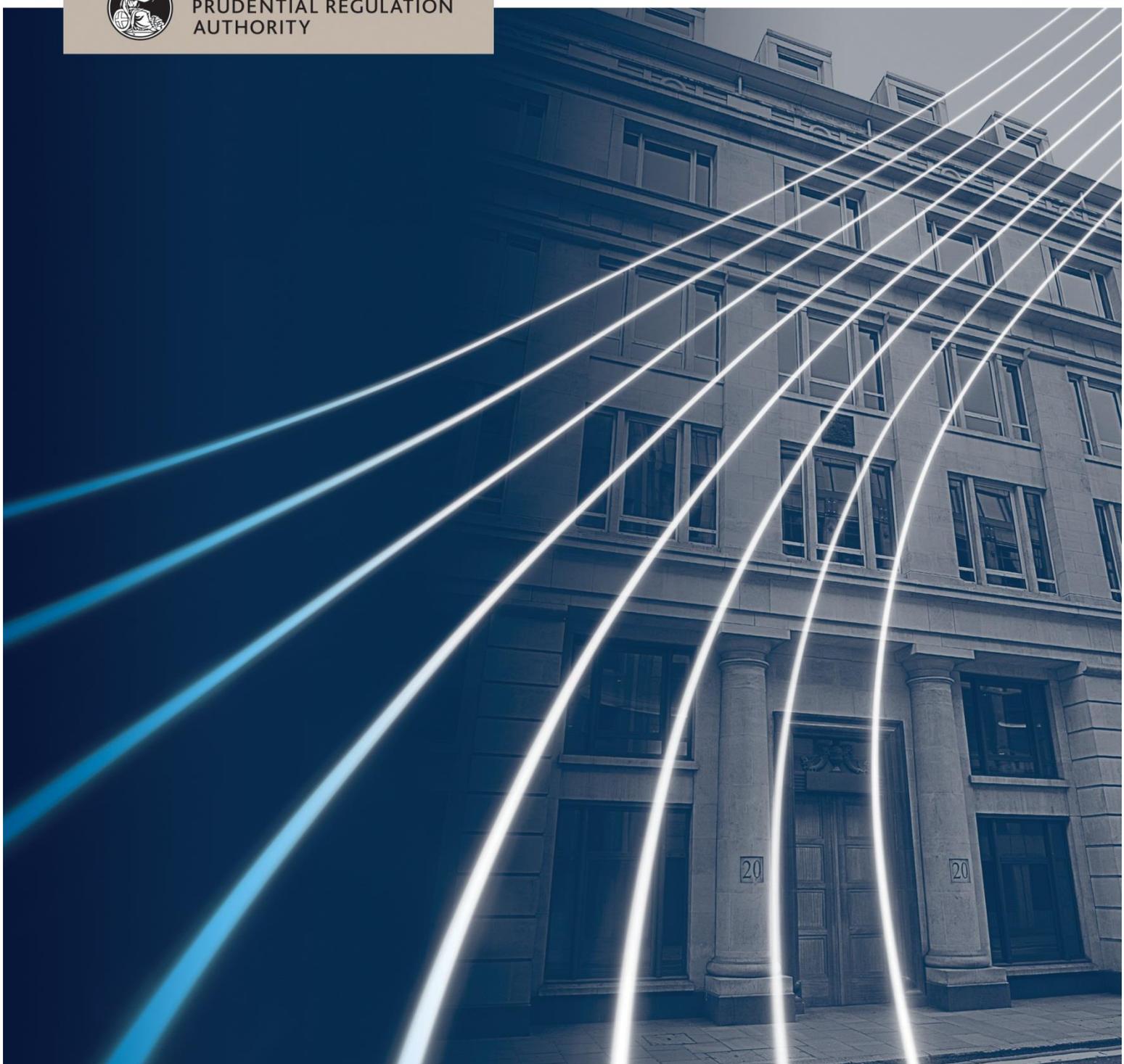


The Prudential Regulation Authority's approach to insurance supervision

October 2018



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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Foreword by the CEO



More than a decade on since the global financial crisis, we are approaching full implementation of the post-crisis reforms. One of these reforms was the formation of the Prudential Regulation Authority (PRA) in April 2013 as the UK's prudential regulator of deposit-takers, insurers and major investment firms.

The PRA was given two primary objectives: a general objective to promote the safety and soundness of the firms it regulates, focusing on the adverse effects that they can have on the stability of the UK financial system; and an objective specific to insurance firms, to contribute to ensuring that policyholders are appropriately protected. The PRA also has a secondary objective to act in a way (so far as is reasonably possible) to facilitate effective competition in the markets for services provided by PRA-authorised firms.

This approach document sets out how we pursue these objectives in respect of insurers (a second document sets out our approach for deposit-takers and designated investment firms). The three principles underpinning our core approach have remained constant over the past years: our supervisors rely on judgement in taking decisions; we assess firms not just against current risks, but also against those that could plausibly arise further ahead; and we focus on those issues and firms that are likely to pose the greatest risk to our objectives. Across these three principles we continue to apply proportionality to ensure our interventions do not go beyond what is necessary in order to achieve our objectives.

Nevertheless, the way we supervise our firms is evolving over time to take account of new developments. This document is therefore updated regularly. A detailed overview of all changes since the last update in March 2016 can be found in the annex, but let me draw out a few key areas.

First, having fully embedded the Senior Managers Regime for banks the Senior Managers and Certification Regime will be extended to insurers in December, and so individual accountability has become a key tool through which we deliver our supervisory approach. We expect firms to identify the most senior individuals responsible for key areas and activities, including the delivery of supervisory priorities, and to document their responsibilities. We can and will take supervisory or enforcement action if our red lines are crossed.

Second, in a context of firms' increasing reliance on digital systems and platforms and the risk of cyber-attacks, operational resilience is on track to become as embedded in our supervisory approach as financial resilience. In this area, we are primarily focused on the continuity of the business services that a firm's customers and the wider economy rely upon. We will prioritise our interventions proportionally based on safety and soundness and any potential financial stability implications of potential operational disruptions.

Third, we are working with the aim of ensuring that the transition to the UK's new relationship with the EU is as smooth as possible in financial services in order to minimise risks to our objectives, through mechanisms such as the Temporary Permissions Regime (TPR) which will allow us to bridge incoming EU27 firms for three years while they seek an authorisation to continue business in the UK.

Across these various individual changes, we also need to defend the new regulatory framework we've put in place. Whilst this doesn't require changes to our overall approach, it does mean that supervisors are vigilant for any sign of regulatory arbitrage (behaviour that is intended to comply with the letter but defy the spirit of our rules), in particular in areas where firms have natural incentives to maximise their room for manoeuvre above regulatory requirements.

I hope this document will prove a useful way for people to understand how we approach our role here at the PRA.

Sam Woods
October 2018

Introduction

We, the Prudential Regulation Authority (PRA), as part of the Bank of England ('the Bank'), are the UK's prudential regulator for deposit-takers, insurance companies, and designated investment firms.

1. This document sets out how we carry out our role in respect of insurers. It is designed to help regulated firms and the market understand how we supervise these institutions, and to aid accountability to the public and Parliament. A second document relates to our supervision of deposit-takers and designated investment firms.¹ The document acts as a standing reference that will be revised and reissued in response to significant legislative and other developments which result in changes to our approach.

2. This document serves three purposes. First, it aids accountability by describing what we seek to achieve and how we intend to achieve it. Second, it communicates to regulated insurers what we expect of them, and what they can expect from us in the course of supervision. Third, it is intended to meet the statutory requirement for us to issue guidance on how we intend to advance our objectives. It sits alongside our requirements and expectations as published in the PRA Rulebook and our policy publications.²

EU withdrawal

3. Our approach to advancing these objectives will remain the same as the UK withdraws from the EU. Our main focus is on trying to ensure that the transition to our new relationship with the EU is as smooth and orderly as possible in order to minimise risks to our objectives.

¹ 'The Prudential Regulation Authority's approach to banking supervision', October 2018, available on the Bank's website at <https://www.bankofengland.co.uk/prudential-regulation/supervision>.

² The way we make policy and links to our policy publications are available on the Bank's website at <https://www.bankofengland.co.uk/prudential-regulation/policy>.

1 Our objectives

Our governing statute is the Financial Services and Markets Act 2000 (as amended) (the Act).

Our primary objectives

4. Under the Act, we have two primary objectives: i) a general objective to promote the safety and soundness of all of the firms we regulate; and ii) an objective specific to our regulation of insurers to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders.
5. The Act requires us to advance our general objective primarily by seeking to:
 - (i) ensure that the business of the firms we regulate is carried on in a way that avoids any adverse effect on the stability of the UK financial system; and
 - (ii) minimise the adverse effect that the failure of one of the firms we regulate could be expected to have on the stability of the UK financial system.

Our secondary objective

6. We also have a secondary objective to act, so far as is reasonably possible, in a way that facilitates effective competition in the markets for services provided by the firms we regulate when they carry on regulated activities. This applies when we are making policies, codes, and rules in pursuit of our primary objectives.
7. Effective competition can be said to exist where suppliers offer a choice of products or services on the most attractive and sustainable terms to customers; where customers have the confidence to make informed decisions; and where firms enter, expand and exit from the market.
8. Our primary and secondary objectives are usually fully aligned. However, cases may exist where some options available to us would not deliver the maximum benefits to safety and soundness, but would deliver significantly greater benefits to competition. The secondary competition objective means that we should consider (but are not required to adopt) those options that may deliver greater benefits to competition. The 'reasonably possible' condition also recognises that we may have limited policy choices, for example where we are bound by other domestic or international law.
9. Regulation designed to improve financial stability can facilitate effective competition. For example, regulation that creates minimum standards of protection for policyholders means customers can have greater confidence that insurers will continue to be required to meet their claims or payments of benefits, although these may only materialise many years into the future. This enables insurers to compete based on the quality and costs of their products, responding to customer demand, taking prudential standards as a given.

Safety and soundness, and the stability of the UK's financial system

10. 'Safety and soundness' involves insurers having resilience against failure, now and in the future, and avoiding harm resulting from disruption to the continuity of financial services. In discharging our general objective we will focus, in particular, on the risk of disruption to the continuity of critical economic functions.³ This is because a stable financial system, that maintains continuity of access to critical economic functions, is a necessary condition for a healthy and successful economy.

11. We are required by statute to promote safety and soundness by seeking to avoid adverse effects on financial stability. The financial services that insurers provide are essential in supporting the pooling and transfer of risk and savings, and so wider economic activity. Insurers do not, however, present the same risks for financial stability as banks. For instance, they do not typically undertake maturity transformation and so are less vulnerable to sudden losses of confidence, 'runs', and contagion than banks. Their failure, nevertheless, has the potential to disrupt the continuity of financial services and so financial stability, for example if critical insurance services were withdrawn on a scale sufficient to lead to a direct impact on economic activity, through operational disruptions in the services they provide, or indirectly through the impact on other financial institutions.

