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Senior Insurance Managers Regime
Strengthening accountability in insurance

January 2015

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Introduction

On 26 November 2014 the Prudential Regulation Authority ("PRA") and Financial Conduct Authority ("FCA") each published a consultation paper ("CP") on the overhaul of the Approved Persons Regime ("APR") for insurance and reinsurance firms in the UK including branch undertakings within the scope of Solvency II, and Lloyd's Managing Agents ("Senior Insurance Managers Regime").

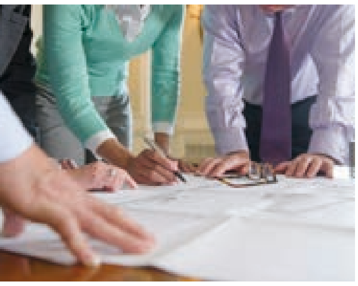
The CPs follow on from those published in July 2014 for banks, building societies, credit unions, and PRA-designated investment firms ("Senior Managers Regime").

The proposals seek to embed Solvency II measures relating to governance and fitness and propriety of individuals, and are consistent with the European Insurance and Occupational Pensions Authority ("EIOPA") technical standards and guidelines. The aim of the proposed regulatory framework is to encourage individuals to take greater responsibility for their actions and to make it easier for firms and regulators to hold individuals to account.

The CPs set out proposals for identifying and approving senior persons responsible for: running an insurer or who have responsibility for a key function; allocating responsibilities amongst senior persons; documenting a governance map; and introducing new conduct standards and fitness and propriety requirements. The proposals are aligned to Solvency II measures and provide practical steps to enable firms to meet those requirements, particularly in relation to the fitness and propriety provisions.

This paper addresses the key points in the CPs and our expectations of what this will mean for firms and individuals in practice, having regard to insights gained from the proposed banking sector Senior Managers Regime.

Key points



- The Senior Insurance Managers Regime is consistent with, and expands on, provisions in the Solvency II Directive.

- The aim of the Senior Insurance Managers Regime is to enhance governance through reinforcement of individual accountability, fitness and propriety requirements and conduct standards.

PRA proposals

- **Controlled Functions ("CF")** – introduces a more focussed group of controlled functions (also known as Senior Insurance Management Functions) which will be subject to PRA pre-approval) listed below:

  – Chief Executive function (SIMF1)
  – Chief Finance function (SIMF2)
  – Chief Risk function (SIMF4)
  – Head of Internal Audit function (SIMF5)
  – Group Entity Senior Insurance Manager function (SIMF7)
  – Third Country Branch Manager function (SIMF19)
  – Chief Actuary function (SIMF 20)
  – With-Profits Actuary function (SIMF21)
  – Chief Underwriting Officer function (SIMF22)
  – Underwriting Risk Oversight function (SIMF23)

- **Key Function Holders** – these are defined as senior persons who are effectively running an insurer or who have responsibility for key functions (to be defined by each firm but expected to include the functions specified by Solvency II, namely the Actuarial Function, Risk Management Function, Internal Audit Function and Compliance Function). Where Key Function Holders are not exercising either a PRA or FCA CF, the PRA proposes to supervise insurers' assessments of their fitness and propriety on an *ex-post* basis.

- **Allocation of Responsibilities** – firms will need to allocate certain prescribed responsibilities (see Appendix) to one or more persons approved by the PRA or FCA.

- **Governance Map** – requires that firms develop and maintain a governance map outlining assignment of the responsibilities and key functions within the firm.

- **Conduct Standards** – introduces three generic conduct standards to apply to both CFs and "Key Function Holders" (senior persons who are running an insurer or have responsibility for a key function) and four specific conduct standards attributable to Key Function Holders. The conduct standards are broadly consistent with the existing APR and those proposed under the Senior Managers Regime. However, whilst the Senior Managers Regime extends the conduct rules to most individuals within banks, the proposed PRA conduct standards in insurers will apply to senior insurance managers and individuals performing a key function.

- **Fit and Proper Assessments** – introduces a set of non-exhaustive factors to consider when assessing fitness and propriety on an ongoing basis and a requirement to obtain employer references and criminal record checks for a CF. Firms are also required to assess whether such checks should be extended to any Key Function Holders.

FCA proposals

- **Significant Influence Functions** – as the PRA is narrowing the focus of its CFs, this will mean many individuals caught under the current regime will not be captured under the new Senior Insurance Managers Regime. The FCA proposes to maintain its own pre-approval requirement for these individuals to ensure they still go through a regulatory approval process.

