

# A new regulatory focus: the PRA and FCA Senior Insurance Managers framework

On 2 February 2015, the PRA and the FCA consultations, which together set out the framework for senior insurance managers, came to a close.

The PRA and FCA are expected to publish consultation feedback, final supervisory statements and rules in March 2015. As the rules will take effect on 1 January 2016 in line with Solvency II, firms are advised to start preparations early.

**To assist with the necessary planning, this note advises on key next steps, outlines the PRA and FCA features of the new framework and highlights areas for which regulatory or legal input should be sought.**

## Introduction

The PRA and FCA consultations both impact on the existing Approved Persons Regime ("APR"). The changes are mainly driven by implementation of Solvency II measures on governance and fitness and propriety but this is not the only driver – both regulators have flagged a clear policy objective of increasing individual accountability.

The PRA, in particular, is driving forward a new regime, in line with its regulatory principles, seeking to ensure accountability and responsibility at a senior level. This regulatory principle, coupled with an appetite to effect cultural change at senior level and the PRA's responsibility as lead transposing

authority for Solvency II, explains why the bulk of changes are PRA led.

The PRA's push for change is reflected in its desire to overhaul the APR and replace it with a **Senior Insurance Managers Regime ("SIMR")**. The FCA has taken a more restrained approach and only proposed **amendments to APR ("the New APR")** to bring it in line with Solvency II. Senior insurance managers will, therefore, be subject to two different regimes – see Annex 1 for a comparison between the old and new frameworks.

## Timing

The proposed framework for insurance managers is still subject to

## Key changes

- Senior insurance managers will be subject to two different PRA and FCA regimes.
- Firms will need to determine 'key functions' and assess 'key function holders' fitness and propriety on an ongoing basis.
- The PRA will require senior insurance managers to perform specific 'Prescribed Responsibilities'.
- Individual's responsibilities and reporting lines will be captured by a Governance Map.
- Conduct Standards, similar to those for banks, will apply to specified individuals.
- There will be greater regulatory focus on smaller, clearly defined responsibilities.

change. Both the PRA and FCA will consult separately on the treatment of Non-Executive Directors ("**NEDs**"), which are expected to bring NEDs into the scope of Solvency II and will form part of the SIMR and New APR framework.

Both the PRA and FCA aim to meet the 31 March 2015 deadline for Solvency II transposition. Meeting this deadline is subject to the NED consultation and a further expected PRA and FCA consultation on transitional measures. Nevertheless, the SIMR and the New APR regime will apply from 1 January 2016 in line with Solvency II implementation.

## Alignment

The PRA consultation follows a July 2014 paper proposing the **Senior Managers Regime ("SMR")** for banks, building societies, credit unions, and PRA-designated investment firms.

One key difference from the SMR for banks is that neither sanctions<sup>1</sup>, the presumption of responsibility<sup>2</sup> nor certifications apply to insurers as they do to the equivalent functions in the SMR.

Aside from that fundamental change, in proposing a new regime for insurers, the PRA sought alignment, where possible, with the SMR for banks. Although the PRA clearly acknowledged differences between risks posed by banks and insurers to firm 'safety and soundness', the alignment causes some uncertainty in scope and application overlap which will no doubt impact on groups containing both banking and insurance entities.

A degree of uncertainty should be no great surprise given that Solvency II is the statutory footing for the new SIMR rules whilst changes to the banking regime reflect the recommendations of the Parliamentary Commission on Banking Standards ("**PCBS**") and implement FSMA amendments made by the Financial Services (Banking Reform) Act 2013 ("**Banking Reform Act**").

The PRA and FCA have not sought to align their respective regimes due to their differing objectives. This and little reference to each other's regimes in the consultations makes it very difficult to determine how the SIMR and New APR will work in

## The Framework

- As mentioned, insurers will be subject to two separate regimes - the SIMR operated by the PRA and the New APR operated by the FCA.
- The SIMR will apply to:
  - Senior insurance managers subject to PRA approval (and FCA consent) for a **Controlled Function ("CF")** - to be known as **Senior Insurance Management Functions ("SIMFs")**; and
  - Senior individuals (or "**key function holders**") who effectively run the firm or have responsibility for other key functions.
- The New APR regime will apply to:
  - Individuals subject to FCA approval (and PRA consent) for a CF – to be known as **FCA Significant Influence Functions ("SIFs")**.
- **NB:**
  - A SIMF can be a key function holder (and vice versa).
  - A SIF can be a key function holder (and vice versa).

practice. Insurers, therefore, should not expect to receive a streamlined approval process. Instead, delay, costs and a more intrusive process with little coordination between the regulators appears inevitable.

