covers:</p> <ul style="list-style-type: none"> • To design and implement the internal model • To test and validate the internal model • To document the internal model and any subsequent changes made to it • To analyze the performance of the internal model and to produce summary reports thereof • To inform the governing body about the performance of the internal model, suggesting areas needing improvement, and updating that body on the status of efforts to improved previous identified weaknesses.
Assessment	Observed

Comments	<p>The capital adequacy framework, implemented through Solvency II, is robust and adequate to a complex insurance sector like the one in the U.K.</p> <p>The wide-spread use of internal models is adequately monitored via an extensive set of additional national reporting templates.</p> <p>After the Brexit, the supervisory community in the EU has lost considerable knowhow which used to be provided by PRA colleagues since the beginning of the pre-application phase, well before the actual Solvency II implementation date. Going forward, a continued exchange on internal model supervision, both in the colleges and holistically with EIOPA and the IAIS would be mutually beneficial.</p>
ICP 18	<p>Intermediaries</p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, in order that they conduct business in a professional and transparent manner.</p>
Description	<p>Insurance distribution activities are subject to FCA regulation and are solo regulated firms subject only to FCA supervision. The FCA is therefore also the prudential regulator for insurance intermediaries.</p> <p>The FCA's Perimeter Guidance manual (PERG), chapter 5 (PERG 5), defines whether a particular activity can be considered as carrying on insurance distribution activities and therefore subject to FCA regulation. Firms carrying out insurance distribution activities must be licensed under FSMA.</p> <p>The FCA's requirements for insurance intermediaries are multi-layered as they are for other types of firms it regulates. FCA-regulated firms are subject to High Level Standards, which include the Principles for Businesses Sourcebook (PRIN) and Threshold Conditions (COND). These high-level standards are supplemented by more detailed requirements as set out below.</p> <p>The FCA's prudential standards for insurance intermediaries are contained in the FCA Handbook's Prudential sourcebook for Mortgage and Home Finance Firms and Insurance Intermediaries (MIPRU). MIPRU contains requirements for capital resources and professional indemnity insurance and requires responsibility for a firm's insurance distribution activity to be allocated to a director or senior manager. The Senior Managers & Certification Regime (SM&CR) was extended to insurance intermediaries in December 2019. This is described in relation to ICP 5.</p> <p>The FCA's training and competence regime consists of the 'competent employees rule', which applies to all U.K. authorized firms and is contained in the FCA Handbook's Senior Management Arrangements Systems and Controls sourcebook (SYSC). The Training and Competence sourcebook contains more detailed requirements for certain retail activities and the need to have an appropriate qualification where necessary. The competent</p>

	<p>employees rule is the main requirement relating to the competence of employees. In broad terms, the rule requires that insurance intermediaries must employ personnel with the skills, knowledge, and expertise necessary for the discharge of the responsibilities allocated to them.</p> <p>SYSC of the FCA Handbook sets out requirements for systems and controls and general organizational requirements including governance arrangements within firms.</p> <p>Principle 10 (Clients' assets) of FCA's Principles for Businesses requires a firm to arrange adequate protection for clients' assets when the firm is responsible for them. Client Assets Sourcebook CASS 5 of the FCA Handbook sets out the rules for firms who handle client monies. Where client money is segregated and held in separate client accounts it is protected under trust arrangements, via a statutory or non-statutory trust. A non-statutory trust arrangement provides extra flexibility but requires additional controls to be put in place by the insurance intermediary and there are reporting obligations to the FCA.</p> <p>The FCA's approach to supervision is set out in the description of ICP 9 and ICP 10. Insurance intermediaries are subject to ongoing supervision. The mission was provided ample evidence of supervisory activities and enforcement activities with respect to insurance intermediaries. One key example provided was a thematic review into the General Insurance distribution chain which resulted in specific guidance for insurers and intermediaries covering many aspects of the FCA Handbook (FG19/5 The GI distribution chain: Guidance for insurance product manufacturers and distributors³⁴).</p> <p>An important supervisory activity undertaken during the COVID-19 pandemic was intensive monitoring of the liquidity positions of the general insurance brokers which are subject to fixed firm supervision. This was part of the FCA's prudential supervision mandate for intermediaries.</p>
Assessment	Observed
Comments	Intermediaries are subject to a comprehensive set of prudential and conduct requirements. FCA supervision which is described in ICP 9 is comprehensive. With respect to intermediaries both fixed firm and flexible firm supervision is applied.
ICP 19	<p>Conduct of Business</p> <p>The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p>
Description	The FCA mission as described in relation to ICP 1 sets out a framework for conduct regulation in the U.K.

³⁴ <https://www.fca.org.uk/publication/finalised-guidance/fg19-05.pdf>

	<p>The FCA has stated it would be prohibitive to list all the legislative requirements and rules that are relied on to ensure that the FCA meets its objectives in the insurance sector. This is indicative of comprehensive requirements yet also an extremely dense and intricate web of requirements that are complex to navigate, leaving open the possibility for significant streamlining in the future. This description will touch on the key requirements in relation to ICP 19.</p> <p>In its Approach to Consumers, the FCA set out its vision, with indicators for well-functioning markets for consumers. These indicators link with the conditions the FCA wants to see when competition is working well and when it observes market integrity.</p> <p>The FCA Handbook sets out requirements for all regulated firms. Conduct requirements are based on a combination of the Principles for Businesses, other high-level rules and detailed rules and guidance. The FCA Handbook includes specific sourcebooks to regulate the conduct of insurers and intermediaries. These are the Conduct of Business Sourcebook (COBS) applicable to firms engaging in life business or designated investment business and the Insurance Conduct of Business Sourcebook (ICOBS) applies to firms conducting general insurance business and pure protection insurance business. These two sourcebooks set out the 'conduct' aspects of how insurers and insurance intermediaries should operate their insurance business (from sales through to claims) and specifically how they should treat policyholders. These conduct of business sourcebooks include high-level rules in the FCA Handbook which require a firm to act honestly, fairly, and professionally in accordance with the best interests of its customers. Many other sections of the Handbook support the FCA in achieving its operational objective of securing an appropriate degree of protection for consumers.</p> <p>The Principles contained in PRIN 2.1 of the FCA Handbook apply to insurers and intermediaries and are high level statements of the core obligations of firms; they act as an overarching framework to govern the actions of firms. The key principles in relation to ICP 19 and supporting more detailed requirements in the FCA Handbook are set out in this list:</p> <ul style="list-style-type: none"> • Principle 2 requires that all firms, including insurers and intermediaries, must conduct their business with due skill, care, and diligence • Principle 5 requires that all firms must observe proper standards of market conduct • Principle 6 requires that firms must pay due regard to the interests of their customers and treat them fairly. More detailed requirements are contained in COBS 2.1.1R (1) and ICOBS 2.5.1 R and COBS 20.2 deals with the fair treatment of with-profits policyholders. The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) provides general expectations applicable to all sectors. Insurance specific rules were introduced through the implementation of the EU-developed Insurance Distribution Directive (IDD) which took effect on 1 October 2018 which was implemented via Chapter 4 of PROD in the FCA Handbook (PROD 4). PROD 4 only applies to new products or significant adaptations of existing products made after
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October 1, 2018. As a result of the General Insurance Pricing Practices Market Study set out in the description of ICP 9 in this assessment, the PROD 4 requirements were extended from 1 October 2021 to all general insurance and pure protection products regardless of when they were manufactured (further details below on PROD4).

- Principle 7 requires that a firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair, and not misleading. Further detailed requirements on communication are set out in ICOBS and COBS.
- Principle 8 requires that firms must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client. SYSC 10 requires an insurance intermediary to take all reasonable steps to identify and prevent conflicts of interest from creating harm for customers. SYSC 3.3 has a similar requirement for insurers.
- Principle 9 requires that a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement. The FCA Handbook sets out multiple requirements on advised sales in ICOBS and COBS.

The Code of Conduct (COCON) sets out rules for conduct of specified staff (as defined in COCON) and provides guidance about those rules to the firms whose staff are subject to them. This is supplemented by the Training and Competence chapter of the FCA handbook.

Under PROD 4, manufacturers of insurance products need to take account of who they are developing an insurance product for, and this includes:

- identifying a target market
- ensuring the product is consistent with the objectives, needs and characteristics of the identified target market
- carefully selecting distribution channels that are appropriate for the target market
- making relevant information about the target market available to distributors
- requiring the manufacturers to take reasonable steps to ensure that the insurance product is distributed to the identified target market.

