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C H A N C E

Briefing note May 2017

# Amendments and optimisation of the Senior Insurance Managers Regime

Following the full implementation of the PRA's senior insurance managers' regime ("**SIMR**") on 7 March 2016, the PRA has shown a commitment to monitoring and revising the regime to improve clarity, flexibility and proportionality. Following a consultation process, the PRA has made revisions to SIMR requirements applicable to insurers who outsource their internal audit function, insurers in run-off and individuals acting as "Notified" non-executive directors ("**NEDs**").

This note highlights the key changes following the publication on 12 May 2017 of the PRA's Policy Statement PS12/17. Although PS12/17 is relevant to all PRA-regulated firms, this note is limited to the new requirements applying to insurers within the scope of Solvency II.

## Key changes

**Outsourcing of internal audit function**

- An insurer which outsources its internal audit function does not need to approve an individual as a Head of Internal Audit Function and can instead choose to allocate oversight of the internal audit function to another person carrying on a Controlled Function.

**Insurers in run-off**

- Small run-off insurers without permission to write new business, who meet a £25 million size threshold in relation to their gross technical provisions and have not written or acquired any business in the last twelve months, can apply for a streamlined SIMR.
- This type of firm is required to appoint one individual with overall responsibility for the business as either a CEO or a Head of Small Run-off Firm Function.

**Conduct Standards for Notified NEDs**

- From July 2017, a Notified NED will be subject to a limited number of Conduct Standards, which will bring them into the scope of SIMR high level requirements.

## Background

In PS12/17 the PRA responds to its Consultation Paper CP34/16: Strengthening individual accountability in banking and insurance: amendments and optimisations. CP34/16, which appears to have received positive feedback, contained 'optimisations' on the application of the SIMR i.e. the outsourcing of the internal audit function by smaller insurers and a clarification of the application of SIMR to insurers in run-off. CP34/16 also provided for the amendment of the application of the Conduct Standards applicable to notified NEDs. The final position on these proposals is detailed in this note.

## Implementation

The optimisations to the SIMR as described above will become effective on Tuesday 12 September 2017. The application of the Conduct Standards to Notified NEDs will become effective on Monday 3 July 2017 and will apply to breaches identified on or after that date.

## Outsourcing of internal audit function

In CP34/16 the PRA proposed to exempt any Solvency II insurers classed as "not significant" and who elect to outsource their internal audit function to a third party from a requirement to have an individual approved as a Head of Internal Audit Function (SIMF5). PS12/17 confirms these firms will instead be required to allocate a new Prescribed Responsibility to one of their oversight (i.e. non-executive) PRA Significant Influence Management Functions ("**SIMF**") or FCA Controlled Functions ("**CF**") for:

- providing for an effective internal audit function; and
- overseeing the performance of the internal audit function.

This new requirement will be welcomed by many insurers who choose to outsource their internal audit function and is significant because, in essence, it prevents insurers from having to apply stringent accountability requirements on a senior auditing individual who is not an employee of the insurer. The outsourced individual will therefore not need to be subject to the insurer's appraisal procedure (to ensure that the job and relevant fitness and proprietary requirements continue to be met) or internal disciplinary process (should the relevant requirement not be met). The allocation of a Prescribed Responsibility inside the insurer to maintain oversight of the outsourced internal audit function appears to be a sensible alternative.

The PRA will apply the new requirement on insurers it deems "not significant", a term not defined in the PRA Rulebook. However, guidance on the term is provided in Supervisory Statement SS35/15 - Strengthening individual accountability in insurance May 2017. Principally, the PRA confirms that the factors that may be taken into account in considering whether or not a firm is significant may include, for example, the potential impact of a firm on the stability of the UK financial system and its capacity to cause disruption to the interests of a substantial number of policyholders. Given the ambiguity of this guidance, insurers should consider their 'category' designation[1] which is likely to give the best indication as to whether the PRA considers them to be significant or not.