12. We aim to identify risks to financial stability that can be generated by insurers and, together with the Financial Policy Committee (FPC) as macroprudential authority, where appropriate, we look to mitigate such effects.

Appropriate protection of policyholders

13. We have a specific insurance objective of 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'. Safety and soundness and policyholder protection are complementary objectives in respect of insurance supervision. Our action to promote the safety and soundness of an insurer will typically have the effect of protecting policyholders, by ensuring that the insurer's liabilities to them can be met both now and in the future.

14. The insurance objective recognises that we are a contributor to, rather than the sole body responsible for, policyholder protection. The Financial Conduct Authority (FCA) also has a role in policyholder protection. The FCA seeks to ensure that consumers are treated fairly in their dealings with insurers. Our focus is to ensure that insurers are able to meet their obligations to policyholders, which, in the case of some policies, may only emerge after many years. Our action to advance policyholder protection will usually operate through factors that affect the safety and soundness of firms.

15. Subject to the requirements placed on us by law, it is for us to decide the degree of protection that is appropriate. The appropriate degree can vary according to the type of product, type of policyholder, their current or future interests, the location of the insurer and the risk, or other factors we consider relevant.

³ Economic functions are defined as the broad set of services the financial sector provides to the UK economy, and hence an aggregation of business services that one, or more, firms or FMIs provide. For example, the economic function of retail mortgages and secured lending would comprise a number of individual business services. If sufficiently significant in terms of both size and function, these economic functions can become critical to the UK economy.

16. Our priorities for protecting policyholders vary according to: the significance to the policyholder of the risk insured; the potential for significant adverse effects on policyholders if cover were to be withdrawn or policies not honoured; and the ability of policyholders to influence prudent behaviour by their insurer, either individually or collectively.

17. Some types of insurance provide individuals and companies with protection against significant risks where the withdrawal of cover could have a very material impact on those policyholders and the economy more generally. For example, certain activities require, either contractually or as a matter of public policy, insurance cover to be maintained, for example employers' liability insurance or professional indemnity cover. Similarly, disruption to life insurance policyholders caused by any delay in the receipt of, or the absence of, annuity income could be important in cases where, as is likely, such payments form a significant source of income.

18. We take a forward-looking approach to assessing an insurer's ability to meet its obligations. In particular an insurer's ability to deliver on obligations to existing policyholders can be affected by the terms on which it deals with new policyholders. As a consequence, we expect insurers not to write new business where the terms on which it is written would expose either existing or new policyholders in aggregate to an unacceptable level of risk.

19. We interpret the definition of 'policyholders' in a broader sense than simply the person who takes out the policy to include those who are the beneficiaries of insurance contracts (for example, third parties under motor policies and employers' liability policies).

20. Our duties arising from the insurance objective extend only in relation to the carrying out of a 'PRA-regulated insurance activity' or firms that are 'PRA-authorized persons' carrying out that activity. The appropriate degree of protection for policyholders and the tools we can use to achieve that may vary depending on the factors described above.

21. The insurance objective is not relevant to policyholders of firms that are foreign subsidiaries of UK-headed groups. However we may consider the impact of such subsidiaries in light of our insurance objective in circumstances where there is the potential for wider group risk or contagion to affect the UK insurer.

Firm failure

22. Contributing to an appropriate degree of policyholder protection and promoting resilience against failure does not mean protecting all policyholders in full in all circumstances, nor does it mean preventing all instances of failure. The Act is explicit that it is not our role to ensure that no insurer fails. Therefore, a key principle underlying our approach is that we do not seek to operate a zero-failure regime.

23. In the event that an insurer's financial position comes under stress, policyholders can be protected through mechanisms by which insurers can exit the market in an orderly way, eg through the removal of permission to undertake new business, and orderly run-off of existing business. If insurers do fail, the Financial Services Compensation Scheme (FSCS) policyholder protection scheme protects eligible policyholders, up to certain limits.

24. Under our prudential regulation regime, insurers must maintain a certain level of resilience against failure. This is essential to ensuring confidence in general in the resilience of the insurers that we supervise for us to deliver on our objectives.

Threshold Conditions

25. The Threshold Conditions are the minimum requirements that firms must meet at all times in order to be permitted to carry on the regulated activities in which they engage. They are designed to ensure that firms conduct their business in a prudent manner and are managed by persons with adequate skills, experience and probity, which are necessary to promote safety and soundness. They are crucial to the operation of our regulatory regime. PRA-authorized firms need to meet both the PRA-specific and FCA-specific Threshold Conditions in Schedule 6 of the Act at all times.⁴ We expect firms not merely to meet and continue to meet the letter of these requirements, but also to consider the overriding principle of safety and soundness. We assess insurers against the Threshold Conditions on a continual basis.

Fundamental Rules

26. The Fundamental Rules are high level rules that collectively act as an expression of our general objective of promoting the safety and soundness of regulated firms. Firms must ensure they are compliant with all applicable PRA rules, including the Fundamental Rules, as set out in the PRA Rulebook.⁵

27. A failure to comply with the Fundamental Rules may be relevant to a firm's ongoing compliance with the Threshold Conditions and may result in enforcement or other actions.

Regulatory principles

28. In designing our policies, issuing codes and making rules, we have regard to a number of 'regulatory principles', including those set out in the Act. These cover: using our resources efficiently; proportionality; the desirability of sustainable UK economic growth; senior management responsibility in firms; recognising differences in the nature and objectives of authorised persons; transparency; disclosure of information relating to persons on whom requirements are imposed by or under the Act; and the general principle of customers taking responsibility for their decisions. HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when advancing our general functions.⁶

Investigations into regulatory failure

29. The Financial Services Act 2012 requires us to investigate and report to HM Treasury on events which indicate possible regulatory failure. We have set out, in a policy statement,⁷ how we will judge whether and when such failures have occurred. Consistent with our statutory objectives, we are clear that firm failures will not automatically indicate regulatory failure.

⁴ Available at <https://www.legislation.gov.uk/ukdsi/2013/9780111533802/article/2>.

⁵ <https://www.prarulebook.co.uk>.

⁶ More information about the PRC, and HM Treasury's recommendations, are available on the Bank's website at <https://www.bankofengland.co.uk/about/people/prudential-regulation-committee>.

⁷ 'Conducting statutory investigations', April 2013: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/conducting-statutory-investigations>.

2 Our approach to advancing our objectives

To advance our objectives, our supervisory approach follows three key principles – it is: i) judgement-based; ii) forward-looking; and iii) focused on key risks. Across all of these principles, we are committed to applying the principle of proportionality in our supervision of firms.

Figure 1: Key principles of our supervisory approach



Judgement-based

30. Our approach relies significantly on the judgement of our supervisors. We supervise insurers to assess whether they are safe and sound, whether they protect policyholders appropriately, and whether they meet, and are likely to continue to meet, the Threshold Conditions. Supervisors reach judgements on the risks that an insurer poses to our objectives and how to address any shortcomings.

31. Our supervisory judgements are based on evidence and analysis. It is, however, inherent in a forward-looking system that, at times, the supervisor's judgement will be at variance with that of the insurer. Furthermore, there will be occasions when events will show that the supervisor's judgement, in hindsight, was wrong. To minimise such outcomes, we are staffed by teams with strong, relevant skills and experience, and our major judgements and decisions involve our most senior and experienced staff and directors.

32. We also engage with the boards and senior management of insurers in forming our decisions, using this dialogue both to ensure that we take account of all relevant information in reaching our judgements, and to communicate clearly the rationale for them. Insurers should not, however, approach their relationship with us as a negotiation.

Forward looking

33. Our approach is forward looking. We assess insurers not just against current risks, but also against those that could plausibly arise in the future. Where we judge it necessary to intervene, we generally aim to do so at an early stage. Insurers should be open and straightforward in their dealings with us, taking the initiative to raise issues of possible prudential concern at an early stage. We will respond proportionately. In this way, trust can be fostered on both sides.

Focused on key risks

34. We focus our supervision on those issues and those firms that, in our judgement, pose the greatest risk to the stability of the UK financial system and, in the case of insurers, to policyholder protection. Consistent with our objectives, we aim to concentrate on material issues when engaging with firms. The frequency and intensity of supervision applied by us to a particular firm therefore increases in line with the risk it poses to our objectives.

Box 1: Working with other authorities

Co-ordination with other authorities is essential to our success.

The Bank of England

We are part of the Bank of England (Bank), and are therefore connected to the Bank's other functions, including its work on market intelligence, oversight of financial market infrastructure, financial sector resilience and resolution. This facilitates the flow of information between these functions.

An effective regulatory framework for financial stability also needs to combine insurer-specific supervision with work to protect and enhance the resilience of the financial system as a whole. We therefore work closely with the Bank's FPC, which has statutory responsibility for reducing risks to the financial system as a whole.

The FPC can make recommendations and give directions to us on specific actions that should be taken to achieve the FPC's objectives. We are responsible for responding to FPC recommendations which may be made on a 'comply or explain' basis, and for complying with the FPC's directions in relation to the use of macroprudential tools, specified by HM Treasury in secondary legislation.⁸

There is a frequent two-way flow of information and exchange of views between us and the FPC. We provide firm-specific information to the FPC, to assist its macroprudential supervision. And the FPC's assessment of systemic risks influences our judgements in pursuit of our own objectives.

Co-ordination between us and the FPC is assisted by the common membership of the Governor of the Bank of England, the Deputy Governor for Financial Stability, the Deputy Governor for Markets and Banking, the Deputy Governor for Monetary Policy, and the Chief Executive Officer (CEO) of the PRA on both our PRC and the FPC.

The Financial Conduct Authority (FCA)

The FCA is the conduct regulator for firms prudentially regulated by us. We have a statutory duty to co-ordinate with the FCA in the exercise of our statutory functions under the Act, including policymaking and supervision. A Memorandum of Understanding (MoU) between us and the FCA describes how we fulfil this duty to co-ordinate in a way that supports each of our ability to advance our own objectives.⁹

A key principle for this co-operation, given the regulators' separate mandates for prudential and conduct regulation of PRA-authorised firms, is that each authority should focus on the key risks to its own objectives, while being aware of the potential for concerns of the other.

Conclusions and key information from supervisory activity that is materially relevant to the other regulator's objective(s) will be exchanged. In order to ensure that both our and the FCA's supervisory judgements about a firm

⁸ See HM Treasury consultation on the FPC's macroprudential tools, published September 2012, available at http://www.hm-treasury.gov.uk/press_83_12.htm.

⁹ See the MoU: <https://www.bankofengland.co.uk/about/governance-and-funding>.

reflect relevant information, we will share information on dual-regulated firms and firms within dual-regulated groups between us.

To support this process, domestic 'supervisory colleges' for individual firms and groups are established as appropriate, with a view to identifying which risks and mitigating actions might have a material effect on the ability of the other regulator to advance its objectives. The frequency of these colleges will reflect the importance of the firm to the other regulator's objectives.