The requirement on firms to handle complaints in a timely and fair manner is set out in Dispute Resolution: complaints (DISP) in the FCA Handbook. The procedure for escalation of a complaint to the Financial Ombudsman Service is set out under DISP 1 of the FCA Handbook requiring insurers and intermediaries to inform customers of their rights to have their complaints adjudicated by the Financial Ombudsman Service. Firms must meet the cost of resolving complaints via a case fee. Funding for the Financial Ombudsman Service is via an annual levy paid by the firms that are authorized and regulated by the

	<p>FCA. However, the Financial Ombudsman Service is not accountable to these firms and the decisions it makes are impartial.</p> <p>Firms are also expected to comply with their legal obligations under the Consumer Insurance (Disclosure and Representation) Act 2012, Consumer Rights Act 2015, the Insurance Act 2015 the Data Protection Act 1998, and many others.</p> <p>Firms are regulated by the U.K. Information Commissioner’s Office (ICO) in terms of compliance with the Data Protection Act 2018 (DPA 2018) and U.K. General Data Protection Regulations (U.K.-GDPR). Together the DPA 2018 and U.K.-GDPR are the U.K.’s data protection framework. Both the DPA 2018 and U.K.-GDPR are principles-based regimes. This means that whilst specific policies or procedures are not mandated within the framework, it does refer to appropriate ‘technical and organizational measures’ being implemented by firms.</p> <p>The FCA publishes information that supports the fair treatment of customers including findings of thematic reviews, publication of consumer complaints data by individual firms and in aggregate, value measures on general insurance contracts, FCA enforcement action, information to assist consumers to deal with issues related to Brexit and warning notices about unauthorized firms and scams.</p> <p>The FCA has a comprehensive approach to supervision and enforcement, as set out in the description of ICP 9 and 10.</p>
Assessment	Observed
Comments	The U.K. has a robust and comprehensive framework for regulation and supervision of conduct of business by insurers. While the requirements are comprehensive, as set out in the description, the legal framework is an extremely dense and intricate web of requirements that are complex to navigate, leaving open the possibility for significant streamlining in the future.
ICP 20	<p>Public Disclosure</p> <p>The supervisor requires insurers to disclose relevant and comprehensive information on a timely basis in order to give policyholders and market participants a clear view of their business activities, risks, performance, and financial position.</p>
Description	<p>The disclosure requirements of ICP 20 are met by several sources of disclosure which target different audiences with their respective information needs. Since the implementation of Solvency II, the annual Solvency and Financial Condition Report (SFCR) provides a structured means for disclosing for all U.K. regulated insurers within the scope of Solvency II.</p> <p>Insurers are furthermore required to produce audited financial statements based on high-quality accounting standards (U.K.-IFRS or U.K. GAAP). Requirements relating to the</p>

preparation and contents of the firm's annual accounts are set out in the Companies Act 2006 (CA2006), Part 15, Accounts & Reports. A regulated company is required to present annual accounts which comprises

- a balance sheet as at the last day of the financial year
- a profit and loss account
- additional information provided by way of notes to the accounts (Section 396 and 404 of the CA2006) and
- a strategic report and a directors report which provide relevant information and context.

Subject to U.K. endorsement a new insurance standard (IFRS 17) will be introduced for IFRS firms from 2023. IFRS 17 has more detailed and comprehensive disclosure requirements than IFRS 4, the current interim accounting standard.

Listed insurance companies fall under disclosure requirements within the Listing Rules and Market Abuse Regulation, FCA's Listing Rules and the Disclosure Guidance and Transparency Rules Sourcebook. Insurance companies that are issuers will be captured by these rules, the extent to which will depend on the type of listing an issuer seeks. There are e.g., specific requirements for new applicants to issue shares, for issuers of debt, and continuing disclosure obligations.

For firms that have a branch in the U.K., the provisions of Part 6 of the Overseas Companies Regulations (2009) apply. A firm with a branch in the U.K. that is required to prepare accounts under parent law must deliver to the registrar of companies copies of all accounting documents prepared in accordance with its parent law within one month of becoming a branch and within three months from the date on which the document is required to be disclosed in accordance with the institution's parent law. If it is not required by parent law to register accounting documents of branches, it is sufficient to make them available for inspection at each branch of the firm in the U.K.

All insurers within the scope of Solvency II are designated as 'Public Interest Entities' and are therefore subject to additional audit requirements including an extended audit report. A company's annual report must be audited in accordance with part 16 of the Companies Act 2006 except in limited circumstances, e.g., dormant (CA2006 475). Auditors must state in their audit report whether, in their opinion, the accounts give a true and fair view and whether the accounts have been properly prepared in accordance with the provisions of CA2006 and with the relevant accounting framework (CA2006 section 495). In addition to that, auditors must state their opinion as to whether information given in the strategic report and directors' report is consistent with the accounts and these have been prepared in accordance with applicable legal requirements (CA2006 section 496).

	<p><i>The Solvency and Financial Condition Report</i></p> <p>All U.K. Solvency II firms (including Lloyd's) must disclose publicly, on an annual basis, a Solvency and Financial Condition Report (SFCR) (PRA Rulebook, Reporting Rule 3.1). The report must comply with the following principles:</p> <ul style="list-style-type: none"> • it must reflect the nature, scale, and complexity of the business of the firm, and in particular the risks inherent in that business • it must be accessible, complete in all material respects, comparable and consistent over time and • it must be relevant, reliable, and comprehensive. <p>The PRA requires firms that meet certain criteria to obtain an audit opinion on key elements of the SFCR. The audit requirements for the SFCR are specified in the External Audit Part of the PRA rulebook with the relevant elements defined in rule 2.2 of that part. The requirements in Rule 4.1 of the external audit part of the PRA rulebook are that an external auditor appointed by the firm must:</p> <ul style="list-style-type: none"> • undertake a reasonable assurance engagement on relevant elements of the SFCR • produce a report that includes an opinion addressed to the governing body confirming that the relevant elements of the SFCR are prepared in all material respects in accordance with the PRA rules and Solvency II Regulations on which it is based • read and consider all information disclosed by the firm in its SFCR that is not a relevant element of the SFCR to identify material inconsistencies with the relevant elements of the SFCR and other knowledge obtained. <p>The PRA Supervisory Statement (SS11/16) and the FRC Practice Note 20 provide further guidance about the expected level of assurance required on the quantitative elements of the SFCR. In particular, the PRA rules require that for firms meeting the criteria, a number of Quantitative Reporting Templates (QRTs), including the balance sheet are subject to audit review.</p> <p>The contents of the SFCR are set out in the Solvency II CDR articles 290 – 303. Further information is provided in articles 359-371 and in EIOPA guidelines that remain applicable for firms in the U.K. after leaving the EU. In addition to the general requirements that are specified, Solvency II also requires QRTs that must be completed and disclosed as part of the SFCR. This includes for example templates that relate to:</p> <ul style="list-style-type: none"> • Balance sheet • Premiums claims and expenses by line of business and by country • Technical provisions (split into non-life, life, and health) • Insurance claims information
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- The impact of long-term guarantee and transitional measures
- Own funds
- Solvency capital requirement (internal models or standard formula)
- Minimum capital requirement.

The following table indicates the main areas where the points outlined in the standard would be expected to be considered by the SFCR. The references relate to Annex XX of the Solvency II CDR.³⁵

Content according to ICP 20.2	Relevant sections in the SFCR
Company Profile	A.1 Business
Corporate Governance Framework	B. System of Governance
Technical Provisions	D.2 Valuation for Solvency Purposes – Technical Provisions
Insurance Risk Exposure	C. Risk Profile – Underwriting risk
Financial Instruments and other investments	D.1 Valuation for Solvency Purposes – Assets
Investment Risk exposure	C1-C3 Risk Profile – Market risk, credit risk, liquidity risk
Asset-liability management	Part of Risk Profile C.6 Other material risks C.7 Any other information
Capital adequacy	E Capital management
Liquidity risk	C.4 – Risk profile – liquidity risk.
Financial performance	A.2 – Underwriting performance A.3 – Investment performance A.4 – Performance of other activities A.5 – Any other information

Disclosure on the company profile

Disclosure of information in regard to an insurer's company profile is governed by articles in the Solvency II CDR and the PRA Rulebook. An insurer's SFCR shall include the

³⁵ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014.

following information:

- A description of the holders of qualifying holdings in the undertaking. Where the undertaking belongs to a group, details of the undertaking's position within the legal structure of the group (Article 293 (1d and 1e) of the CDR). EIOPA guidelines also suggests providing ownership structure and a simplified group structure.
- The material lines of business and material geographical areas where it carries out business (Article 293 (1f) of the CDR).
- Any significant business or other events that have occurred over the reporting period that have had a material impact on the undertaking (Article 293 (1g) of the CDR).
- A description of the risk management system comprising strategies, processes and reporting procedures (Article 294 (3) of the CDR). Article 269 details the tasks that the risk management function shall perform, which includes detailed reporting on risk exposures in relation to strategic affairs such as corporate strategy, mergers and acquisitions and major projects and investments (Article 269 (1d); identification and assessing emerging risks (Article 269 (1e)).

In order to enhance comparability and consistency, these requirements are supplemented by EIOPA Guidelines on reporting and public disclosure.