## The SIMR

### SIMFs

The PRA proposes to focus only on those executive roles which are most critical to its statutory objectives. This

more focused approach will lead to greater PRA scrutiny of fewer individuals than under the current regime. The PRA has indicated that it expects one individual to occupy each applicable SIMF although, as is the case under the SMR, it will allow sharing of functions in some instances where responsibilities are clearly allocated. Any individual holding the below SIMFs must be approved by the PRA. The new SIMFs are:

- SIMF 1- Chief Executive function
- SIMF 2- Chief Finance function
- SIMF 4 - Chief Risk function
- SIMF 5 - Head of Internal Audit
- SIMF 7 - Group entity Senior Insurance manager function
- SIMF 19 - Third country branch manager function
- SIMF 20 - Chief Actuary function
- SIMF 21 - With-Profits Actuary function
- SIMF 22- Chief Underwriting function
- SIMF 23 - Underwriting Risk Oversight function (Lloyds only)

The first four SIMFs listed above – Chief Executive function (SIMF1), Chief Finance function (SIMF 2), Chief Risk function (SIMF 4) and Head of Internal Audit (SIMF5) – are used by the PRA to bring the SIMR in line with comparable functions for banks.

As mentioned above, the most eye-catching elements of the SMR for banks; the reversal of the burden of proof requiring senior managers to show that they took reasonable steps to avoid a breach by a firm and the introduction of a new criminal offence

<sup>1</sup> Section 36 of the Banking Reform Act 2013.

<sup>2</sup> Section 66B(5) of FSMA.

of recklessly taking a decision causing an institution to fail; are absent from the SIMR. However, it still substantially increases the potential for senior managers to be held liable for failings by insurers.

The threat is even more real given the SIMR allocate individuals with a specific responsibility and enabling the PRA to identify accountability for breach or failure. Individuals holding SIMFs, therefore, must be more acutely aware of the legal and regulatory requirements and should be ready to evidence systems and procedures to demonstrate compliance.

#### Key function holders

The PRA proposes new rules requiring insurers to identify 'key functions' or persons who 'effectively run the firm' or that have 'other key functions'.

An accompanying Supervisory Statement advises how a firm should identify such key function holders in areas not specified by Solvency II (i.e. areas other than Actuarial Function, Risk Management Function, Internal Audit Function and Compliance Function). However, no further guidance is provided on how to determine those 'effectively running the firm'. The lack of prescriptive criteria provides insurers with autonomy, albeit limited. To pass PRA scrutiny, insurers must be ready to demonstrate how 'other key functions' are proportionate to the nature, scale and complexity of the risks inherent in their business.

#### Overlap

Firms should note the possibility of overlap between SIMF holders and key function holders. Such overlap is to be expected given the PRA's desire to impose Solvency II

## Notification

The PRA expects a firm to make the following notifications:

- Changes to the identity of a key function holders - Plus disclosure of information to assess whether the new holder is fit and proper.
  - NB:** Notification is not required if the key function holder is also a FCA SIF.
- Any information which would reasonably be material to the assessment of a current or former key function holder's fitness and propriety.
- Changes to the identity of key function holders due to the former

requirements onto a regime principally based on FSMA and then to align the SIMR with the SMR. Where overlap is identified, firms should be ready to evidence how conflicts of interest are minimised and that an individual's qualifications, training and competence are suitable for both roles. A SIMF holder who is also performing a key function will be subject to both PRA approval and firm assessment.

### The New APR

#### SIFs

In light of the SIMR, the FCA proposes to rename certain CFs - which are not SIMFs - as SIFs. The proposed FCA SIFs are:

- CF1 - Director function (for Directors not approved as a PRA SIMF)
- CF8 – Apportionment and Oversight function
- CF10 - Compliance function

- CF10a – CASS Operational Oversight function
- CF11 – Money Laundering Reporting officer function
- CF28 – Systems and Controls function (for ISPVs, only for those individuals not approved for a PRA SIMF)
- CF29 – Significant Management function (for those individuals not approved for a PRA SIMF)
- CF30 – Customer function
- CF51 –Actuarial function in a third country branch function

The FCA has indicated that the Significant Management (CF29), Compliance Oversight (CF10) and Apportionment and Oversight (CF8) functions are those most likely to be captured as Solvency II 'key functions' and therefore subject to PRA rules for key function holders as well as FCA approval.