Co-ordination between us and the FCA is assisted by the reciprocal membership of the CEOs on each other's board. This cross-board role focuses on areas of overlap and discussions of material relevance to each CEO's own organisation. Co-ordination between the organisations is also assisted by common membership of CEOs on the FPC.

We and the FCA are also party to other MoUs with the Bank as a whole and HM Treasury on international engagement, and the rest of the Bank on the oversight of financial market infrastructure.

The Financial Services Compensation Scheme (FSCS)

The FSCS is the UK's compensation fund of last resort for customers of authorised financial services firms. It can safeguard the rights of claimants, secure continuity of insurance cover, pay claims as they fall due, and pay compensation to eligible claimants. The MoU between us and the FSCS details how the two authorities co-operate and co-ordinate.¹⁰

We work closely with the FSCS to assess and enhance the resolution framework for insurers to discharge our primary objectives. We will seek to ensure that, through the Proactive Intervention Framework (PIF) (see Chapter 4), the FSCS has reasonable notice of activity where we may require significant involvement of the FSCS.

Other UK bodies

We often need to work with other UK regulators, and other UK government agencies either to pursue our own objectives or to assist them in theirs. This may also include other enforcement agencies.

We have agreements to support the sharing of information and judgements and the co-ordination of actions. Our general approach to these arrangements and the relationships they underpin is focused on:

- enabling all parties to focus on their own objectives;
- the substantive issues of the potential co-ordination;
- avoiding, where possible, a detailed, prescriptive approach, to ensure that judgement and flexibility are not lost; and
- provisions for regular review, ensuring that MoUs remain current and embedded within the organisations

European and international co-operation

Insurance is an international industry. We attach great importance to being an influential and persuasive participant in international policy debates, seeking to achieve agreement at the global level to the reforms necessary for a strong, balanced and coherent prudential framework.

We actively participate in the work of the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS), and other global forums; as well as working with European institutions such as the European Insurance and Occupational Pensions Authority (EIOPA). We support in particular IAIS initiatives to strengthen the supervisory framework for internationally active insurers, reflecting the view that for these insurers, the group supervisor should be ready and able to conduct effective consolidated supervision of all activities (regulated and unregulated) within a group.

¹⁰ For more information on the MoU between the PRA and the FSCS, see: <https://www.bankofengland.co.uk/about/governance-and-funding>.

3 Identifying risks to our objectives

The intensity of our supervisory activity varies across insurers. The level of supervision principally reflects our judgement of an insurer's potential impact on policyholders and on the stability of the financial system, its proximity to failure (as encapsulated in the Proactive Intervention Framework (PIF), which is described later), its resolvability and our statutory obligations. Other factors that play a part include the type of business carried out by the insurer and the complexity of the insurer's business and organisation.

Our risk framework

35. We take a structured approach when forming our judgements. To do this we use a risk assessment framework – see Figure 2. The risk assessment framework for insurers is the same as for banks, but is used in a different way, reflecting our additional objective to contribute to securing appropriate policyholder protection, the different risks to which insurers are exposed, and the different way in which insurers fail.

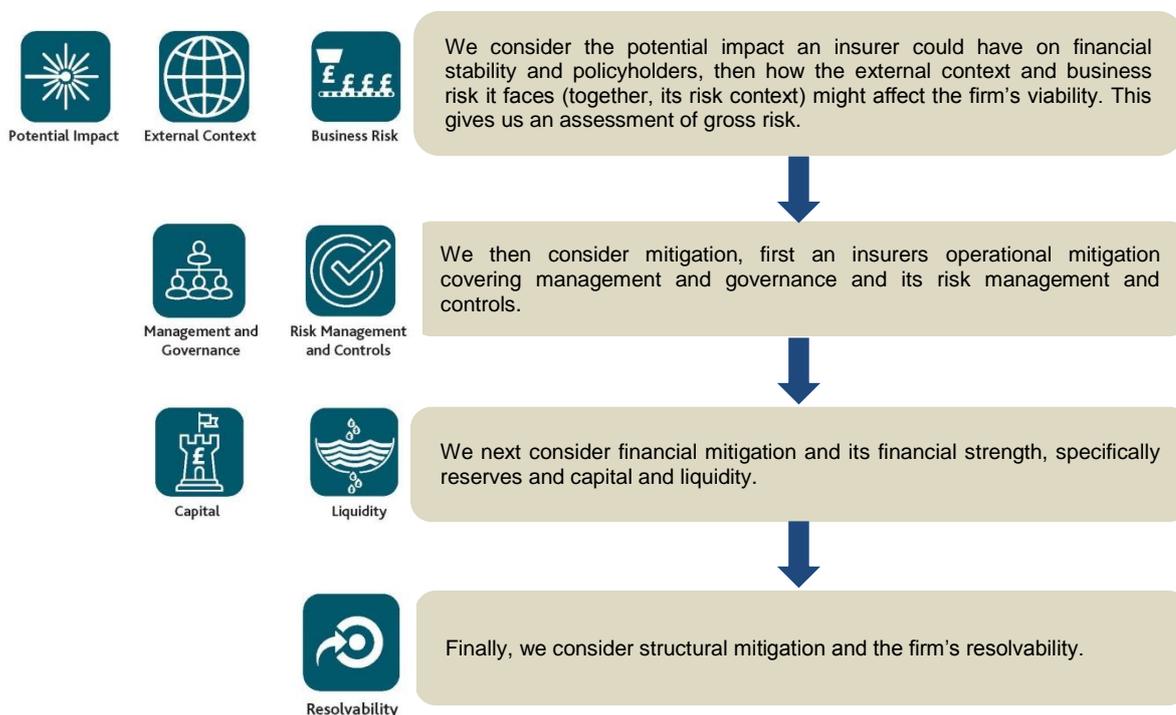
36. Much of our proposed approach to the supervision of insurers is designed to deliver the supervisory activities which the UK is required to carry out under Solvency II.¹¹ The key features of Solvency II are:

- market-consistent valuation of assets and liabilities;
- high quality of capital;
- a forward-looking and risk-based approach to setting capital requirements;
- minimum governance and effective risk management requirements;
- a rigorous approach to group supervision;
- a Ladder of Intervention designed to ensure intervention by us in proportion to the risks that a firm's financial soundness poses to its policyholders; and
- strong market discipline through firm disclosures.

37. Some insurers fall outside the scope of the Solvency II Directive (known as non-Directive firms), mainly due to their size. These firms should make themselves familiar with the requirements for non-Directive firms.

¹¹ For more information on Solvency II see: <https://www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii>.

Figure 2: Our risk assessment framework



| Gross risk | | | Mitigating factors | | | | |
|------------------|------------------|---------------|---------------------------|------------------------------|----------------------|-----------|-----------------------|
| Potential impact | Risk context | | Operational mitigation | | Financial mitigation | | Structural mitigation |
| Potential impact | External context | Business risk | Management and governance | Risk management and controls | Capital | Liquidity | Resolvability |

Potential impact

38. A core part of the risk assessment is the potential impact assessment. We assess the significance of an insurer to our objectives. This ‘potential impact’ reflects an insurer’s potential adversely to affect our objectives by failing, coming under operational or financial stress, or because of the way in which it carries out its business.

39. We divide all insurers we supervise into the five ‘categories’ of impact below:

Category 1 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.

Category 2 Insurers whose size (including number of policyholders) and type of business mean that there is significant capacity to cause disruption to the interests of a substantial number of policyholders.

- Category 3** Insurers whose size (including number of policyholders) and type of business mean that there is minor capacity to cause disruption to the interests of a substantial number of policyholders.
- Category 4** Insurers whose size (including number of policyholders) and type of business mean that there is very little capacity to cause disruption to the interests of a substantial number of policyholders.
- Category 5** Insurers whose size (including number of policyholders) and type of business mean that there is almost no capacity to cause disruption to the interests of a substantial number of policyholders.

40. We also consider the substitutability of the services that the insurer provides, and the extent to which this could mitigate the impact of failure including in stressed circumstances.

41. We use quantitative and qualitative analysis to allocate insurers to categories. Numerical scoring based on insurers' regulatory reporting provides a 'suggested' categorisation which supervisors review in light of qualitative analysis to confirm that it presents a full picture of an insurer's potential impact. Supervisors will seek to consider the lines of business and risks insured by the insurer, and whether these have the potential for significant adverse effects on policyholders if continuity of cover were not to be maintained or obligations not paid. If so, consideration will be given to whether these justify the insurer being placed in a different category from that suggested by the initial quantitative analysis.

42. Insurers are told which category they have been assigned, providing a broad indication of the level of supervisory interaction to expect.

43. The potential impact of failure leads to an allocation of supervisory resources through our categorisation of firms. Supervisory resources are allocated to where there is the greatest potential for harm. This is the starting point for our allocation of resources to protect policyholders. Additional specialist resources are targeted on those areas that could pose most risk to policyholders for in-depth review, such as the valuation of assets not traded in the market, or whether insurers are making prudent provision for the future payments they expect to make.

External context

44. Any assessment of the risks facing insurers requires an appreciation of the external context in which they operate. Our assessment therefore includes consideration of system-wide risks, for example, from low interest rates or rising credit spreads, and sectoral risks, for example, medical improvements affecting longevity risk. This can also include operational risks, such as the evolving cyber threat.

45. We draw on work by other parts of the Bank, including the views of the FPC on the macroprudential environment. Sectoral analysis to understand key market developments over the medium term draws upon both market intelligence and, where appropriate, standardised

information from insurers.¹² We also consider actions by other regulators, including the FCA, that might materially affect the prudential soundness of PRA-regulated insurers.

Business risk

46. Business model analysis forms an important part of our supervisory approach. We examine threats to the viability of an insurer's business model, and the ways in which an insurer could create adverse effects on other participants in the system by the way it carries on its business, including as a result of operational failures. The analysis includes an assessment of where and how an insurer makes money, and the risks it takes in doing so. Insurers are assessed at the level of the insurer or the sector as appropriate.

47. For those insurers posing greater risk to policyholders or the stability of the system, the analysis is more detailed; it includes a review of the drivers of profitability, risk appetite, performance targets and underlying assumptions, and an insurer's own forecasts and their plausibility. We use this analysis to form a projection of the insurer's ability to achieve its business and capital plans and associated risks over the medium term. This projection, and the general picture that supervisors form of the nature of the business, guide our work in assessing the adequacy of the management actions the insurer has available to mitigate risk. If we believe that mitigating measures alone cannot adequately reduce material risks to safety and soundness and policyholder protection, the insurer will be required to change its plans.

48. Peer analysis forms an important part of this assessment, providing a diagnostic tool to highlight where individual institutions may be outliers relative to their sector and so in need of further analysis. Such analysis also supports an understanding of common sectoral risks that have the potential to affect the stability of the system.