Disclosure on governance and risk management systems

Article 294 of the Solvency II CDR outlines the disclosure requirements relating to insurers' governance and risk management systems (including strategies, processes and reporting procedures). This also covers how such systems are implemented and integrated into the organizational structure and how decision-making processes are to be disclosed within the SFCR.

The PRA Rulebook Reporting Rule 3.3 (2) requires a description of the system of governance for a firm and an assessment of its adequacy for the risk profile of the firm to be included in the SFCR for all Solvency II insurers.

The general governance requirements (Article 258 of the Solvency II CDR) state that policies on risk management, internal control, and internal audit shall clearly set out the relevant responsibilities, objectives, processes and reporting procedures that are applicable, and all of which shall be consistent with the insurer's overall business strategy.

The SFCR (Article 294 CDR) requires detailed information regarding the system of governance including:

- The structure of the management or supervisory body, providing a description of its main roles and a brief description of the segregation of responsibilities.
- Material changes to the system of governance that have taken place during the year.
- Information on the remuneration policy of the firm.

- Information relating to the 'fit and proper' policy of the firm.
- A description of the risk management system comprising strategies, processes and reporting procedures.
- Information about the internal control system of the firm.
- A description of how the actuarial function is implemented.
- A description of the outsourcing policy.
- An assessment of the adequacy of the system of governance.

EIOPA's published guidelines on reporting and disclosure provide additional elements for disclosure to improve comparability and consistency, such as the consideration of responsible roles and committees. For example, guideline 3 states that in relation to governance structure, the SFCR should explain how the key functions have the necessary authority, resources, and operational independence to carry out their tasks and how they report to and advise the administrative, management or supervisory body of the firm.

Disclosure on technical provisions

The PRA Rulebook Reporting Rule 3.3 (4), applicable to all Solvency II insurers, requires a description, separately for assets, technical provisions, and other liabilities, of the bases and methods used for their valuation, together with an explanation of any major differences in the bases and methods used for the valuation of those assets, technical provisions, and liabilities in financial statements of the firm, to be included in the SFCR.

The CDR requires standardized quantitative reporting templates (QRTs) to be disclosed as part of the SFCR. The relevant templates include S.12.01 (life and health insurance) information on the technical provisions, and template S.17.01 (non-life) technical provisions reported broken down by lines of business.

Article 296 (2) of the Solvency II CDR provides detailed requirements for the disclosure of the valuation of the technical provisions.

Discount rates and key assumptions: In general, firms rely on the risk-free interest rates published by the PRA (for all major currencies) in the estimation of technical provisions. Key assumptions such as matching adjustment and volatility adjustments, cashflow projection and the methodology used for the derivation of the estimates are required to be disclosed.

Where a firm uses matching adjustments or volatility adjustments, both can affect the discount rate used in calculating the present value of liabilities. The Rule 3.4 (1) of the Reporting part of the PRA Rulebook states that where an insurer applies a matching adjustment the following must be disclosed:

- a description of the adjustment and of the portfolio of obligations and assigned assets to which the matching relates

	<ul style="list-style-type: none"> • a quantification of the impact of a change to zero of the matching adjustment on the firm's financial position. <p>Rule 3.4 (2) similarly sets out the disclosure requirements for where a firm has applied a volatility adjustment.</p> <p>EIOPA Guideline (Guideline 8) specifies that significant simplified methods used to calculate technical provisions, including those used for calculating the risk margin, should be disclosed.</p> <p><i>Disclosure on insurance risk exposures and their management</i></p> <p>The SFCR must contain quantitative and qualitative information about underwriting risk and other risk categories (Article 295 (1)). The qualitative information included in the SFCR is supported by quantitative information. The SFCR requires disclosure of a series of quantitative reporting templates (QRTs). Templates S.25s collect information on each material risk category in a standardized format and are required on an annual basis. Firms must disclose information regarding the risk exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles (Article 295(2)).</p> <p>Firms are required (Article 296 (4)) to disclose information in the SFCR on a number of risk management issues as a minimum (Article 260 CDR). These risk management issues include some issues relating to underwriting and reserving:</p> <ul style="list-style-type: none"> • actions to be taken by the firm to assess and manage the risk of loss or of adverse change in the values of insurance and reinsurance liabilities, resulting from inadequate pricing and provisioning assumptions • the sufficiency and quality of relevant data to be considered in the underwriting and reserving processes and their consistency with the standards of sufficiency and quality • the adequacy of claims management procedures including the extent to which they cover the overall cycle of claims. <p>The CDR sets out that the SFCR shall include the following information regarding the firm (Article 294(3), 294(4) and 359):</p> <ul style="list-style-type: none"> • A description of the undertaking's risk management system comprising strategies, processes and reporting procedures • How the risk management function has been implemented and integrated into the organization • How effective the system is? • A description of how the insurer has conducted an own risk and solvency assessment (ORSA) • A statement detailing how the ORSA was reviewed and approved
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- A statement explaining how the insurer has determined its own solvency needs given its risk profile and the associated capital management.

As detailed in Article 258 (of the CDR), insurers must establish, implement, and maintain effective cooperation, decision making procedures and a clear allocation of functions that takes into account the nature, scale, and complexity of the risk inherent in the undertaking's business (Article 258 (1)).

System of governance encompasses risk management and other elements. Within risk management, Conditions Governing Business Rule 2.5 and 3.1 part of the PRA Rulebook sets out the requirements of policies in the following areas:

- Underwriting and reserving
- Asset-liability management
- Investment risk management, in particular derivatives and similar commitments
- Liquidity and concentration risk management
- Operational risk management
- Reinsurance and other risk-mitigation techniques.

Disclosure requirements of the elements above are set out in Articles 294 and 295 of the CDR, including a description of processes and techniques.

Information on the use of reinsurance is available in a number of the Quantitative Reporting Templates (e.g., s.05.01.02) which show premiums and claims (for example) on a gross and net basis. Similarly, information about reinsurance recoverables is available (e.g., s.17.01.02). In both cases this information is available by product. The CDR sets out that the SFCR shall include the following information regarding the firm (Articles 295 (2), 295(4), 296 (2)h and 359):

- Regarding the risk exposure and including the transfer of risk to special purpose vehicles
- A description of the recoverables from reinsurance contracts and any special purpose vehicles.
- A description of the techniques used for mitigating risks and the processes for monitoring the effectiveness of these risk mitigation techniques.

A description must be included about material risk concentrations which an insurer is exposed to (Article 295(3) of the CDR). To assess risk concentrations, the retained EU legislation requires firms to consider at least, direct, and indirect exposure to individual counterparties, groups of individuals but connected counterparties, geographical areas or industry sectors, and natural disaster or catastrophes.

Disclosure on financial instruments and investments

The SFCR (Solvency II CDR - Article 296 - 1) is required to include information about the

	<p>valuation of the assets of the insurer for solvency purposes. This information would include:</p> <ul style="list-style-type: none"> • separately for each material class of assets, the value of the assets, as well as a description of the bases, methods and main assumptions used for valuation for solvency purposes • separately for each material class of assets, a quantitative and qualitative explanation of any material differences between the bases, methods and main assumptions used by that undertaking for the valuation for solvency purposes and those used for its valuation in financial statements. <p>The Quantitative Solvency II templates require a balance sheet to be shown (SFCR S.02.01.02) with investments separated out into defined classes.</p> <p>Further detail about this disclosure is provided in the EIOPA guidelines:</p> <p>Guideline 6 – When aggregating assets into material classes to describe the valuation basis that has been applied to them, firms should consider the nature, function, risk, and materiality of those assets.</p> <p>Guideline 7 – In relation to each material class of asset, the insurer should describe at least the recognition and valuation basis applied, including methods and inputs used, as well as judgements made other than estimations which would materially affect the amounts recognized, in particular:</p> <ul style="list-style-type: none"> • For material financial assets: information on the criteria used to assess whether markets are active and, if the markets are inactive, a description of the valuation model used • Any changes made to the recognition and valuation bases used or to estimations during the reporting period • Assumptions and judgments including those about the future and other major sources of estimation uncertainty. <p>Although the SFCR disclosures provide information about the Solvency II valuation and the differences to those in the financial statements, accounting standards require information to be provided about the financial statement valuations.</p> <p><i>Disclosure on investment risk exposures</i></p> <p>The SFCR is required to include detailed information about the risk profile of a firm (article 295), separately for market risk, credit risk, liquidity risk, operational and other material risks. For each of these forms of investment risks, firms are required to disclose information about their risk exposure (Article 295 – CDR):</p> <ul style="list-style-type: none"> • a description of the measures used to assess these risks within the firm, including any material changes over the reporting period
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- a description of the material risks that that firm is exposed to, including any material changes over the reporting period
- a description of how assets have been invested in accordance with the 'prudent person principle
- a description of the material risk concentrations
- a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk mitigation techniques
- a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events
- any other material information regarding their risk profile.