### Prescribed Responsibilities

Under PRA proposals, a firm will allocate a number of 'Prescribed Responsibilities' to one or more holder(s) of a SIMF, SIF or a NED (subject to PRA and FCA consultation on NEDs, expected in March 2015). These Responsibilities require:

- ensuring that the firm has complied with the obligation to satisfy itself that persons performing a key function are fit and proper;
- leading the development of the firm's culture and standards;
- embedding the firm's culture and standards in its day-to-day management;

- production and integrity of the firm's financial information and regulatory reporting;
- allocation and maintenance of the firm's capital and liquidity;
- development and maintenance of the firm's business model;
- performance of the firm's ORSA;
- induction, training and professional development for all the firm's key function holders;
- maintenance of the independence, integrity and effectiveness of the whistleblowing procedures, and the protection of staff raising concerns; and
- oversight of the firm's remuneration policies and practices.

The legal basis of the Prescribed Responsibilities is unclear. It can be assumed that the PRA used the high-level drafting of Article 41(5) of the Solvency II Directive, which empowers supervisory authorities with 'means, methods and powers to... verify a system of governance and evaluate emerging risks' to place these additional requirements on firms.

Firms should determine the key responsibilities of each SIMF, SIF and NED before allocating Prescribed Responsibilities. Clear delegation of responsibility is essential when evidencing to the PRA an effective system of internal governance.

### Governance map

Under the PRA's proposals, firms will be required to maintain Governance Maps. Whilst the PRA has not prescribed the form these should take, it has indicated that these should be living documents which accurately

and comprehensively depict reporting lines and the 'key functions' identified by the firm. Where a firm is part of a group - the interactions of the firm and its management with other group entities and group wide governance arrangements must also be recorded.

It is expected that the PRA will refer to the Governance Map during its initial assessment for SIMF application. The Map is also likely to be used as part of the PRA's daily supervision of insurers and, in enforcement cases, to evidence individual responsibility and accountability.

### Fitness and propriety

The PRA 'fit and proper' proposals place responsibility on firms for assessing, on an on-going basis, the fitness and propriety of individuals holding SIMFs and key functions.

Firms will be expected to demonstrate prompt and full investigation of any matters raised before, during and after assessment. The PRA will also expect prompt disclosure of any information which would reasonably be seen as material for a SIMF approval. Further guidance is provided in a Supervisory Statement on the assessment process which is supported by detailed rules governing 'fit and proper' assessments in the new PRA Rulebook format.

The FCA indicates that it will amend the APR regime in the light of the EIOPA Guidelines (currently in draft) which set out specific considerations that firms need to take into account when assessing the fitness and propriety of individuals carrying on Solvency II functions. The FCA also indicates that it will consult on changes to 'Form A' for all FCA SIFs in Solvency II firms once the EIOPA Guidelines are finalised.

### Conduct Standards

Both the PRA and FCA propose to align their respective Standards for insurers with those required for banks. The PRA's eight Conduct Standards; therefore, track the equivalent provisions for banks but introduce a new additional requirement (reflecting the PRA's insurance objective) requiring due regard to the interests of current and potential future policyholders.

The application of the PRA's Conduct Standards is unclear. Although the proposals state that the standards would apply to those who are 'key function holders' and those 'performing' a key function, the PRA does not explain what 'performing' actually entails. The reason for the apparent distinction between 'key function holders' and those 'performing' a key function is not yet clear. This is an area the PRA has been invited to clarify in its finalised rules and guidance. For now, it can be assumed that 'performing' is the discharge of the responsibility assigned to a key function holder. In which case why has the PRA distinguished between the two? This has the potential to lead to uncertainty and the PRA should prioritise in clearly defining the difference.

The FCA's Conduct Standards are the same as for the PRA, but include the additional rules of treating customers fairly and observing proper standards of market conduct.

The PRA and FCA are likely to rely on Conduct Standards in taking enforcement action against individuals. The high level drafting of the Standards is purposive – it allows scope to frame a breach rather than relying on a specific rule breach. Firms must ensure that compliance

manuals and employee handbooks incorporate the revised Conduct Standards. This will help evidence to the PRA and FCA the right firm

culture - high expectations on all individuals and that breaches of the Standards are taken seriously.