Management and governance

49. It is the responsibility of each insurer's board and management to manage the insurer prudently, consistent with its safety and soundness and the appropriate protection of policyholders, and thereby contributing to the stability of the financial system.¹³

50. Boards and senior management must understand the kind of behaviour that delivers an acceptable level of safety and soundness from the perspective of policyholders and the financial system, and act accordingly. This includes following our policies in line with their spirit and intended outcome, not managing the business only to the letter, or gaming the rules. And it includes embedding the principle of safety and soundness in the culture of the whole organisation. Without such effective, prudent management and governance, it is not possible for insurers to ensure their own safety and soundness.

51. Diversity plays an important role in promoting good governance. There is a risk that groupthink undermines good governance in firms, leading to decisions that undermine the safety and soundness of firms. The board must include diversity of skills, approach and

¹² Data reported in a pre-agreed format by a defined set of insurers, using common definitions.

¹³ Supervisory Statement (SS) 5/16 'Corporate governance: Board responsibilities' sets out further information for the boards of PRA-regulated firms on those aspects of governance to which we attach particular importance and may devote particular attention in the course of our supervision: <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss>.

experience to provide effective challenge. Firms should consider diversity when recruiting members to the governing body.

52. This requirement for an insurer to be 'fit and proper' is in addition to the obvious need for an insurer to comply with all applicable laws, rules and regulations, including the Threshold Conditions, and our Fundamental Rules. These obligations are extensive and not limited to the laws, regulations and rules enforced by us. This is because other laws and regulations, for instance, conformity with tax laws, could affect an insurer's fitness and properness, and the probity and reputation of its management. In addition, its senior managers and directors must observe all the conduct rules or standards that apply to them.

Culture and behaviour

53. We expect insurers to have a culture that supports prudent management. We do not have any 'right culture' in mind when making our assessment; rather we focus on whether boards and management clearly understand the circumstances in which the insurer's solvency and viability would be under question, whether accepted practices are challenged, and whether action is taken to address risks on a timely basis. In particular, we want to be satisfied that designated risk management and control functions carry real weight within insurers and that consideration is given to the wide range of risks facing insurers.

54. The Senior Managers and Certification Regime (SM&CR) establishes the link between seniority and accountability: strengthening individual accountability and also reinforcing collective responsibility. Accordingly, we expect insurers to allocate clear responsibilities to individuals performing Senior Management Functions (SMFs) and to document them in a clear, concise and effective manner. SMFs are subject to a number of statutory and regulatory requirements designed to strengthen their accountability internally and vis-à-vis the PRA and FCA. This includes a 'duty of responsibility' whereby they are required to take reasonable steps to prevent or stop regulatory breaches in their area of responsibility; and a requirement to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility effectively. Moreover, senior management committees (and other similar forums) should operate in a spirit of collective responsibility, rather than simply placing the burden on the committee chair who holds the Senior Management Function (SMF) responsibility. We expect firms to have in place sufficient controls to minimise incentives for excessive risk-taking by management and staff. Remuneration and incentive structures should reward careful and prudent management.¹⁴

Competence

55. Firms must be run by people who are competent to fill their roles. This means ensuring that individuals 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,

¹⁴ SS10/16 'Solvency II: Remuneration requirements' sets out some more detailed PRA expectations on the design and application of remuneration policies, practices, and procedures by insurers. <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-remuneration-requirements-ss>.

and as the challenges it faces change, it may need different board members and management.¹⁵

56. It is the responsibility of a firm's board to ensure that individuals appointed to SMFs are competent to fill them.¹⁶

Structures

57. We expect insurers to have in place clear structures of accountability and delegation of responsibilities for individuals and committees, including checks and balances to prevent dominance by an individual. Senior individuals remain accountable for the actions of those to whom they delegate responsibilities, including where insurers use third parties in respect of outsourced functions. Insurers within the scope of Solvency II are required to maintain a governance map that shows the responsibilities for each senior individual, as well as their lines of reporting and accountability both within the insurer and the wider group, where applicable. The objective for firms and groups should be to have a clear, unambiguous, and effective structure of responsibility with a clear governance map.

58. Not all legal entities within a group are necessarily directly regulated. Nonetheless, unregulated group entities can be important to the functioning of the group as a whole (for instance, by providing important support services), or can undertake activities which have the potential to create risks for the group as a whole and so for authorised insurers. As a result of the responsibilities of their holding companies and their regulated entities, we expect all boards of regulated legal entities within groups to have regard to our objectives.

59. These requirements on the boards and executive management of legal entities within groups apply equally to overseas insurers that establish separately incorporated entities within the UK. In particular, we expect boards and senior management of these insurers to have proper regard to our objectives, both for the group as a whole and for individual insurers (and subgroups) in the UK, since issues at the parent or group level could have an effect on the PRA-authorised entity and our objectives more generally.

60. Insurers are able to operate in the UK as branches of overseas legal entities, meaning that there is no separate legal entity in the UK. Such branches can take one of two forms: those where the legal entity overseas is located within the European Economic Area (EEA); and those located outside the EEA (third country branches). Regardless of the corporate structure and location of the parent, we expect all UK branches, like UK subsidiaries, to act responsibly in a manner that is consistent with safety and soundness and the appropriate protection of policyholders. We expect branches to appoint a senior individual as head of the branch with

¹⁵ For more information see <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss> and <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss>.

¹⁶ For more information see SS6/15 referenced above on board responsibilities see: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss516>.

authority to act as a primary contact with us in relation to their affairs. This individual should also act as a channel for communication with the head office.¹⁷

Senior Managers and other individuals performing key functions

61. We have the power under the Act to require individuals in identified roles with a significant influence on the affairs of an insurer (SMF roles), and who are critical to the advancement of our objectives, to seek our approval before taking up their position. Such individuals are known as Senior Managers. Approval is granted only if we, as prudential regulator, and the FCA, as conduct regulator, are both satisfied that an individual is fit and proper. In addition, firms themselves should carry out appropriate checks before appointing Senior Managers and satisfy themselves that they are fit and proper for their intended role.¹⁸

Disciplinary action against individuals

62. While our preference is to use our statutory powers prospectively to secure remedial action, we also have a set of disciplinary powers which we will use retrospectively if necessary.

63. We have disciplinary powers over individuals approved to perform an SMF by us or an equivalent function by the FCA (eg as a member of the governing body) and are empowered to use these where an individual fails to comply with our Conduct Rules, or has been knowingly involved in a contravention by their firm of a requirement imposed by us. The powers enable us, among other sanctions, to impose penalties to censure an individual publicly, to withdraw approval from individuals holding SMFs, and to prohibit individuals from holding SMFs in the future.

64. In assessing whether to take disciplinary action against a Senior Manager or director, we consider a variety of factors, including:

- the impact the individual's behaviour has had, or is having, on us advancing our objectives, including the behaviour of other persons in the insurer over whom the individual should exercise control, and thus whether that behaviour calls into question the person's fitness and properness (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 our requirements, from committing similar or other breaches; and
- the individual's behaviour towards us, including the level of co-operation and openness with which the individual deals with us, and the appropriateness of the individual's actions in response to concerns raised.

Risk management and controls

65. Insurers should have robust frameworks for risk management, including for financial and operational risks. Controls should be commensurate with the nature, scale and complexity of

¹⁷ For more information on international insurers see Supervisory Statement 2/18 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision': <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/international-insurers-pras-approach-to-branch-authorisation-and-supervision-ss>.

¹⁸ See information on strengthening individual accountability in insurance: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss>.

their business. Competent and, where appropriate, independent control functions should oversee these frameworks. Boards should ensure they receive adequate and timely information on key risks and variance from the insurers agreed risk appetite to enable them to monitor and challenge executive management.

66. We expect insurers to articulate for themselves the amount of risk they are willing to take across different business lines to achieve their strategic objectives. This risk appetite should be consistent with our objectives, and the insurer should pay appropriate attention to identifying, measuring and controlling risks, including those arising in unlikely but very severe scenarios.

67. We expect key decisions, both on assuming new risks and managing existing ones, to be taken at the appropriate level, including, where they are sufficiently important, at the level of the board. Risks should be reported to the board and senior management on a timely basis, with risks outside the agreed risk appetite and key sensitivities highlighted.¹⁹

Control framework

68. An insurer's control framework encompasses the processes, delegated authorities and limits that put into effect an insurer's approach to risk management and control, both operational and financial. We expect an insurer's control framework to be comprehensive in its coverage of the whole firm and all classes of risk, to be commensurate with the nature, scale, and complexity of the insurer's business, and to deliver a properly controlled operating environment (including, for example, through segregation of duties and reconciliations or through the processes to report and act on any breaches of limits).

69. We expect insurers to have high standards in the management of operational as well as financial risks. For example, insurers should have procedures in place to ensure continuity of services they provide, such as the payment of claims to policyholders. Insurers are expected to comply with standards for resilience, including where they outsource material operational functions to third parties.

70. We expect insurers to have available the information needed to support their control frameworks. This information should be of an appropriate quality, integrity, and completeness to provide a reliable basis for making decisions and to control the business within agreed tolerances and should be produced in a sufficiently timely manner. It should be able to be accessed and analysed in aggregate for the business as a whole, across the group, and for each business line and legal entity within it, to facilitate understanding and swift management of the risks to which the insurer is exposed.

71. Insurers should have in place separate risk management and control functions (notably risk management, finance and internal audit) to the extent warranted by the nature, scale, and complexity of their business. We expect these functions to support and challenge the

¹⁹ SS4/18 'Financial management and planning by insurers' sets out our expectations concerning the development and maintenance of a risk appetite statement; how to apply their risk appetite when developing and monitoring medium-term business plans; and the assessment of the suitability and sustainability of capital distribution plans in the context of this risk appetite: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss>.

management of risks across the business as a whole by expressing views on the appropriateness of the level of risk being run and the adequacy and integrity of the associated governance, risk management, financial, and other control arrangements.

Operational resilience

72. Operational resilience refers to the ability of firms to keep going operationally as well financially. In a context of firms' increasing reliance on digital systems and platforms, and the risk of cyber-attacks, our supervisory approach in this area is evolving.

73. A discussion paper, published jointly in July 2018 by the PRA, FCA and Bank,²⁰ signalled that our supervisory approach in this area will primarily be focused on the continuity of the business services that a firm's customers and the wider economy rely upon. As part of this, we expect firms to develop impact tolerances. These should acknowledge that disruptive events will happen. Firms need to be able to recover within their set tolerance for a wide range of severe but plausible scenarios.²¹

74. Most banks and insurers may well decide to set their impact tolerance tighter than required by us. They are likely to experience private costs before their safety and soundness is at risk. Nevertheless, in line with our statutory obligations (see Chapter 1), firms doing activity where operational disruption could have a financial stability impact, will be held to higher standards (including more prudent impact tolerances) than smaller firms. Firms' operational resilience is the responsibility of their boards. We require firms to have clear lines of accountability for their operational resilience, through responsibility for the internal operations and technology of the firm. Boards should ensure there is sufficient challenge to the executive and that they have access to people within the business with appropriate technical skills.