Firms are required (Article 296 (4)) to disclose information in the SFCR about a number of risk management issues as a minimum (Article 260 CDR) as part of providing information about valuations for solvency purposes. These risk management issues include the following:

- Asset-liability management:
 - (i) the structural mismatch between assets and liabilities and in particular the duration mismatch of those assets and liabilities
 - (ii) any dependency between risks of different asset and liability classes
 - (iii) any dependency between the risks of different (re)insurance obligations
 - (iv) any off-balance sheet exposures of the firm
 - (v) the effect of relevant risk-mitigating techniques on asset-liability management.
- Investment risk management:
 - (i) actions to be taken by the firm to ensure that the undertaking's investments comply with the prudent person principle
 - (ii) actions to be taken by the firm to ensure that investments take into account the nature of the undertaking's business, its approved risk tolerance limits, its solvency position and its long-term risk exposure
 - (iii) the firm's own internal assessment of the credit risk of investment counterparties, including where the counterparties are central governments
 - (iv) where the firm uses derivatives or any other financial instrument with similar characteristics or effects, the objectives of, and strategy underlying their use and the way in which they facilitate efficient portfolio management or contribute to a reduction of risks, as well as procedures to assess the risk of such instruments and the principles of risk management

	<p>to be applied to them</p> <p>(v) where appropriate in order to ensure effective risk-management, internal quantitative limits on assets and exposures, including off-balance sheet exposures.</p> <ul style="list-style-type: none"> • Liquidity risk management: <ul style="list-style-type: none"> (i) actions to be taken by the insurance or reinsurance undertaking to take into account both short term and long-term liquidity risk (ii) the appropriateness of the composition of the assets in terms of their nature, duration, and liquidity in order to meet the undertaking's obligations as they fall due (iii) a plan to deal with changes in expected cash in-flows and out-flows. <p>In addition to this disclosure in the SFCR, information about risks, including investment risks is a common feature of other U.K. public reporting requirements.</p> <p><i>Disclosure on asset-liability management</i></p> <p>The disclosure requirements on asset-liability management are part of the overall disclosure requirements of a firm's risk management framework. This part is set out in the PRA Rulebook (Condition Governing Business Rules 2.5 and 3.1). Article 260 of Solvency II CDR sets out further detail and requires consideration of:</p> <ul style="list-style-type: none"> • The structural mismatch between asset and liabilities and in particular the duration mismatch • Any dependency between risks of different assets and liability classes • Any dependency between the risks of different (re)insurance obligations • Any off-balance sheet exposures of the undertaking • The effect of relevant risk-mitigating techniques on asset-liability management. <p>This standard, on the disclosure of ALM, is serviced by the requirements of the overall risk management disclosure within the SFCR as set out in the CDR. At a high level the following aspects of risk management must be disclosed (Articles 294(3), 294 (4) and 359):</p> <ul style="list-style-type: none"> • A description of the risk management system comprising strategies, processes and reporting procedures • How the risk management function has been implemented and integrated into the organization. <p>Article 295 of the CDR stipulates the disclosure of qualitative and quantitative information in regard to risk categories including underwriting risk and market risk. The degree of mismatch would be quantified as part of the assessment of the capital requirements of the relevant risk category.</p>
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Risk sensitivity analyses also provide quantification of the potential impact of asset-liability mismatch. Article 295 (6) (of the CDR) requires that risk sensitivity analyses be disclosed within the SFCR. It shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks events.

Disclosure on capital adequacy

Article 297 (of the CDR) sets out the disclosure requirements relating to capital management. The SFCR shall include the following information regarding the own funds of an insurer (Article 297 (1)):

- Information on the objectives, policies and processes employed for managing the own funds
- For each tier, information on the structure, amount, and quality of own funds at the end of the reporting period, including an analysis of any significant changes in each tier compared to prior reporting period
- The eligible amount of own funds to cover the SCR, classified by tier
- The eligible amount to cover the MCR, by tier.

The SFCR must include information regarding the SCR and MCR (Article 297 (2)):

- The amount of the insurer's SCR and MCR at the end of the reporting period
- The amount of the insurer's SCR split by risk modules for firms using the standard formula and by risk categories where the firm uses an internal model
- Information on whether and for which risk module of the standard formula simplified calculations were used
- Information on whether and for which parameters of the standard formula the insurer used undertaking-specific parameters
- Information on the inputs used to calculate the MCR
- Any material changes to the SCR and the MCR over the reporting period and reasons for such changes.

Where an internal model is used to calculate the SCR, an insurer must disclose (Article 297 (4)) information including:

- A description of the various purposes for which the internal model is used
- A description of scope of the internal model in terms of business units and risk categories
- A description of the methods used in the internal model for calculating the SCR

	<ul style="list-style-type: none"> • An explanation, by risk module of the main differences in methodologies and assumptions used in the standard formula and in the internal model. <p>The SFCR should further include a description of the structure of the internal model, aggregation methodologies and diversification effects.</p> <p><i>Disclosure on liquidity risk</i></p> <p>Article 295 (1) of the CDR stipulates that the SFCR must include qualitative and quantitative information regarding the risk profile of an insurer, including for liquidity risk. Sub-section 5 (Article 295 (5)) further states that with regards to liquidity risk, the SFCR shall include the total amount of expected profit included in future premium as calculated in accordance with the relevant articles.</p> <p>The CDR sets out that the SFCR must include disclosure of information regarding the insurer's risk management system (Article 294(3)), this would include liquidity risk where relevant:</p> <ul style="list-style-type: none"> • A description of the undertaking's risk management system comprising strategies, processes and reporting procedures. • How the risk management function has been implemented and integrated into the organization. • How the firm is able to effectively identify, measure, monitor, manage and report, on a continuous basis, the risks on an individual and aggregated level, to which the undertaking is or could be exposed. <p><i>Disclosure on financial performance</i></p> <p>This standard is principally met through the requirements of Solvency II which requires a breakdown of earnings, claims statistics including claims development, information that would be relevant for an assessment of pricing adequacy as well as information about investment performance.</p> <p>Earnings Analysis: Solvency II templates require a detailed breakdown of premiums, claims and expenses by line of business and by country (S.05.01.02, S.05.02.01). In addition, the SFCR is required to include qualitative and quantitative information on the firm's performance. This particularly refers to:</p> <ul style="list-style-type: none"> • Underwriting performance: This includes performance at an aggregate level, by material line of business and material geographical areas where it carries out business over the reporting period, together with a comparison of the information with that reported on the previous reporting period, as shown in the undertaking's financial statements (Article 293(2)). • Investment performance: The SFCR must also include (Article 293(3)) qualitative and quantitative information (including comparatives) regarding the performance of the investments of the firm relating to:
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- a) information on income and expenses arising from investments by asset class and, where necessary for a proper understanding of the income and expenses, the components of such income and expenses
- b) information about any gains and losses recognized directly in equity
- c) information about any investments in securitization.

- other material income and expenses of the firm (Article 293(4) and (5)).

Claims statistics including claims development: Solvency II requires the disclosure of non-life claims development triangles in S.19.01. The default length of run-off triangle is 10+1 years but the disclosure requirement is based on the undertakings' claims development. Similarly, template S.05.02 requires a breakdown of claims (in addition to premiums and expenses) by line of business and by country.

Pricing adequacy: Understanding pricing adequacy requires information about the sources of profit. This enables users of the public disclosures to come to an informed view about whether the pricing applied to products is adequate today and has been in the past.

The availability of information relevant to earnings analysis and claims information is shown above. This includes for example the requirement (S.05.02) that premiums, claims, and expenses are shown by business line and by country. These factors can be combined in order to provide information about pricing adequacy. In addition, Article 293(2) (SII – CDR) requires firms to provide both quantitative and qualitative information about underwriting performance at an aggregate level as well as by business line and by country.

Investment performance: Solvency II firms are required to provide qualitative and quantitative information that relates to the performance of their investments over the reporting period. (SII CDR – Article 293(3)). This is required to include a comparison to the prior year and specifically:

- information on income and expenses arising from investments by asset class and, where necessary for a proper understanding of the income and expenses, the components of such income and expenses
- information about any gains and losses recognized directly in equity
- information about any investments in securitization.

Disclosure on non-GAAP financial measures

Guidance on non-GAAP financial measures (also called alternative performance measures (APMs)) has been published by the International Organization of Securities Commissions (IOSCO) and the European Securities and Markets Authority (ESMA).