## Annex 1

## Tables showing changes to Controlled Functions under the current Approved Persons Regime and the new Senior Insurance Managers framework

## UK incorporated (non-ISPV) firm

Current APR <sup>3</sup>	SIMR	New APR
Current PRA / FCA Controlled Function	New PRA SIMF	FCA SIFs
PRA Director (CF1)	CFO (SIMF2) CRO (SIMF4) Head of Internal Audit (SIMF5) Chief Actuary (SIMF20) Underwriting Function (General Insurance Firms (SIMF22) Underwriting Risk Oversight Officer (Lloyd's) (SIMF23) Group Entity Senior Manager (SIMF7)	CF1s not otherwise approved by the PRA
PRA NED (CF2)	<i>Subject to PRA consultation</i>	<i>Subject to FCA consultation</i>
PRA CEO (CF3)	CEO (SIMF1)	
FCA Apportionment and oversight (CF8)		<i>Subject to FCA review</i>
FCA Compliance (CF10)		Compliance (CF10)
FCA CASS Operational Oversight (CF10a)		CASS Operational Oversight (CF10a)
FCA Money Laundering Reporting (CF11)		Money Laundering Reporting Officer (CF11)
PRA Actuarial function holder (CF12)	Chief Actuary (SIMF20)	
PRA With-profits Actuary (CF12A)	With-profits Actuary (SIMF21)	
PRA Lloyd's Actuary (CF12B)	Chief Actuary (SIMF20)	
PRA Systems and Controls (CF28)	CFO (SIMF2) CRO (SIMF4) Chief of Internal Audit (SIMF5)	
FCA Significant Management (CF29)	Underwriting Function (General Insurance Firms) (SIF23) Underwriting Risk Oversight Officer (Lloyd's) (SIMF23) Group Entity Senior Manager (SIMF7)	CF29s not otherwise approved by the PRA
FCA Customer function (CF30)		Customer function (CF30)

<sup>3</sup> Functions CF 4 (Partner), CF 5 (Director of an unincorporated association) and CF 6 (Small friendly society) are not relevant to Solvency II firms.

## ISPV

Current APR		SIMR	New APR
Current PRA / FCA Controlled Function		New PRA SMIF	FCA SIFs
PRA Director (CF1)		CFO (SIMF2) Chief Actuary (SIMF20) Group Entity Senior Manager (SIMF7)	All CF1s not otherwise approved by the PRA
PRA NED (CF2)		<i>Subject to PRA consultation</i>	<i>Subject to FCA consultation</i>
PRA CEO (CF3)		CEO (SIMF1)	
FCA Apportionment and oversight (CF8)			<i>Subject to FCA review</i>
FCA Compliance (CF10)			Compliance (CF10)
FCA CASS Operational Oversight (CF10a)			CASS Operational Oversight (CF10a)
FCA Money Laundering Reporting (CF11)			Money Laundering Reporting Officer (CF11)
PRA Actuarial function (CF12)		Chief Actuary (SIMF20)	
PRA Systems and Controls (CF28)		CFO (SIMF2)	CF28s not otherwise approved by the PRA <sup>4</sup>
PRA Significant Management (CF29)		Group Entity Senior Manager (SIMF7)	All CF29s not otherwise approved by the PRA
FCA Customer function (CF30)			Customer Function (CF30)

<sup>4</sup> Conduct perspective only

**Third country branch**

Current APR		SIMR	New APR
Current PRA / FCA Controlled Function		New PRA SIMF <sup>5</sup>	FCA SIFs <sup>6</sup>
PRA Director (CF1)			Director (CF1)
PRA NED (CF2)		<i>Subject to PRA consultation</i>	<i>Subject to FCA consultation</i>
PRA CEO (CF3)		Third Country Branch Manager function (SIMF19)	
FCA Apportionment and oversight (CF8)			<i>Subject to FCA review</i>
FCA Compliance (CF10)			Compliance (CF10)
FCA CASS Operational Oversight (CF10a)			CASS Operational Oversight (CF10a)
FCA Money Laundering Reporting (CF11)			Money Laundering Reporting Officer (CF11)
PRA Actuary function holder (CF12)			Actuarial conduct function holder in a third country branch (CF51)
PRA With-profits Actuary (CF12A)		With-profits Actuary (SIMF21)	
PRA Systems and Controls (CF28)			Systems and Controls (CF 28) <sup>7</sup>
PRA Significant Management (CF29)			Significant Management (CF29)
FCA Customer function (CF30)			Customer Function (CF30)

<sup>5</sup> Further individuals may be approved by the PRA under certain circumstances. See the PRA's CP 26/14 [www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2614.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2614.aspx)

<sup>6</sup> Functions only apply so far as is set out in SUP 10A.1.6: <http://fshandbook.info/FS/html/handbook/SUP/10A>

<sup>7</sup> Conduct perspective only



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