Financial resources

Capital

75. Capital is required to allow for uncertainty over the valuation of both liabilities and assets. Having enough capital of sufficiently high quality reduces the risk of an insurer becoming unable to meet the claims of its policyholders and creditors. It is therefore crucial for maintaining their level of protection.

76. The Solvency II regime compares the level and quality of capital held by an insurer (including the firm's ability to raise more capital if needed) with the capital requirements applicable to that firm. These requirements are calculated to ensure that the insurer could still pay out to policyholders after the occurrence of a 1-in-200 year stress event, where the stress event used in the calculation reflects the risk profile of the particular insurer.

77. Our supervisory process also seeks to consider whether an insurer has plausible recovery and resolution actions that it could take, including in times of general market stress.

²⁰ For more information see DP1/18 'Building the UK financial sector's operational resilience': <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>.

²¹ See 'Good cop/bad cop' – speech by Sam Woods, the Deputy Governor for Prudential Regulation and the Chief Executive of the PRA at <https://www.bankofengland.co.uk/speech/2018/sam-woods-mansion-house-city-banquet>.

Application of the Own Risk and Solvency Assessment (ORSA)

78. We expect insurers to take responsibility for maintaining an appropriate level of capital at all times, and the preparation and application of an appropriate ORSA is expected to be central to this.

79. The PRA expects insurers to set a risk appetite for the levels of capital that are to be maintained in reasonably foreseeable market conditions: for example, as assessed through stress and scenario tests, or through some suitable alternative approach, to provide no more than a '1 in x' probability that the Solvency Capital Requirement (SCR) coverage might fall below 100%.²² If an insurer's capital management policies are calibrated such that frequent or foreseeable breaches of the SCR are likely to occur, the PRA may consider whether the insurer is meeting the requirement to have in place an effective system of governance. Similarly, if the level of capital of an insurer regularly or persistently falls outside of its risk appetite, or an insurer makes frequent changes to its risk appetite for its planned levels of capital, the PRA may consider whether this indicates failings in the governance process by which the insurer sets its risk appetite.

80. The ORSA should help to ensure there is an effective link between a firm's business plan, risk appetite, and capital management plans. It should include an analysis of the firm's risk profile, as well as a series of financial projections, along with suitable stress and scenario tests showing how the firm would plan to maintain adequate financial resources in changing conditions.²³

Quality of capital

81. We expect all capital to be capable of absorbing losses in the manner indicated by its place in the capital structure. Solvency II sets out the types and quality of capital which can be recognised as permissible capital instruments for insurers. We will object to insurers issuing regulatory capital instruments that are deliberately structured to meet the letter but not the spirit of these criteria, notably where their incentive is to minimise issuance cost and promote the attractiveness to investors at the expense of genuine loss-absorbing capacity.

82. Lower-quality capital (for example, Tier 2 debt), and other forms of loss-absorbing capital, may not prevent a firm's failure, but they can play a role if an insurer has failed. Since costs incurred by the FSCS are mutualised, an insurer's capital, including subordinated loan capital, can help reduce the impact of failure on other insurers. Such capital can also be valuable in the event of an insurance business being transferred from an insurer that has entered, or is about to enter, an insolvency proceeding.

²² See SS4/18 for information on setting a risk appetite for SCR coverage: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss>.

²³ Further guidance on the ORSA can be found in SS19/16 <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-orsa>.

Location of capital

83. We are mindful that capital resources are not always freely transferable around a group when it matters most. Therefore, we expect capital to be located in the regulated entities where it is needed. Policyholders', creditors' and counterparties' claims are on specific legal entities, not on groups, and should an insurer fail, its orderly resolution will be facilitated if individual legal entities, and UK subgroups, hold capital commensurate with their risks. We expect groups to assess the extent to which capital resources of entities in a group would be available to absorb losses elsewhere in the group and for groups to be adequately capitalised on a group basis after taking account of our views on availability.

The framework for determining regulatory capital

84. We expect insurers to take responsibility for maintaining at all times an adequate level and quality of capital, taking into account the risks to which they are exposed, and consistent with their safety and soundness and the protection of policyholders. Capital should be sufficient to absorb unexpected losses, including those arising from uncertainties about provisions and valuations, in a wide range of severe but plausible stresses, both market-wide and firm-specific.

85. We expect insurers, in scope of Solvency II, to manage their capital such that the SCR and the Minimum Capital Requirement (MCR) are not breached in the absence of a severe stress event. This overall approach is designed to maintain the confidence of an insurer's creditors and ensure the protection of its policyholders, even in stressed circumstances.

86. We form judgements about how insurers appropriately reflect their risk profile in determining their SCR, given the risks to which they are exposed and uncertainties about the values of assets and liabilities. We assess the extent to which the insurer has considered life and non-life underwriting risks and credit, market, and operational risks adequately in its assessment of capital adequacy, and also assess the scale of other risks which the insurer faces. We expect insurers to take responsibility for determining the appropriate method for the calculation of their SCR, and to ensure the appropriateness of that methodology over time.

87. We expect Solvency II insurers to develop, as part of their ORSA, a framework for stress testing and solvency assessment. This framework should include financial projections that enable them to monitor the assumptions underlying their assessments, and the significance of any volatility in their earnings or in their capital. The projections should encompass a range of severe yet plausible scenarios. In assessing risk, we expect insurers and insurance groups to employ a range of stress-testing techniques proportionate to the nature, scale and complexity of their business. In support of this, we expect all insurers to ensure that assets and liabilities are appropriately valued and that technical provisions are adequate. We expect Solvency II insurers to develop, as part of their ORSA, a framework for stress testing and solvency assessment.

88. We expect insurance groups to consider the cash flow implications of these financial projections, including under stressed conditions. In particular, groups should assess whether they will still be able to generate sufficient available cash flows in the stress scenario (eg from surpluses or dividends from other subsidiaries). These cash flows should cover any payments

of interest, or capital on loans to finance new business and to meet proposed group dividends, along with any other anticipated group liabilities as they fall due.

89. Insurers and groups are expected to develop, as a matter of routine, planned management actions in response to stress scenarios that are realistic, credible, consistent with regulatory expectations, and achievable, and which should be approved by their boards. They should also consider whether any of the actions identified should be taken in advance as precautionary measures, or whether they would be relevant or desirable only in the stress scenario. Such plans, designed to return insurers to a stable, sustainable position following firm-specific or market-wide stress, should include options to address capital shortfalls through generating capital internally and externally. Plans to generate capital internally should include restricting dividends and variable remuneration. We assess the appropriateness of insurers' plans in terms of the adequacy of the recovery options identified and the triggers and governance to activate them.

90. We analyse a firm's financial strength to assess the adequacy of its solvency position on a forward-looking basis, including in times of stress when asset valuations may become strained and the adequacy of technical provisions may, in consequence, come under stress. It is important that firms exercise appropriate and adequate oversight of the valuation processes. Underwriting concentrations and performance are also considered, including reviewing sensitivities to longevity and discount rate assumptions.

91. For Solvency II firms, we come to a view on whether the method of calculating the SCR (eg whether using the standard formula, the standard formula with Undertaking Specific Parameters, or a full or partial internal model) adequately reflects the particular risks an insurer is exposed to. Our view is informed by the insurer's own assessments, but also reflects our views of the risks to our objectives.

92. We have particular regard to the idiosyncratic risks facing the insurer, in the context of its business model, the wider circumstances or external context, and the effectiveness of the insurer's governance and of its management of the risks it faces.

Internal capital models

93. Internal capital models should be supported by adequate testing and validation on an ongoing basis. Insurers will be expected to explain any significant changes in capital requirements arising from modelled approaches. Insurers should not use internal modelling as a way to lower capital requirements and, in particular, when assessing changes to be made to the model, insurers should pay attention to risks for which capital need is increasing and avoid a biased focus on risks for which capital need might be decreasing.²⁴

94. Senior management and the board should understand the extent of any reliance on models for managing risk, as well as the limitations from the structure and complexity of models, the data used as inputs and key underpinning assumptions. Models, and their output, should be subject to effective, ongoing, and independent validation to ensure that they are

²⁴ For more information please see <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss>.

performing as anticipated. We expect senior management to have a clear understanding and advise the board of key assumptions supporting the models, the risks that are not adequately captured by them, and the alternative risk management processes in place to ensure that such risks are adequately measured and incorporated into the firm's overall risk management framework.

95. We monitor 'model drift' – the risk that capital requirements calculated using an internal model drift lower over time - as one of the tools to help ensure that capital requirements continue to reflect the risk to which insurers are exposed. The internal model SCR is compared to other measures of risk including the standard formula SCR, pre-corridor MCR, net written premiums, and best estimate liabilities. Supervisors expect insurers to explain any significant model drift over time.

Liquidity and funding

96. We expect all insurers to take responsibility for ensuring that there is no significant risk that they cannot meet their liabilities as they fall due, and to have appropriate risk management strategies and systems in place for managing their liquidity.

97. Insurers should consider the risk of losing collateral they have posted and the assumptions they make about the ease of replacing trades in managing their liquidity.

98. We also expect insurers to manage the liquidity risks associated with holding material derivative positions appropriately, including demonstrating that they can deal with the requirements of the European Market Infrastructure Regulation (EMIR). Derivative positions have the potential to cause liquidity shocks to insurers and such shocks may not necessarily have capital implications where extensive hedging is used. A liquidity requirement will arise where the value of the derivative moves against the insurer or the value of the posted collateral. Further stress may be caused with derivatives that are centrally cleared, as these will require insurers to post cash variation margin against movements in the derivative value.

99. Liquidity resources are not always freely transferable around a group when it matters most, and also that they may be transferred away from one area which needs them to support other areas. We therefore expect liquidity to be available without impediment, including in stressed times, in the regulated entities where it is needed. For life insurers, we expect liquidity to be adequate in the portfolio as a whole and in its component funds. This includes not only the shareholders' funds, non-profits funds and with-profits funds, but also unit-linked funds. Insurers should ensure that the liquidity in these funds is adequate in stressed conditions as well as normal business conditions. We may sometimes require insurers to hold additional liquidity where we anticipate a specific stress event.

Resolvability

100. One of the key channels through which insurers can adversely affect our objectives is through disorderly failure which disrupts continuity of critical functions, causes dislocation in financial markets and results in spill-overs to the wider economy.

101. To mitigate this risk, it is important for there to be mechanisms by which all types of insurer supervised by us can exit the market in an orderly manner: that is, with minimal

disruption to the supply of critical functions, including the degree of continuity for policyholders' cover against insured risks (delivered either through continuity of cover or through compensation or other payments for premiums paid). An insurer's resolvability reflects the extent to which it can exit the market in such an orderly manner, preserving the supply of critical functions and minimising adverse effects on financial stability and the wider economy, consistent with our objectives, and without exposing taxpayers to loss.