## Insurers in run-off

The PRA had proposed that certain run-off firms without permission to write new business should be subject to a streamlined SIMR. Following feedback from its consultation, the PRA has revised this original proposal so that the streamlined SIMR will be automatically available for small run-off insurers who:

- do not have permission to write new business and have not written any new business nor acquired any further book of business in the last 12 months; and
- have less than £25 million technical provisions as reported in its two most recent annual accounts.

Other run-off insurers will be able to apply for a waiver or modification of the relevant PRA rules and such applications will be assessed against the statutory tests as set out in Section 138A of FSMA. In order to avoid insurers moving from time to time between the streamlined and full SIMRs as a result of the size threshold no longer being met, the PRA confirms in PS12/17 that the streamlined regime, once triggered, will continue to apply as long as the insurer does not hold a permission to effect contracts of insurance and does not write any further new business or acquire any additional blocks of business from another insurer. This is a significant improvement for insurers in run-off who tend to face cost and personnel restrictions and can now seek to avoid the full (and, therefore, costly) application of SIMR.

The final rules will now also allow a small run-off insurer to appoint one individual with overall responsibility for the business as either a CEO (SIMF1) or a Head of Small Run-Off Firm Function (SIMF26). Should responsibility be allocated to the CEO, this will enable the CEO of the insurer moving into run-off to continue performing the SIMF1function without having to be re-approved. Again this appears to be a proportionate requirement showing that the PRA recognises the constraints of run-off.

## Conduct Standards for Notified NEDs

A number of amendments relating to the PRA's and FCA's accountability regimes are now coming into effect and are a direct result of the improvements in conduct standards resulting from the Bank of England and Financial Services Act 2016 (the "**BoE Act**") which received Royal Assent on 4 May 2016.

The BoE Act amended Section 64 of FSMA to enable the PRA and FCA to apply rules of conduct to all 'member(s) of the board of directors, or if there is no such board, the equivalent body responsible for the management of the authorised person concerned', including Notified NEDs in insurers. To be clear, a Notified NED is an NED who is not approved by the PRA or FCA to perform a CF at that firm. Accordingly, the PRA confirms in PS12/17 that the Conduct

[1] See page 35 - The Prudential Regulation Authority's approach to insurance supervision March 2016

Standards applicable to Notified NEDs are as follows:

- Individual Conduct Standard 1: You must act with integrity.
- Individual Conduct Standard 2: You must act with due skill, care and diligence.
- Individual Conduct Standard 3: You must be open and co-operative with the FCA, the PRA and other regulators.
- Senior Insurance Manager Conduct Standard 4: You must disclose appropriately any information of which the FCA or the PRA would reasonably expect to have notice.
- Senior Insurance Manager Conduct Standard 5: When exercising your responsibilities, you must pay due regard to the interests of current and potential future policyholders in ensuring the provision by the firm of an appropriate degree of protection for their insured benefits.

The above new requirements are significant as they bring Notified NEDs into the SIMR, although by a relatively small degree compared to the more onerous approval and assessments requirements placed on those in SIMF roles. However, the PRA's requirements go some way to address industry concerns that the SIMR will lead to the emergence of two-tier unitary boards, due to the fact that only certain NEDs are subject to the SIMR.

## How can we help?

Clifford Chance has experts in PRA and FCA accountability requirements, including lawyers who have previously worked within the PRA and/or the FCA and who are familiar with the regulatory assessments used to assess Senior Managers. For this reason, we provide specialist advice and assistance in the preparation for Controlled Function interviews and assessments. We also provide tailored training (for example, on Board/NED responsibilities, Conduct Risk, Solvency II governance requirements) to in-house lawyers and the Compliance Function.

To ensure full compliance with the PRA and FCA accountability regimes, we also have experience of creating/implementing Governance Maps, advising on allocation of Prescribed Responsibilities, undertaking reviews of Compliance Manuals and internal policies (for example, Risk Management, Conflicts, Whistleblowing) and have experience in undertaking firm governance reviews and Board effectiveness reviews.

Our leading global corporate insurance practice regularly advises the world's insurance and reinsurance companies on a full range of areas including M&A and other corporate transactions as well as reinsurance agreements, collateral arrangements, distribution and capitalisation queries, Solvency II and other financial services regulation.

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