IOSCO's statement on APMs was intended to assist issuers in providing clear and useful disclosure for investors and other users of APMs, and to help reduce the risk that such

	<p>measures are presented in a way that could be misleading.</p> <p>Similarly, the ESMA guidance on APMs (ESMA guidelines on alternative performance measures) applies in relation to APMs disclosed by issuers or persons responsible for the prospectus when publishing regulated information and prospectuses (and supplements). The guidance was published on the FCA’s website as non-legislative material and referenced in the FCA Handbook.³⁶</p> <p>The Financial Reporting Council (FRC) sets the U.K. Corporate Governance and Stewardship Codes and U.K. standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the U.K., the FRC sets auditing and ethical standards and monitors and enforces audit quality. It is responsible for monitoring the compliance with the ESMA Guidelines. The FRC consider the guidelines when reviewing company reports and accounts in assessing whether they are fair, balanced, and comprehensive.</p>
Assessment	Observed
Comments	<p>Solvency II has introduced an extensive set of disclosure requirements fully in line with ICP 20, in particular the SFCR which also provides a set of harmonized quantitative reporting templates. In addition, the full range of additional disclosure requirements under the Companies Act or under Listing rules is available, too.</p> <p>It is however noted that the PRA does not systematically monitor the requirement of SFCRs being audited.</p>
ICP 21	<p>Countering Fraud in Insurance</p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p>
Description	<p>The FCA and PRA are not lead competent authorities for insurance counter fraud activities in the U.K. Responsibility for detecting, preventing, and prosecuting fraud is spread across U.K. authorities, including the Serious Fraud Office, National Economic Crime Centre (NECC of which the FCA is a member), and for insurance specifically, the City of London Police’s Insurance Fraud Enforcement Department (IFED). Other relevant bodies are the Department for Business, Innovation and Skills, the Crown Prosecution Services, the National Police Chiefs Council in England, Scotland, Wales and Northern Ireland, the</p>

³⁶ Following the end of the transition period following the U.K.’s withdrawal from the EU, non-legislative material produced by European Supervisory Authorities (ESA) has not been incorporated into U.K. law. However, the EU law and EU-derived law to which non-legislative material relates has largely been retained. Therefore, the FCA considers that the EU non-legislative material remains relevant to the FCA and market participants in their compliance with regulatory requirements including provisions in the FCA Handbook.

	<p>Crown Office and Procurator Fiscal Service, the Public Prosecution Service for Northern Ireland, and the Association of Chief Police Officers in Scotland.³⁷</p> <p>The insurance industry has established and funds the IFED and the Insurance Fraud Bureau (IFB), to address organized fraud. The FCA has a MoU with the IFB. A number of fraud databases and data sharing schemes have been established, including the Insurance Fraud Register (IFR), the Claims and Underwriting Exchange (CUE) and MyLicence. Substantial work has also been done by the Police, funded by the Association of British Insurers (ABI), and Lloyd's of London.</p> <p>The Insurance Fraud Taskforce (IFT) was set up in January 2015 and reported in January 2016. The members were representative of trade bodies representing different parts of the insurance sector, the Financial Services Consumer Panel, and the Financial Ombudsman Service. Support was provided by HMT and the Ministry of Justice, but it was a private sector-led panel. The IFT made a wide range of specific recommendations for government, industry, regulators, and other stakeholders. The recommendations were designed to address different types of fraud including organized, premeditated, and opportunistic fraud at the claims stage and application fraud when a policy is purchased. In 2017, a progress report was published. This included initiatives to implement recommendations by the FCA and industry bodies.</p> <p>This report demonstrates that the industry and authorities are aware of the four main types of insurance fraud and developed recommendations to address each type of fraud: claims fraud, application fraud, opportunistic fraud, and organized fraud.</p> <p>The Insurance Act 2015 sections 12 and 13 provides remedies for insurers due to fraudulent insurance claims.</p> <p>While the FCA is not the lead competent authority for insurance counter fraud activities in the U.K., it has powers to act against various offences, and it has an oversight role of firms' ability to handle fraud. If new or systemic weaknesses were identified through its engagement with other bodies, the FCA has the powers to act where necessary.</p> <p>The FCA has the following powers granted under U.K. legislation:</p> <ul style="list-style-type: none"> • To institute proceedings for offences under FSMA³⁸ and legislation made under FSMA (e.g., breach of restrictions on financial promotions, performing functions in breach of contravention order etc.) • To institute proceedings under Part 7 of the Financial Services Act 2012 (e.g., making a false or misleading statement etc.) • To prosecute crimes, under s327 (concealment) and s328 (arrangements) of the Proceeds of Crime Act 2002 (POCA)
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³⁷ FCA Enforcement Guide, Appendix 2

³⁸ Under S401 of FSMA the FCA is the appropriate regulator to institute proceedings

	<ul style="list-style-type: none"> • Prosecute offences under the Fraud Act 2006 which makes provision for criminal liability for fraud and obtaining services dishonestly. <p>Under Principle 11 of the FCA Handbook, firms are expected to report material cyber incidents or other suspected fraudulent activity. The FCA’s Handbook includes a guide to countering financial crime, which provides examples of good practice, and this includes a specific chapter relating to fraud. SYSC 3.2.6R of the FCA Handbook requires firms to establish and maintain effective systems and controls to prevent the risk that they might be used to further financial crime.</p> <p>Further, the broad requirements of the FCA Principles for Business and Threshold Conditions speak to the need for insurers to put in place processes to minimize insurance fraud.</p> <p>The FCA assesses potential fraud risk on an ongoing basis and where weaknesses are identified, necessary action is taken to ensure that firms undertake remedial work. This includes working with industry trade bodies to encourage and maintain an industry approach to counter fraud and raise awareness of fraud activity that the FCA becomes aware of through its supervision and contact with the public.</p> <p>Where appropriate, the FCA’s Unauthorised Business Department (UBD) takes enforcement action against firms and individuals not authorized or exempt under FSMA or relevant legislation (such as the Payment Services Regulations and the Electronic Money Regulations), and who carry on regulated activities in breach of authorization and exemption requirements and/or contravene restrictions on financial promotions. UBD also liaise with relevant external counter fraud agencies as listed above where the activity would best be addressed by those other agencies.</p> <p>The FCA plays an active role in combating fraud through its coordinated activities with the National Economic Crime Centre (NECC) of which the FCA is a member. The NECC sits is hosted by the National Crime Agency. The FCA has seconded staff to work in the NECC.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>There is a network of legislation, authorities and industry funded bodies working together to address insurance fraud in the U.K. The FCA plays an active role in monitoring the insurance industry’s risk management with respect to fraud risk as well as active participation in work carried out by the lead authorities and through its membership of the NECC.</p>

ICP 22	<p>Anti-Money Laundering and Combating the Financing of Terrorism</p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and terrorist financing. The supervisor takes effective measures to combat money laundering and terrorist financing.</p>
Description	<p>The Financial Action Task Force (FATF) published the Mutual Evaluation Report (MER) on the effectiveness of the U.K.'s AML/CFT regime, in December 2018.³⁹ The MER found that the U.K. has a robust understanding of its money laundering/terrorist financing Risks (ML/TF) which is reflected in its 2020 National Risk Assessments (NRA). Relative to other sectors, the NRA's noted that the insurance sector in the U.K. is at low ML/TF risk. According to the NRA:</p> <p style="padding-left: 40px;">‘This is likely because the design of both general and life insurance products makes it difficult and unattractive for criminals to layer the proceeds of crime at speed. Criminals also have to provide significant personal information to inform an insurer’s risk-based assessment during on-boarding, which may be a further deterrent. The international nature of the London insurance market increases the sector’s exposure to providing cover in high-risk jurisdictions, trades or industries.’</p> <p>The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (‘the MLRs’) are applicable to insurers and intermediaries who carry out or effect contracts of long-term insurance. Long-term insurance is defined in Part 2 of Schedule 1 to The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and includes life insurance policies. Approximately 1,200 insurers are in the scope of the MLRs and supervised by the FCA for AML/CFT compliance. This represents 5 percent of the FCA’s overall supervisory population.</p> <p>HMT and Home Office’s 2020 NRA found that the insurance sector is unattractive for money laundering. The FCA, as one of the AML/CFT supervisors contributed to the NRA exercise.</p> <p>The international AML/CFT standards (FATF Recommendations and FATF Glossary) focuses on the ML/TF risks from life insurance and other investment-related insurance. Accordingly, the U.K. MLRs define financial institutions that have AML/CFT obligations to include those persons authorized by FSMA to carry out or effect any contract of long-term insurance.</p> <p>Regulation 7(1)(a) of the MLRs appoints the FCA as the supervisory authority for monitoring the compliance of credit and financial institutions authorized under the FSMA with the obligations set out in the MLRs, including those that carry out or effect any</p>

³⁹ <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf>

contract of long-term insurance. The following regulations provide the broad requirements for the FCA to meet:

- Regulation 17 of the MLRs requires the FCA, as the supervisory authority for the financial sector, to identify and assess the international and domestic ML/TF risks to which its supervised population are subject.
- Regulation 46 of the MLRs requires the FCA to effectively monitor its supervised population to ensure compliance with the MLRs following a risk-based approach informed by the risk assessments required by Regulation 17.
- Regulation 47 of the MLRs requires supervisory authorities to make up to date information on AML/CFT available to those it supervises.

The FCA requires all authorized firms to have systems and controls in place to mitigate the risk that they might be used to commit financial crime including, but not limited to, money laundering. These obligations are set out in SYSC 3.2.6/6.1.1 of the FCA's handbook and apply to all insurers authorized by the FCA.