102. At present, the UK does not have a special resolution regime for insurers. When insurers fail, they exit the market via:

- *Run-off*: the firm is closed to new business and the liabilities 'run off' over time. Insurers may use a scheme of arrangement approved by a court under the Companies Act to agree a compromise with their creditors and to accelerate the process. Accelerating run-off can involve transfers of liabilities to another insurance company through a court sanctioned process known as a Part VII transfer.²⁵ In such a transfer we will work closely with the Independent Expert appointed on behalf of policyholders to ensure that the policyholders affected by the transfer, whether directly or indirectly, because they are a policyholder of one of the parties to the transfer, are not disadvantaged by it.
- *Statutory reorganisation or winding-up*: an insurer that is insolvent may enter a modified administration or liquidation procedure. The administrator of a failed insurer is required to continue to carry on the insurer's business so far as that business consists of carrying out the insurer's contracts of long-term insurance with a view to the business being transferred out as a going concern. Such continuity might be achieved by reducing the value of policies, by transferring policies elsewhere, or by finding replacement cover. The FSCS provides compensation to eligible policyholders for claims against insurers that are declared to be in default, or seeks to ensure continuation of cover.

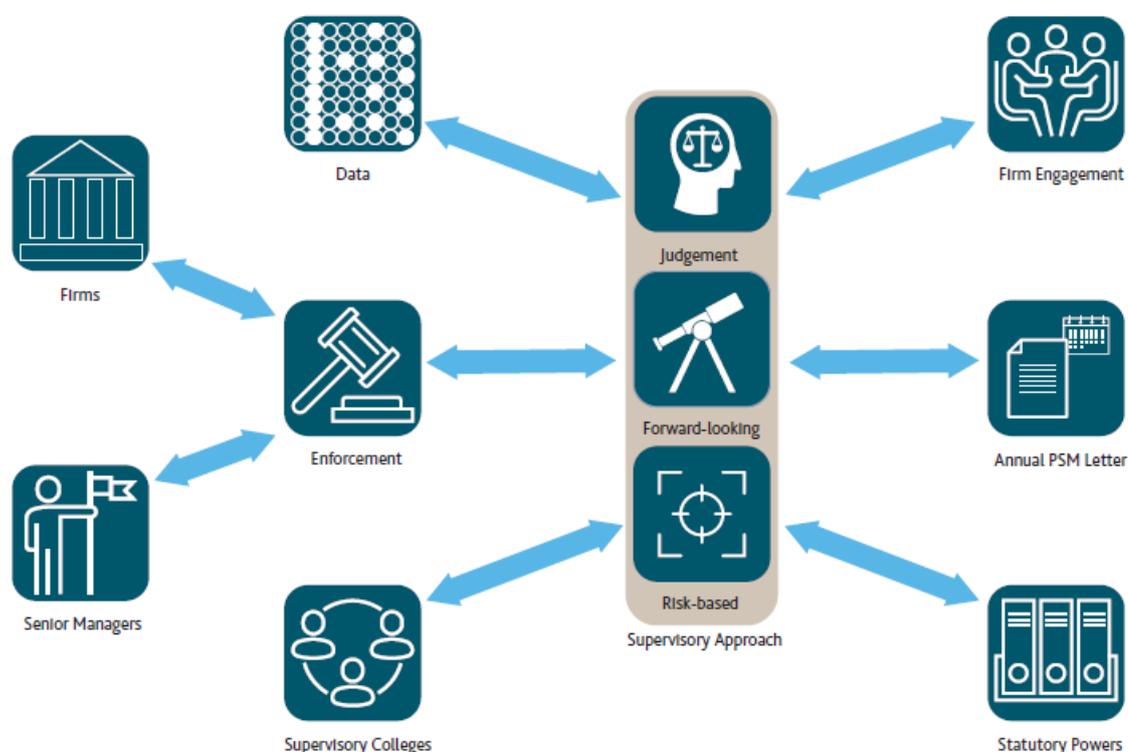
103. These arrangements vary in the extent to which they have been put into practice. For example, to date no life insurance firm of a significant size has failed and required compensation from the FSCS to be paid to its policyholders (although the FSCS has paid compensation in relation to such failures that occurred prior to its inception). Nor has an insurer with a large derivatives portfolio been put into insolvency in the UK. But that does not mean such events could not happen, and it is not clear that existing arrangements would be adequate in such an eventuality.

²⁵ For more information on insurance business transfers see: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-insurance-business-transfers>.

4 Supervisory activity

This section describes how, in practice, we supervise insurers, including information on our highest decision-making body (see Box 2) and our approach to authorising new insurers (see Box 3). As part of this, it describes the Proactive Intervention Framework (PIF) and our high-level approach to using our legal powers. For UK insurers, our assessment covers all entities within the consolidated group.

Figure 3: Supervisory activity



104. Our supervision involves engagement with insurers at all levels of seniority. At a senior level, boards as a whole, and the non-executive directors in the absence of executive management, should expect regular dialogue with us, either in groups or on an individual basis. We always focus on material issues in our engagement with insurers.

105. We are not formulaic about the supervisory activity we perform, since the focus on key risks means that this activity depends inevitably on an insurer's particular circumstances. Nonetheless, our supervisory work comprises a selection of possible activities described below.

Supervisory activities and tools

106. In forming supervisory judgements, we draw on a broad set of quantitative and qualitative information and data. Supervisors require insurers to meet the legislative

requirements of Solvency II in relation to regulatory reporting and disclosure to submit sufficient data, of appropriate quality, to support their judgements about key risks.

107. We gather and analyse information on a regular basis, for example through regulatory returns.²⁶ We also gather and analyse relevant information in the public domain, for example insurers' annual reports and disclosures.

108. To support our detailed information gathering and analysis, we require insurers to participate in meetings with supervisors at a senior and working level. Some discussions are strategic in nature, while other interactions focus on information-gathering and analytical work. For Category 1 and 2 insurers (as referred to in paragraph 115), we also conduct detailed onsite testing or reviews of particular areas. These cover asset quality, underwriting, reserving, reinsurance, capital management, liquidity management, financial and operational risk management, and governance. Such reviews involve discussions with staff, reviews of internal documents and testing. In addition, we may review an insurer's approach to stress testing, or undertake bespoke stress testing of our own. We involve our risk specialist, actuarial, and other technical staff in onsite work, stress testing, and other assessments as appropriate. Where we feel we can rely on their effectiveness, we may use insurers' risk, compliance, internal audit, and actuarial functions to identify and measure risks.

109. Insurers' external auditors can and should play a role in supporting prudential supervision, given their ability to identify and flag to us current and potential risks in an insurer. As required by the Act, we maintain arrangements to provide an insurer's external auditors with relevant data and information, for example, if we consider an insurer's valuation of less liquid assets, or its approach to reserving to be significantly out of line with its peers, as well as exchanging opinions with those auditors as to the implications of such information. We expect to work with insurers' external auditors in an open, co-operative and constructive manner and will maintain rules setting out the duties external auditors have to co-operate with us in connection with our supervision of PRA-authorised firms. We expect auditors to disclose to us emerging concerns within insurers where this would assist us in carrying out our functions. We have published a Code of Practice detailing the arrangements we maintain with firms' external auditors to promote a mutually beneficial and constructive relationship.²⁷

110. Given their role in assessing the risks to which an insurer is exposed, actuaries can play an important part in supporting prudential supervision. Full, regular and timely dialogue between actuaries and supervisors should form a key part of supervision, so we seek also to maintain a constructive relationship with actuaries, as a profession and individually, enabling us to understand and critically challenge actuarial judgements within insurers. Engagement

²⁶ We consider that some firms may be eligible for the limitation of regular supervisory reporting where the predefined submission period is less than one year, as set out in Article 35(6) of the Solvency II Directive. We will grant this limitation through a waiver. Specifically, we consider that Category 4 and 5 firms, whether solo or part of a group, meet the requirements of exemption from quarterly reporting. For more information see SS11/15 'Solvency II: Regulatory Reporting and exemptions': <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-regulatory-reporting-and-exemptions-ss>.

²⁷ More detail is available in the Statement of Policy 'The Bank of England's power to direct institutions to address impediments to resolvability': <https://www.bankofengland.co.uk/paper/2015/the-boes-power-to-direct-institutions-to-address-impediments-to-resolvability-sop>.

with the Financial Reporting Council (FRC) Board and its advisory Actuarial Council, and the Institute and Faculty of Actuaries is an important part of this dialogue.

111. To assist with our risk assessment, we may at times use our statutory powers, in particular our information-gathering power and our power to commission reports by Skilled Persons on specific areas of interest (under sections 165, 165A, 166 and 166A of the Act). Such reviews can be undertaken where we seek additional information, an assessment, further analysis, expert advice and recommendations, or assurance around a particular subject. We may enter into a contract with a Skilled Person directly, following a transparent and consistent approach to selecting and appointing them, or we may allow the regulated firm to contract with the Skilled Person. We are always regarded as the end user of a Skilled Person report regardless of the appointment approach taken.

112. We also make use of the FCA's findings on insurers' key conduct risks and any material prudential risks in relation to FCA-authorised subsidiaries of dual-regulated groups where they are materially relevant to our objectives.

113. Our onsite reviews are not designed to uncover all instances of malpractice. Rather, we aim to assess the adequacy of an insurer's control framework in preventing operational risk (including serious fraud) that could disrupt the provision of its services, threaten its safety and soundness and impact the protection of policyholders, drawing to the attention of the relevant authorities any suspicion or information that may be of material interest to us.

Using powers in the course of supervision

114. If deemed necessary to reduce risks, we have a variety of formal powers available to us under statute which we can use in the course of supervision. These include powers by which we can intervene directly in a firm's business. For example, we may vary an insurer's permission or impose a requirement under Part 4A of the Act to prevent or curtail an insurer from undertaking certain regulated activities, which may require a change to an insurer's business model or future strategy.

115. While we look to insurers to co-operate with us in resolving supervisory issues, we will not hesitate to use formal powers where we consider them to be an appropriate means of achieving our desired supervisory outcomes. This means that in certain cases we will choose to deploy formal powers at an early stage and not merely as a last resort.

116. We consider when and how to use our formal powers, and assess the particular facts and circumstances, on a case-by-case basis. In all cases, we are likely to consider a number of factors in connection with the possible deployment of such powers, including:

- the confidence supervisors have that insurers will respond appropriately to our requests without the use of powers;
- our view of the insurer's proximity to failure, as reflected in its position within the PIF; and
- the likely impact, on policyholders and the stability of the system, of the firm's failure.

117. In addition, we may use our powers to approve or allow certain changes requested by insurers (eg in its permissions to perform regulated activities or outward passporting of a UK insurer). Where those changes could adversely affect our objectives, we may use our powers to refuse such requests.

118. We have a power to impose a requirement under Part 4A, section 55M of the Act on a firm to undertake or cease a particular action. One of the grounds for exercising this power is if it appears to us that it is desirable to exercise the power to advance any of our objectives.