Part 9 of the MLRs provides the FCA with enforcement powers and sets out that failure to meet requirements under the MLRs can result in civil penalties and notices or criminal charges. The FCA also has relevant powers under FSMA as detailed elsewhere in this detailed assessment. Where the FCA finds significant failings or serious misconduct in a firm it can use the range of regulatory tools listed to ensure these are rectified.

The FCA is a participant in the Joint Money Laundering Intelligence Taskforce (JMLIT whose remit has expanded to include the insurance sector) and other forums. JMLIT is part of the NECC (see ICP 21 for further description). JMLIT consists of over 40 financial institutions, the FCA, Cifas (a not-for-profit fraud prevention service), and five law enforcement agencies (National Crime Agency, Her Majesty's Revenue and Customs, Serious Fraud Office, the City of London Police, and the Metropolitan Police Service). JMLIT was cited as a key strength by the FATF mutual evaluation since it facilitates exchange of strategic and tactical intelligence between government agencies and private sector stakeholders with AML/CFT obligations.

The Joint Money Laundering Steering Group (JMLSG) produces guidance to all financial services firms within the FCA's supervisory remit on meeting their AML/CFT obligations, this includes insurers. The FCA has a close working relationship with the JMLSG. The JMLSG guidance is subject to Treasury Ministerial approval which is given after advice from the FCA. The Proceeds of Crime Act 2002 (POCA) and the Terrorism Act 2000 require a court to take account of industry guidance that has been approved by an HMT minister when considering whether a person has committed an offence. The MLRs also provide that a court must decide whether industry guidance was followed in assessing whether a person complied with requirements of the MLRs. The FCA Handbook SYSC 3.2.6E and DEPP 6.2.1 (4) state that the FCA will take into account FCA-confirmed Industry Guidance in deciding whether to take action.

	<p>The FCA communicates expectations of financial crime controls in several ways, including speeches by FCA Executives at various financial services conferences and public events, which are published on the FCA’s website. The FCA also includes financial crime material in the FCA’s Annual Report and the FCA Financial Crime Guide for firms. The FCA’s website is also regularly updated with Financial Crime specific information.</p> <p>During the mission, the FCA has been able to demonstrate firm interventions within the insurance sector related to AML/CFT. The FCA’s interventions in this area are proportionate to the size and inherent risk in the insurance sector.</p> <p>The FCA is developing and implementing new analytical tools to identify the effectiveness of firms’ systems and controls using large amounts of data. This is part of the FCA’s 2020 data strategy. It intends to leverage advanced analytics and new technologies to transform how it regulates. This approach is in the implementation phase and not directly assessed in this mission.</p> <p>In 2016, the FCA introduced its annual financial crime data return (REP-CRIM), a comprehensive regulatory reporting requirement that gathers information on AML controls from over 2,000 firms (including 115 firms in the insurance sector) to identify inherent AML risks more accurately and target supervisory work effectively. The FCA has decided to extend this data return to approximately 7,000 firms in total.⁴⁰ This increased scope is to ensure that a broader subset of firms provide REP-CRIM information enabling the FCA to deter overall AML market risks.</p> <p>FATF found in the 2018 Mutual Evaluation that the FCA cooperates closely and proactively with foreign counterparts, including by encouraging information-sharing through an extensive secondment program. The FCA participates in a range of ML/TF regional networks and groups including Financial Information Network (FIN -NET), the Basel Committee’s AML Expert Group. The FCA’s extensive list of MoUs and MMoUs described in ICP 3 assessment also facilitates cooperation.</p> <p>Given the lower risk in the insurance sector in the U.K. it has not been necessary to seek cooperation from another authority or to provide assistance from another authority, but the structures exist to permit cooperation if it were necessary.</p>
Assessment	Observed
Comments	<p>The U.K.’s AML/CFT regime has been highly rated by the FATF in the 2018 MER. With respect to key ML/TF risks, the insurance sector posed generally lower ML/TF risk and the resources applied to the insurance sector appear suitable to those identified risks. The mission found an adequate approach to ML/TF risks in the insurance sector, evidence of proactive supervision and significant involvement by the supervised sector in the creation and implementation of regulation. The outsourcing of the development of guidance to</p>

⁴⁰ FCA Policy Statement PS21/4 March 2021

	<p>the JMLSG was an interesting facet of the U.K.'s approach to AML/CFT but given there is a process for HMT Ministerial approval for this guidance after FCA advice, it is not a cause for concern. There is possible benefit in ownership and acceptance of the guidance when developed directly by the industry bodies making up the financial sector.</p>
ICP 23	<p>Group-wide Supervision</p> <p>The group-wide supervisor, in cooperation and coordination with other involved supervisors, identifies the insurance group and determines the scope of group supervision.</p>
Description	<p>The PRA identifies insurance groups (and the legal entities within them) based on the following legal provisions:</p> <ul style="list-style-type: none"> • S192B of FSMA setting out the definition of a “qualifying parent undertaking” • S421 of FSMA setting out the definition of a “group” • PRA rule 2.3 setting out the limited circumstances where the PRA is able to exclude entities from scope of group supervision. <p>When setting out the expectations for U.K. Solvency II group supervision scope of application the PRA rulebook also stipulates the types of groups it applies to:</p> <ul style="list-style-type: none"> • a U.K. Solvency II firm is a participating undertaking in at least one other U.K. Solvency II firm, third-country (re)insurance undertaking or • the parent undertaking of a U.K. Solvency II firm is an insurance holding company or a mixed financial holding company which has its head office in the U.K. or Gibraltar or • the parent undertaking of a U.K. Solvency II firm is an insurance holding company or a mixed financial holding company which does not have its head office in the U.K. or Gibraltar or is a third-country (re)insurance undertaking or • the parent undertaking of a U.K. Solvency II firm is a mixed activity insurance holding company. <p>The PRA expects all entities in an insurance group to be included in the scope of group supervision, regardless of them being regulated or not. Only under limited circumstances the PRA would agree to exclude an entity from the scope of group supervision, either when it is of negligible interest with respect to the objectives of group supervision, or when its inclusion would be inappropriate or misleading with respect to the objectives of group supervision.</p> <p>Where a group, for which the PRA is the group supervisor, wishes to exclude entities from the scope of group supervision, it will be expected to make a formal application to the PRA. The PRA assesses applications to exclude entities from the scope of group supervision on a case-by-case basis and will consult with other concerned supervisory authorities as appropriate. Where that application is approved, the (time-limited)</p>

exclusion will be given effect by the PRA issuing a direction under section 138A of FSMA.

In practice, PRA supervisors consider the firm's application for excluding an entity from scope of group supervision against the decision criteria set in PRA Rule 2.3 and consider the following as material issues:

- How does the proposed exclusion impact the PRA's ability to supervise the group?
- Can firms hide risk in the excluded entity?
- Will the exclusion provide a misleading picture of group capital?

SS9/15 (Solvency II: Group supervision) provides additional details for firms to consider when seeking to exclude an entity from scope of PRA consolidated supervision.

To identify the head of an insurance group the PRA relies on the PRA Rulebook "parent undertaking" definition for Solvency II Firms Sector which defines control both from the perspective of ownership but also through a firm's ability to operationally control another entity. Specifically, it is "an undertaking which has the following relationship to another undertaking ("S"):

- 1) it holds a majority of the voting rights in S; or
- 2) it is a member of S and has the right to appoint or remove a majority of its board of directors; or
- 3) it has the right to exercise a dominant influence over S through:
 - a) provisions contained in S's memorandum or articles; or
 - b) a control contract; or
- 4) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or
- 5) it has the power to exercise, or actually exercises, dominant influence or control over S; or it and S are managed on a unified basis; or
- 6) it is a parent undertaking of a parent undertaking of S; or
- 7) where, in the opinion of the PRA, it effectively exercises a dominant influence over S; and
- 8) in relation to (2) and (4), the undertaking will be treated as a member of S if any of its subsidiary undertakings is a member of S, or if any shares in S are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings."

The PRA as group supervisor receives significant amounts of group-specific data. With regard to the entities providing the PRA with the abovementioned regulatory submissions SS9/15 (Solvency II: Group supervision) clarifies that for a group, for which the PRA is the group supervisor, it is sufficient for one undertaking of the group to undertake the

	<p>following activities on behalf of the group to:</p> <ul style="list-style-type: none"> • submit the relevant data for and the results of the group eligible own funds and the group SCR to the PRA • ensure ongoing compliance with the conditions for the prudent management of subsidiaries, where the PRA has agreed to the use of a single document, the production of the single document covering all relevant ORSAs and the production of the single SFCR • inform the PRA in an event of non-compliance with the group SCR within the appropriate timeframe • submit a recovery plan and take measures to ensure compliance with the group SCR in an event of non-compliance with the group SCR within the appropriate timeframes. <p>The competencies for financial conglomerates supervision are split between the PRA for insurance- and banking-led financial conglomerates, and the FCA for investment management-led financial conglomerates. Where the PRA is both the Solvency II and the Financial Conglomerates Directive (FICOD) competent supervisor, it will coordinate internally the levels of application of the sectorial requirements. Where the FCA is the lead FICOD supervisor, the two authorities will cooperate for purposes of determining scope of their supervision.</p> <p>Unregulated group entities can undertake activities which have the potential to create risks for the group as a whole and so for authorized insurers. Hence, several supervisory statements set out the PRA's expectations in respect of linkages between the insurer and other non-insurance entities within the group:</p> <ul style="list-style-type: none"> • SS8/14 (Subordinated guarantees and the quality of capital for insurers) addresses where the quality of the capital in the insurer is undermined by subordinated guarantees • SS5/15 (Solvency II: The treatment of pension scheme risks) addresses pension schemes sponsored by intragroup service companies • SS5/19 (Liquidity risk management for insurers) addresses impact of intra-group transactions on an insurer's liquidity position • SS1/20 (Solvency II: Prudent Person Principle) addresses conflicts of interest arising where assets covering technical provisions include intragroup loans and participations • CP29/19 (Operational resilience: Impact tolerances for important business services) proposal for groups to identify important group business services and impact tolerances in the event of a severe disruption <p>The FCA is not a group-wide supervisor for any insurance group but cooperates with group-wide supervisors as determined by ICP 3. Instead, the FCA is an involved supervisor in relation to certain aspects of control and will follow processes and procedures as</p>
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	<p>outlined in ICPs 4, 5 and 6 in respect to control by group entities and managers, including the Group Senior Manager function as appropriate.</p> <p><i>ComFrame requirements</i></p> <p>On 28 May 2020 the PRA published on its website the list of IAIGs headquartered in the U.K., comprising Aviva plc, Legal & General Group Plc, British United Provident Association Limited, and RSA Insurance Group plc⁴¹. These were identified in accordance with the criteria set out in ComFrame (CF 23.0.a and CF 23.0.b) for the purpose of the Insurance Capital Standard (ICS) version 2.0. When undertaking the U.K. IAIG identification, the PRA relied on the principles set out in section 3B(1)(a), (b), and (f) of FSMA and had regard to</p> <ul style="list-style-type: none"> • The need to use the PRA’s resources economically: the process of identifying IAIGs provides principles for effectively supervising large, international groups and avoiding regulatory gaps and thus may help the PRA more efficiently supervise these firms • The principle that a burden or restriction should be proportionate to the benefits, i.e., the identification exercise ensures that the burden of higher standards for group supervision is applied to the largest, most complex firms • The principle that the PRA should exercise its functions transparently. <p>The PRA has adopted a more conservative approach that imposes a higher threshold to opt a firm out compared to opting a firm in. As a result, the PRA did not opt-out any firms from the IAIG identification. Instead, the PRA opted-in two firms based on their international footprint and proximity to the IAIG size criteria.</p> <p>As part of its regular supervisory engagement with relevant U.K. groups, the PRA has provided details as to the outcomes of its IAIG identification exercise. Firms were made aware that the list of U.K. IAIGs would be published on the PRA website.</p> <p>Involved supervisors participating in U.K.-led supervisory colleges, are provided by the PRA with details to the outcomes of the IAIG identification exercise. Where necessary, the PRA will also engage with other involved supervisors to obtain information necessary for purposes of group supervision of U.K. IAIGs.</p> <p>The PRA keeps IAIG identification decisions under constant review. Reflecting principles set out in section 3B(1)(a), (b), and (f) of FSMA the need for constant review of the IAIG identification decisions has been highlighted on multiple occasions at the PRA Supervision Policy and Risk Committee. Going forward, the PRA reviews the IAIG status of relevant U.K. groups as part of its firm-specific PSM discussions.</p>
Assessment	Observed

⁴¹ Since then, RSA was acquired and delisted, and it was no longer considered as an IAIG at the time of the mission.

Comments	<p>The framework for group supervision, which is determined by Solvency II, is robust, and the PRA has set out its expectations on group-related issues in various supervisory statements.</p> <p>Similarly, the identification of IAIGs has been performed in a transparent way and is regularly reviewed.</p>
ICP 24	<p>Macroprudential Supervision</p> <p>The supervisor identifies, monitors, and analyses market and financial developments and other environmental factors that may impact insurers and the insurance sector, uses this information to identify vulnerabilities and address, where necessary, the build-up and transmission of systemic risk at the individual insurer and at the sector-wide level.</p>
Description	<p>The PRA aims to identify risks to financial stability that can be generated by insurers and, together with the Financial Policy Committee (FPC) as the macroprudential authority, looks into potential measures to mitigate such effects.</p> <p>According to the Bank of England Act, the functions of the FPC are to monitor the stability of the U.K. financial system with a view to identifying and assessing systemic risks, and to give directions requiring the PRA or the FCA to exercise its functions so as to ensure the implementation of a macroprudential measure. The FPC must furthermore prepare and publish reports relating to financial stability which must include:</p> <ul style="list-style-type: none"> • the Committee's view of the stability of the U.K. financial system at the time when the report is prepared • an assessment of the developments that have influenced the current position • an assessment of the strengths and weaknesses of the U.K. financial system • an assessment of risks to the stability of the U.K. financial system and • the Committee's view of the outlook for the stability of the U.K. financial system. <p>In recent years, the Financial Stability Report occasionally mentioned the insurance sector, but it does not feature a regular section on sector-specific trends, risks, and vulnerabilities.</p> <p>The PRA provides the FPC with a comprehensive horizon scanning, covering different types of non-bank financial entities, including insurers. The input is kept brief by purpose and summarizes for each sector insights from e.g., the business model analysis team and from desk-based stress testing. However, the last deep-dive into the risks of the insurance sector was undertaken by the FPC in 2016.</p> <p>Since 2016, the PRA had conducted various analysis on specific developments in the insurance sector which could potentially have implications for financial stability, including:</p> <ul style="list-style-type: none"> • Procyclicality, incentives to fire sale, and spillovers by holding similar assets

- Investment risks, e.g., from illiquid assets or fallen angels
- Reinsurance and interconnectedness with other parts of the financial sector.

Less focus, though, has been given to the international role of U.K. insurers and reinsurers, including the substitutability of their capacity in certain jurisdictions and business lines, also based on the grounds of absent granular data. More generally, cross-border topics were, however, discussed at international fora, such as the FSB and the IAIS.

While Solvency II has significantly expanded the availability of supervisory reporting data, some gaps remain, most notably in the areas of liquidity risk and cross-border business. Liquidity analyses suffer from the absence of data on short-term cash flows, and even basic stock data like the amount of cash and cash equivalents is not reported consistently by all insurers. Derivatives data—which is also available from trade repositories under EMIR—needs to be further enhanced and quality-checked to allow for the monitoring of margin call risks. Data on cross-border business and intermediation channels is limited, complicating e.g., an assessment of the role and potential systemic relevance of Lloyd’s in foreign markets. For insurance intermediaries (including some of the larger brokers in the Lloyd’s and London market), liquidity reserves have been collected only ad-hoc during the pandemic, taking note of the competence of the PRA under S165A of the FSMA to collect data for systemic risk analysis.

The BoE has expanded stress testing beyond the banking sector. During the pandemic, the PRA carried out additional stress tests of the largest life and general insurance firms. It published aggregated results in June 2020 showing the sector to be robust to downside stress. The stress on general insurers focused on risks arising from business interruption policies, where the FCA was seeking a court declaration on test cases to provide clarity for policyholders and firms. The stress test on life insurers focused on the potential impact of credit downgrades on matching adjustment portfolios.

The PRA’s joint stress test with the Bermuda Monetary Authority (BMA) in 2019 is a leading example of supervisory cooperation on systemic risk analysis. General insurers in the U.K. significantly rely on Bermuda-based reinsurers—any such concentration could potentially be a counterparty and/or liquidity for the primary insurer, typically exacerbating a current stress, e.g., after a natural disaster. Against this background, the PRA and the BMA conducted a joint exercise with natural catastrophe scenarios, exploring the cross-border interplay between primary insurers and reinsurers in more detail.

The PRA has not designated any insurer as systemically important. Nevertheless, its level of microprudential supervision principally reflects judgement of an insurer’s potential impact on policyholders, on the stability of the financial system (including the overall macro context), and its resolvability. This classification process integrates the potential systemic importance of the firm in its assessment.