119. There is substantial flexibility for us to tailor requirements specific to the circumstances of a firm and the nature of our concerns, including serious cultural failings.

120. It may also be appropriate to use our own-initiative variation of permission power under section 55J of the Act to change the firm's permissions in certain circumstances, or to agree a voluntary variation of permission with the firm.

121. We do not have to publicise the imposition of requirements if publication would be unfair to the person concerned, prejudicial to the safety and soundness of a firm, or prejudicial to securing the appropriate degree of protection for policyholders.²⁸

Proactive Intervention Framework (PIF)

122. Supervisors consider an insurer's proximity to failure when drawing up a supervisory plan. Our judgement about proximity to failure is captured in an insurer's position within the PIF.

123. Judgements about an insurer's proximity to failure are derived from those elements of the supervisory assessment framework that reflect the risks faced by an insurer and its ability to manage them, namely, external context, business risk, management and governance, risk management and controls, capital, and liquidity. The PIF is not sensitive to an insurer's potential impact or resolvability.

124. The PIF is designed to ensure that we put into effect our aim 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 insurer sits in a particular stage at each point in time (see Figure 4). When an insurer moves to a higher PIF stage (ie as we determine the insurer's viability has deteriorated), supervisors will review their supervisory actions accordingly. Senior management of insurers 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. The intensity of supervisory resources will increase if we assess an insurer has moved closer to breaching Threshold Conditions, posing a risk of failure and harm to policyholders (see Figure 4).

125. An insurer's PIF stage is reviewed at least annually and in response to relevant, material developments.

²⁸ For more information see the Statement of Policy 'The use of PRA powers to address serious failings in the culture of firms' June 2014: <https://www.bankofengland.co.uk/prudential-regulation/publication/2014/the-use-of-pra-powers-to-address-serious-failings-in-the-culture-of-firms>.

126. We consider it important for markets and counterparties to make their own judgements on the viability of an insurer. We will not therefore routinely disclose to the market our own judgement on an insurer’s proximity to failure, not least given the possible risk that such disclosures could act to destabilise in times of stress. As a result, we do not routinely disclose PIF scores to firms.

Figure 4: Stages in the Proactive Intervention Framework

| Stage | Possible supervisory actions |
|--|---|
| <p>Stage 1 – Low risk to viability of insurer</p> | <ul style="list-style-type: none"> – Insurer subject to the normal supervisory risk assessment process and required to plan for stressed conditions and identify appropriate recovery actions or exit strategies. – We assess insurer resolvability. |
| <p>Stage 2 – Moderate risk to viability of insurer Supervisors have identified vulnerabilities in an insurer’s financial position of deficiencies in its risk management and/or governance practices.</p> | <p><i>Recovery</i></p> <ul style="list-style-type: none"> – The intensity of supervision will increase and the insurer will be required to reassess the appropriateness of recovery actions and exit strategies. – We may set additional reporting requirements, and make use of information gathering and investigatory powers. – We will review the insurer’s risk profile and the regulatory capital requirements and consider realigning the latter, as well as setting restrictions on the insurer’s activities until remedial actions have been completed. <p><i>Resolution</i></p> <ul style="list-style-type: none"> – We will identify and instigate any initial contingency planning needed, potentially including information gathering and liaison with the FSCS. |
| <p>Stage 3 – Risk to viability absent action by the insurer Significant threats to an insurer’s safety and soundness have been identified</p> | <p><i>Recovery</i></p> <ul style="list-style-type: none"> – The insurer may be required to submit a recovery plan designed to address specific policyholder protection issues that have been identified, current problems, and to initiate recovery actions in a timely manner to address the vulnerabilities identified. Actions may include: capital raising; asset disposal; and business transfer or sale of the insurer. – Other actions we may require include: changes to management and/or the composition of the board; limits on asset disposal/acquisition or capital distribution; restrictions on existing or planned activities; a limit on balance sheet growth; and an assessment of the effectiveness of risk transfer arrangements such as reinsurance. – At the insurer’s or our initiative, an insurer’s authorisation to carry out new business may be removed. <p><i>Resolution</i></p> <ul style="list-style-type: none"> – We will intensify contingency planning for resolution. – We will co-ordinate with the FSCS to ensure it has obtained the information necessary to evaluate continuity of cover or payout options (this will include an assessment of the potential exposure of the FSCS). |

| | |
|--|---|
| <p>Stage 4 – Imminent risk to viability of insurer The position of an insurer has deteriorated such that we assesses that there is a real risk that the insurer will fail to meet the Threshold Conditions, but some possibility of corrective action remains</p> | <p><i>Recovery</i></p> <ul style="list-style-type: none"> – We may remove the insurer's authorisation to write new business. – Insurer to accelerate and complete recovery actions, demonstrating to us that these have mitigated the imminent risk to the viability of the insurer. <p><i>Resolution</i></p> <ul style="list-style-type: none"> – Working with the FSCS, we will complete all necessary actions for resolution of the insurer including planning for commencement of orderly liquidation or administration and with the assistance of the insolvency practitioner in waiting. |
| <p>Stage 5 – Insurer in resolution or being actively wound up</p> | <p><i>Resolution</i></p> <ul style="list-style-type: none"> – As necessary, we will trigger the appropriate insolvency process and the insolvency practitioner will work with the FSCS and us to effect continuity of cover and/or compensation to eligible claimants. – As appropriate, we will monitor insurers exiting the system. |

Mitigating risk

127. There are annual internal stock-take meetings for all supervisors to discuss the major risks their insurers face, the supervisory strategy and proposed remedial actions, including guidance about the adequacy of an insurer's capital. Major judgements are made by senior and experienced individuals. These formal assessments are also subject to 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.

128. There are clear and direct links between the risks that we identify and the actions we expect from insurers in consequence. For example, if we have identified deficiencies in an insurer's forecasts of earnings, or an excessive level of proposed employee remuneration or dividends to shareholders, leading to risks to its financial health, we will require the insurer to take steps to tackle this. Or the assessment may have revealed that senior management has an inadequate view of the insurer's aggregate exposures, compromising the effectiveness of the insurer's governance and, in consequence, the firm's soundness. We may then expect the insurer to enhance internal systems for monitoring aggregate exposures or to review the design and effectiveness of its governance and reporting lines.

Conveying supervisory messages

129. We send an annual letter to each insurer clearly outlining the key risks that are of greatest concern and on which we require action. The test of materiality for points raised with insurers is high, with a focus on root cause analysis rather than symptoms, and with supervisory interventions clearly and directly linked to reducing risks to our objectives. We expect to verify ourselves that action is taken on these key risks, and communicate to the firm's board when and how we intend to do this. We send individually tailored letters to all insurers, except those with the lowest potential impact where a standard letter outlines issues relevant to all insurers in that group, except where specific issues have been identified with a particular insurer.

130. Insurers may sometimes disagree with our decisions; this is inherent given the tensions between the public and private interest. We discuss issues with insurers in reaching our decision, and carefully consider representations made, not least to ensure that our decisions are made on the basis of all the relevant evidence. However, insurers should not approach their relationship with us as a negotiation.

131. Any less significant issues that have arisen, and of which we feel the insurer should be aware, are conveyed but with the onus on the firm itself to address these. We expect confirmation by the most appropriate senior manager within the firm, for example the CEO or Finance Director, that issues have been closed.

Supervisory colleges

132. We are an active participant in international co-ordination of supervision for major insurers. For UK insurance groups, we organise and chair the supervisory college.

133. To be fully effective, both EEA and worldwide colleges need to operate in a manner which enables supervisors to be open and transparent with each other. As the lead authority and college chair for UK insurance groups, we are prepared to tackle instances where we believe that other authorities are not acting in a manner consistent with our objectives and we encourage other authorities to challenge us if they have concerns.

Box 2: The Prudential Regulation Committee (PRC)

The Prudential Regulation Committee (PRC) was created by the Bank of England Act 1998 and has responsibility within the Bank for exercising the Bank's functions as the PRA, as set out in the Bank of England Act 1998 and the Financial Services and Markets Act 2000.

The PRC makes our most important decisions. It sets the PRA levy, by way of rules, and adopts the budget of the PRA, with the approval of Court. It makes the key supervisory decision in relation to the target firms we supervise. It has a number of non-delegable responsibilities, including the PRA's high-level strategy and policy-making functions. The PRC is accountable to Parliament, in the same way as the Monetary Policy Committee (MPC) and Financial Policy Committee (FPC), the Bank's other statutory decision-making bodies.

The PRC is chaired by the Governor of the Bank of England. Other members of the PRC are: the Deputy Governors for Financial Stability, Markets and Banking, and Prudential Regulation; the Chief Executive of the FCA; a member appointed by the Governor with the approval of the Chancellor; and at least six members appointed by the Chancellor.

Box 3: Authorising new firms

Firms wishing to effect or carry out contracts of insurance must apply to us for authorisation. The application process is a joint assessment between us and the FCA, and we have established a New Insurer Start-Up Unit to help prospective insurers, including a guide.²⁹ We assess applicant firms from a prudential perspective, with the focus of the FCA being on conduct. The applicant firm will only be authorised if both regulators are satisfied that the firm will meet their respective Threshold Conditions, at the point of authorisation and on an ongoing basis. As provided for in the MoU, we lead and manage a single administrative process, and, as the lead regulator, we will act as decision maker on the application.

We set out the information that we require firms to supply to complete our assessment. We stand ready to answer questions where necessary, though this does not extend to providing consultancy on completing applications. Along with the FCA, we have committed to engaging with applicants at an early stage in pre-application meetings, which will aim to produce as complete an application as possible.

We take a proportionate approach to the assessment of applications. All applicants are subject to a minimum level of assessment, beyond which the assessment depends on the potential impact of a firm's failure on the financial system.

We ensure that, at the point of authorisation, and consistent with requirements, new insurers hold capital sufficient to cover the risks that they run.

Our aim through this proportionate approach is for barriers to entry to be kept to the minimum consistent with our objectives, so enabling us to contribute to a competitive insurance market.

Authorising new insurance special purpose vehicles (ISPVs)

Firms wishing to become ISPVs and undertake the regulated activity of insurance risk transformation³⁰ must also apply to us for authorisation. Authorisation will only be granted where both we and the FCA are satisfied that the ISPV meets the relevant requirements. The legal and regulatory requirements governing establishment and operation of ISPVs can be found on our dedicated ISPV webpage³¹ which also outlines the different stages of the authorisation process, including expected timelines.

²⁹ See more information on the New Insurers Start-up Unit webpage: <https://www.bankofengland.co.uk/prudential-regulation/new-insurer-start-up-unit>.

³⁰ As defined in Regulation 13A of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).

³¹ <https://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles>.

5 Tailored application of the Supervisory Approach

We are responsible for supervising a diverse range of insurance companies. These include life, general, wholesale, reinsurance and international companies. Even within these broad categories there is substantial diversity in firm structures and sizes as well as products, which shapes the business models and risks to which these insurers are exposed. We tailor our application of the supervisory assessment framework to take account of this diversity.