Aggregate market statistics for the U.K. insurance market were temporarily not publicly available after EIOPA ceased to include the U.K. in its quarterly statistics on individual

	member states. In December 2021, the PRA launched a new statistics portal which remedied this shortcoming.
Assessment	Largely Observed
Comments	<p>Macroprudential supervision of the insurance sector could be enhanced through a more structured and regular consideration of macroprudential risk of the insurance sector. While the FPC requests deep dives and analysis of specific activities, the last sectorial deep dive for the insurance sector was undertaken in 2016. Regular reporting should be provided by the PRA Insurance Directorate on broad trends in the insurance sector that may have near-term or long-term consequences for the functioning of the insurance market and other financial sectors. A process inspired, for example, by the IAIS Global Monitoring Exercise (GME) and implemented in a more domestic context may be appropriate, and the process could be tied to the qualitative input required for the GME.</p> <p>Reflecting the U.K.'s key role in global insurance markets, the Bank of England should undertake a deep dive review of the role and potential systemic relevance of Lloyd's and the London Market in international markets and do this in cooperation with other supervisors. The review should focus on substitutability and market share given London's preeminent role in insuring specialist risks around the world.</p>
ICP 25	<p>Supervisory Cooperation and Coordination</p> <p>The supervisor cooperates and coordinates with involved supervisors and relevant authorities to ensure effective supervision of insurers operating on a cross-border basis.</p>
Description	<p>PRA's supervisory stance with regard to insurance groups is determined by Solvency II Regulations 2015. Regulation 26 states that "Where an insurance undertaking or reinsurance undertaking that is authorized by the PRA under Part 4A of FSMA is part of a group, the PRA is the group supervisor and must supervise that group." Regulation 28 states that where the insurance group is headquartered in an equivalent third-country for purposes of Solvency II group supervision, the PRA will rely on group supervision exercised by third-country supervisory authorities.</p> <p>In the absence of third-country equivalence at the ultimate parent level, PRA can either apply Solvency II group supervision provisions or "other methods" which ensure appropriate supervision of the insurers in a group; However, the default is for U.K. firms in the group to ensure compliance with full Solvency II requirements for the worldwide group. Application of other methods can be achieved through the waiver modification process by the group supervisor and firm.</p> <p>The PRA's duties as group supervisor for U.K.-based insurance groups are set out in Regulation 28 of the Solvency II SI 2015 and further detailed in internal supervisory guidance:</p>

- Determination of the scope of group supervision
- Leadership, planning and co-ordination of group-wide supervisory activities
- Aggregation, preparation and analysis of group-wide information and dissemination of the relevant information to the involved supervisors for discussion purposes
- Performing a group-wide supervisory assessment, including assessing group capital management, risk and solvency, risk concentration, intra-group transactions and group governance
- Coordination of information sharing procedures amongst other involved supervisors
- Coordination on group-wide issues including preventive and corrective measures and sanctions
- Identification of gaps in supervision; and
- Chairing of the supervisory college where one is established or setting up a suitable coordination arrangement.

Most U.K. groups have a college in place for a number of years now, underpinned by coordination agreements that provide a detailed overview as to how supervision of a group operating on a cross-border basis is to be organized. In cases where a supervisory college is not established, the PRA sets out in writing the coordination arrangements agreed on a bilateral basis with other relevant involved supervisors.

Principles the PRA will follow when determining what are the most suitable coordination arrangements for U.K. groups operating on a cross-border basis:

- If the group is an IAIG, PRA supervision must organize an International College.
- An International College is optional for all other groups, but they should be organized when it would provide value to supervisors, in cases such as:
 - a. The group is a Cat 1 or 2 group
 - b. A material proportion of the group's liabilities are written abroad (about 10 percent or more)
 - c. A part of the group writes highly capital intensive or highly loss-making business abroad, regardless of size
 - d. The group has significant intra-group transactions in place
 - e. Other factors to consider include: a complex group structure, the use of an internal model, the relationship with third-country regulators, existing firm issues which require collaboration with other regulators, shared central services such as a central treasury function, and the impact of climate change on overseas entities.

	<ul style="list-style-type: none"> • If the group is only active in one other jurisdiction, an International College is not necessary and matters to discuss can be covered in bilateral meetings between PRA supervisors and the supervisors in the other jurisdiction. • If the group primarily conducts non-insurance business in a jurisdiction, the participation of supervisors from that jurisdiction in the International College is not necessary although the PRA supervisors may seek bilateral engagement with them when matters arise. <p>The college coordination agreements for PRA led supervisory colleges provide for the emergency plan and the information to be exchanged in a crisis situation.</p> <p>PRA-chaired supervisory colleges agree as part of the college agreement the way they will engage in situations of crisis including exchange of information in cases such as:</p> <ul style="list-style-type: none"> • non-compliance or risk of non-compliance with the minimum consolidated group SCR • significant non-compliance or risk of non-compliance with the group SCR • major violation of legal requirements, including governance requirements • unbalanced distribution of own funds: indicator for problems of an individual undertaking • liquidity problems caused by the holding structure • risk of insolvency of important undertakings that are part of the group • major downgrading of the rating of the parent undertaking or a significant undertaking that is part of the group where relevant • major fall in share price of listed entities that are part of the group or their main shareholders of the parent undertaking • macro-economic and financial developments as well as insurance sector specific developments which may impact the financial soundness of the group (e.g., contagion risk) • breakdown of a crucial IT system. <p>As an involved supervisor the PRA:</p> <ul style="list-style-type: none"> • actively participates in the group supervision process, such as that facilitated by a supervisory college • informs the group-wide supervisor and, if necessary, other involved supervisors, of material findings affecting their insurance legal entity that could affect entities in other jurisdictions
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- shares all relevant information with the group-wide supervisor to assist with supervision at the group-wide level and discusses findings and concerns at the group level with the group-wide supervisor
- analyzes information received from the group-wide supervisor
- cooperates in the analysis and decision making as well as implementation and enforcement
- assists the group-wide supervisor in carrying out the supervisory process at the group level
- identifies gaps in supervision
- shares information as to:
 - any granting and withdrawal of a license
 - location of significant business
 - developments in the legal structure of the insurance group
 - changes in business model
 - changes to the Board or Senior Management
 - changes in the systems of risk management and internal controls
 - significant developments or material changes in the business operations
 - significant developments in the financial position and regulatory capital adequacy.

FCA

FSMA states that the FCA's strategic objective is to ensure that the relevant markets function well. This necessitates co-operation with other group and involved supervisors to help ensure that the global and interdependent insurance market functions well.

The FCA works closely with international regulators and stakeholders such as the IAIS. FCA supervisors are encouraged to be pro-active about engaging with colleges and getting conduct risk onto their agendas.

Where the PRA is the Group Supervisor and:

- FCA dual regulates a U.K. insurer entity alongside the PRA: As the PRA is recognized as the National Competent Authority by EIOPA, the FCA necessarily needs a separate PRA/FCA (internal) college in advance to agree on matters to take to the Group College of Supervisors, and to agree the line that the U.K. will take on any vote, it being recognized that the U.K. has only one vote at the Group College, i.e. the FCA and PRA do not each have a vote.

	<ul style="list-style-type: none"> • FCA is the solo supervisor of an entity in the group: FCA will be invited to attend the college as a full member. <p>Supervision teams are expected to hold at least one domestic college annually for all firms. For fixed firms, colleges are held on an individual firm basis, whereas for flexible portfolio firms, colleges are held on a peer group or cluster basis.</p> <p>Whilst the FCA is not a group-wide supervisor for any insurance groups, through its responsibilities under the MoU, it supports the group-wide supervisor. This includes sharing of information relating to legal entities, business models, how they operate and govern themselves and the risks to the FCA’s strategic objectives perceived in the business.</p> <p>The FCA signs Coordination Arrangements prepared by the Group Supervisor for colleges and is a signatory to co-operation agreements among Crisis Management Group Members.</p> <p><i>ComFrame requirements</i></p> <p>PRA Supervisory guidance sets out the principles the PRA will follow when determining what are the most suitable coordination arrangements for U.K. groups operating on a cross-border basis. If the group is an IAIG, PRA supervision must organize an International College on an annual basis.</p> <p>The college coordination agreements for PRA-led supervisory colleges set out in detail the content and frequency of information exchanges at the college level. The PRA disseminates ICS related data at the level of the college and considers it together with the other involved supervisors.</p> <p>The college coordination agreements for all PRA-led supervisory colleges contain provisions as to cooperation in situations of crisis including the organization of specialized emergency teams. They furthermore provide for the emergency plan and the information to be exchanged in a crisis situation. However, at the time of the FSAP mission, the PRA has not yet put in place Crisis Management Groups for all U.K. IAIGs.</p> <p>As a member of an IAIG’s supervisory college the FCA communicates and exchanges information in accordance with the signed coordination agreements and MoUs.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>Generally, the roles of the PRA as a group supervisor are laid out in detail, and cooperation with foreign supervisors works effectively. The same holds true for the PRA and the FCA in their respective roles as involved supervisors.</p> <p>However, the PRA should finalize the establishment of Crisis Management Groups for all IAIGs (at the time of the mission, this process was expected to be completed during 2022)</p>

	<p>and ensure an appropriate membership which would include resolution authorities wherever necessary.</p> <p>Furthermore, setting up a platform for supervisory cooperation for Lloyd's (and potentially the London market in general) could improve interactions and the exchange of information with supervisors abroad, irrespective of whether Lloyd's has regulated entity status there or operates without a physical presence.</p>
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