The Society of Lloyd's and the Lloyd's market

133. We are the prudential supervisor of the Society of Lloyd's and the managing agents that operate within the Lloyd's market.

- We supervise the Lloyd's market to the same standards as regulated firms in the insurance market outside of Lloyd's. But the unique legal framework of Lloyd's means that we need to tailor our approach.
- Supervision is carried out at two levels: i) the Society of Lloyd's itself (which provides central functions, including the maintenance of the New Central Fund);³² and ii) each of the managing agents (which carry out the underwriting and risk management functions for Lloyd's members).

134. We have powers to intervene directly with individual members of Lloyd's (or with all of them together) and/or to direct the Council or the Society (acting through the Council) if we determine that such action is necessary for the purpose of advancing our objectives.

135. An MoU between us and the FCA sets out how we co-ordinate in respect of the supervision of the Lloyd's market. In general we and the FCA will consult with the other before using a power of direction over members and, in particular, will obtain consent from the other when exercising powers to require members of Lloyd's to become authorised. We have a co-operation agreement with the Society of Lloyd's which sets out how we and the Society envisage working together to ensure the effective supervision of managing agents.

With-profits insurers

136. A separate MoU sets out how we work together with the FCA to protect the interests of with-profits policyholders appropriately.³³ Special arrangements are needed because the returns on with-profits policies are not well defined, and are at the discretion of the insurer.

³² As provided for in the Lloyd's New Central Fund Byelaw (Number 23 of 1996).

³³ Available at <http://www.bankofengland.co.uk/about/Pages/mous/default.aspx>.

137. We seek to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness. The FCA has responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications to policyholders, the FCA's conduct rules, and the insurer's overriding obligation to treat customers fairly.

138. There may be circumstances where the proposed discretionary benefit allocations call into question the safety and soundness of the firm as a whole and so its ability to meet its obligations to policyholders generally. In such circumstances, we will work with the insurer and the FCA to explore alternative ways those allocations could be made without materially impairing the insurer's safety and soundness. If no reasonable alternative exists, given the risk to the insurer's overall safety and soundness and its ability to meet obligations to policyholders, the statute gives us the power to take action to prevent such allocations being made. Where we are satisfied that the insurer's decisions, or the FCA's requirements, do not materially affect the overall safety and soundness of the firm, we will not take action.

Insurers posing a very low risk to our objectives

139. There are a large number of insurers within the category of having the lowest potential impact on our objectives, made up of small overseas insurers (branches or subsidiaries), small regional or niche insurers, as well as small mutual insurers.

140. Although at an individual level, these insurers have almost no capacity to cause significant harm to the stability of the system, our statutory objective to contribute to securing an appropriate degree of protection for all policyholders motivates a baseline level of supervisory monitoring for all insurers. Further, there is a risk that several insurers may fail together through a common exposure, with possible wider impact on financial stability.

141. Given that these insurers are likely to pose low risks to our objectives, we supervise them on a portfolio basis. Insurers' regulatory returns are analysed on a peer/portfolio basis. Any outliers and unusual trends are examined separately and may result in individual analysis of a firm's regulatory returns.

142. Our approach to supervision of these firms is reactive, as such we also examine individual insurers when a risk crystallises (as discovered through, for example, a visit to the insurer, or an approach from the insurer itself), or in response to authorisation requests from the insurer (for example a request to change its permissions to undertake regulated activities, or to extend the nature or scale of its business).

143. Category 5 insurers contact us through a centralised enquiries function and do not have an individual-named supervisor.

144. We conduct regional visits annually which allow us to engage with a select number of firms. Nevertheless, all insurers, regardless of category, are subject to onsite work by us, with a period of notice, at any time.

Mutual insurers

145. Our approach to the supervision of mutual insurers is consistent with the approach adopted for other insurers. It reflects variety in the sector, for example different constitutions, different governance frameworks, and different policyholders. It also recognises that there are issues that are specific to the mutual sector, for example constraints on raising external capital.

Reinsurers

146. Our approach to supervising reinsurers is based on the same principles as our supervision of primary insurers. However, reinsurance may give rise to a greater degree of connectivity with other parts of the financial system than is usually seen with primary insurance business. Undertaking an appropriate degree of supervision of the reinsurance business transacted in the UK is therefore an important element in meeting our objectives.

Insurance special purpose vehicles (ISPVs)

147. Only our general objective, to promote the safety and soundness of the firms it regulates, applies to ISPVs. Our approach to the supervision of ISPVs is in line with the approach to our supervision of insurance companies.

148. ISPVs are subject to ongoing supervision by us and will need to comply with the relevant Threshold Conditions and Solvency II requirements on an ongoing basis. Ongoing supervision activity for ISPVs is designed to be proportionate and risk based, in line with the risks that the vehicle poses to our objectives. As with low potential impact insurers, a peer group approach is applied to understand the risks posed by ISPVs on aggregate.³⁴

Non-Directive firms (NDFs)

149. We supervise NDFs in peer groups on a reactive basis. NDFs are not subject to the Solvency II tests and standards, either for reasons of scale or other reasons as detailed under Articles 4-12 of the Solvency II Directive.³⁵ Furthermore, an NDF may no longer be live writing and could be in run-off or liquidation.

150. NDFs have their own reporting requirements, as prescribed in the PRA Rulebook. In most cases, non-Directive insurance companies submit their regulatory reporting on an annual basis, for which supervisors review the key components of capital coverage and changes in capital requirement, premium, and asset volumes. The same approach is adopted for non-Directive friendly societies, but on a triennial basis according to their reporting schedule.

International insurers

151. Many overseas insurers, including some reinsurers, operate in the UK and are significant providers of financial services to the UK economy.

152. For UK subsidiaries of overseas insurance groups, we have full powers and responsibilities and so our approach is to treat such insurers in the same way as UK-owned

³⁴ Details of the approach to ongoing supervision are outlined in Supervisory Statement 8/17 'Authorisation and supervision of insurance special purpose vehicles': <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/authorisation-and-supervision-of-insurance-special-purpose-vehicles-ss>.

³⁵ See the full Solvency II Directive here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02009L0138-20140523>.

insurers. We will apply our full prudential requirements to the UK subsidiary. At the same time, we rely on the group supervision pursued by the competent EEA group supervisor, in line with the provisions of Solvency II.

153. When the UK subsidiary is part of a broader non-EEA group, our supervisory approach will depend on whether the third country group supervision regime is deemed equivalent to Solvency II. If the non-EEA group is subject to an equivalent group supervision regime, we will rely on the global supervision exercised by the equivalent non-EEA group supervisor.

154. For UK branches of EEA insurers and those providing cross-border services into the UK, our powers and responsibilities are limited under Solvency II. In order to assure ourselves that risks to our objectives from such branches are adequately managed, we look to engage with the home state supervisors (in particular through supervisory colleges) where we believe the failure of one of these insurers would have a material effect on policyholders or financial stability in the UK. Subject to the outcome of the negotiations between the UK and the EU, and in particular absent some new agreement in relation to EEA insurers, these insurers will have to apply for authorisation in order to carry on PRA-regulated activities after the UK withdraws from the EU. They would then be treated in the same way as other international insurer branches. Insurers that are authorised to carry on a regulated activity in the UK under the EU passporting regime can enter into the temporary permissions regime if, prior to exit day, they notify us or the FCA (as applicable) or they have made an application for permission under Part 4A of the Act.³⁶

155. For UK branches of non-EEA insurers (third country branches) our authorisation applies to the whole insurer. At the point at which a new third country insurer seeks initial authorisation to establish a branch in the UK, and then on an ongoing basis, we will form a judgement on the adequacy of the worldwide financial resources of the third-country undertaking and its compliance with its home country prudential regime. We will also assess whether the home country prudential regime is broadly equivalent to the regime applied to UK insurance firms.

³⁶ See our dedicated page on EU withdrawal for further information: <https://www.bankofengland.co.uk/eu-withdrawal>.

Annex

October 2018: This issue of 'The Prudential Regulation Authority's approach to insurance supervision' contains amendments to simplify and improve readability. The document has also been updated to reflect recent developments in policies and approach. The key changes are outlined below.

- Removal of Executive Summary to remove duplication of information in the Executive Summary, Foreword, and Introduction.
- New foreword from Sam Woods, PRA CEO and Deputy Governor for Prudential Regulation at the Bank (pages 1-2)
- Addition of text regarding the UK's withdrawal from the EU (page 3)
- Updates made to 'Our objectives' section to remove duplicative information and to make content clearer (pages 4-7).
- Updates made to 'Appropriate protection of policyholders' (pages 5-6).
- Removal of Threshold Conditions box, with key information remaining. Addition of link to FSMA, Schedule 6 where the full Threshold Conditions can be viewed (page 7).
- Removal of Fundamental Rules box, with key information remaining. Addition of link to Policy Statement 5/14 'The PRA Rulebook' where the full Fundamental Rules can be viewed (page 7).
- Updates made to 'Our approach to advancing our objectives' section (pages 8-10).
- Updates made to Box 1 'Working with other authorities', including addition of text on domestic supervisory colleges (pages 9-10).
- Addition of new chapter 'Identifying risks to our objectives', incorporating sections taken from Chapters 1 and 2 of the March 2016 issue of this document (pages 11-24).
- Updates made to 'Management and Governance' section including updates to 'Senior Managers and other individuals performing key functions' section, removing duplicative information published on the Bank of England website. Link added to information on strengthening individual accountability in insurance (pages 14-17).
- Updates made to 'Risk Management and Controls' section, including merging of information from the 'Control Framework' and 'Risk Management and Control functions' sections of the March 2016 issue of this document, under title 'Control framework' (pages 18-19).
- Addition of new sub-section on operational resilience (page 19).

- Updates made to the 'Resolvability' section, including removal of the sub-sections 'Expectation of insurers' and 'Supervision – what the PRA does to assess and enhance resolvability'. Key, overview content remains (page 23-24).
- Updates made to the 'Supervisory Activity' section, including removal of the sub-section 'Analysis of assets and investments' (pages 25-32).
- New box added giving information on the PRA's Prudential Regulation Committee (PRC) (page 31).
- New content added on insurance special purpose vehicles (ISPVs) regarding how we authorise them (page 32) and how we tailor our supervisory approach for them (page 35).
- New chapter added 'Tailored application of the supervisory approach', incorporating content from a similar section in the March 2016 issue of this document as well as addition of new content on how we tailor our supervisory approach for non-Directive firms and ISPVs (pages 33-36).
- Update to 'International approach' section (page 35-36).
- Removal of 'Making policy to support the PRA's general approach' chapter as now the PRA is an established regulator with policy published on the Bank of England's website. A link has been added in the Introduction to information regarding the way we make policy.
- Removal of box 'Underlying economic justification for prudential regulation' as now the PRA is an established regulator and detailed justification is not necessary. Useful content from this previous section has been added to the 'Our secondary objective' section (page 4).