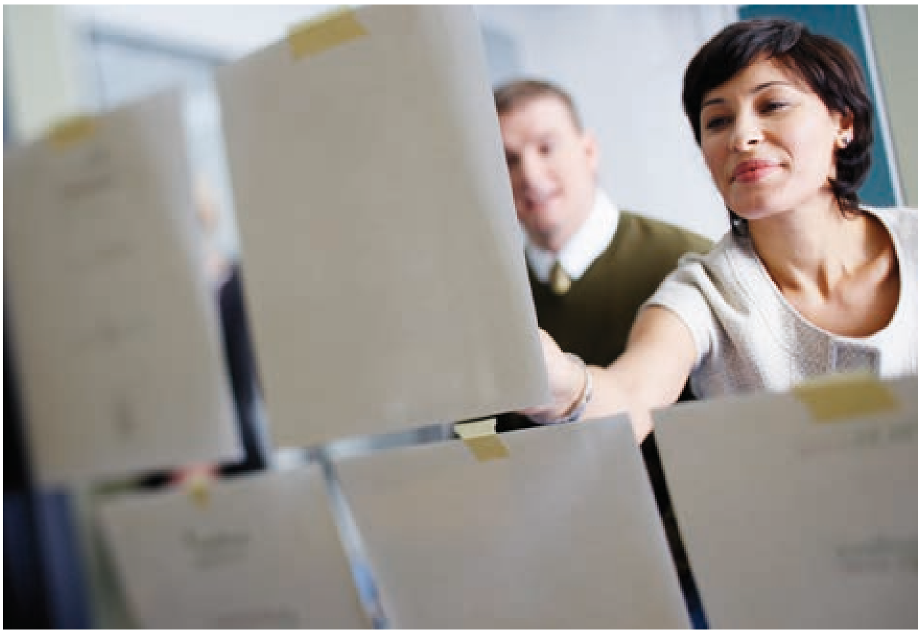
  For the remaining PRA Controlled Functions, the FCA will maintain the existing pre-approval model to ensure that candidates for those functions are suitable from a conduct perspective.

Implementing Solvency II

We have provided advisory support, independent assurance and review services to insurance firms preparing for Solvency II compliance. Our experience is that the level of preparedness of insurers for the requirements presented in the CPs will vary significantly firm to firm. For example, the investment some firms have made in defining and documenting their risk governance and risk operating models should support their approach to demonstrating compliance with the potential 'governance map' requirement. This may be captured in documents explaining how the Board, Board Committees, Executive Committees and 'key functions' are defined and how they interrelate. Supporting documentation, such as responsibility matrices mapping decision-making accountabilities, responsibilities and who should be consulted and informed, could also be useful in demonstrating how proposed requirements are addressed. For other firms, work will be required to enhance definitions and supporting documentation and systems. Areas we have seen insurers focus on to enhance their approach include improving the linkage between senior management accountabilities and supporting processes, e.g. policy compliance and risk and control data.

We expect some firms may need to enhance their approach with respect to defining procedures for assessing the fitness and propriety on an ongoing basis of those who run the business. We have found firms have defined fit and proper assessment processes that are followed during the recruitment process, however, action has been required to define and implement ongoing fitness and propriety tests.

Firms should use this opportunity to align their approaches to satisfying governance, risk and control requirements defined by EIOPA, PRA, FCA and the Financial Reporting Council UK Corporate Governance Code update, issued in September 2014.



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Implications for Non-Executive Directors

The PRA and FCA have proposed to defer consultation on the treatment of Non-Executive Directors ("NEDs") under the Senior Insurance Managers Regime, given the significant amount of feedback received on the proposals for NEDs in banks and other firms addressed by the Senior Managers Regime earlier this year. Publicly disclosed feedback raised by responses, such as the British Bankers' Association and the Association for Financial Markets in Europe[1], include concerns regarding ongoing independence of NEDs and collective board responsibility where specific responsibilities to "manage" are allocated to individual NEDs.

The suggestion from these bodies has been that a separate regime more aligned with current rules in UK company law and the UK Corporate Governance Code is developed rather than NEDs covered by a regime developed for senior managers. A consultation paper addressing implications for both banks and insurers is expected in early 2015.

1 British Bankers' Association and the Association for Financial Markets in Europe published response to FCA CP14/13 and PRA CP 14/14 October 2014

Practical considerations for firms

In interpreting and addressing the proposals, firms should take account of the following:

- **Regulatory transition owner** – firms should appoint an individual or sponsor to oversee implementation of the proposals. Our experience has been that firms which have appointed a sponsor or individual accountable for implementation are more prepared for Solvency II and are likely to be better able to embed the requirements of the Senior Insurance Managers Regime.

- **Organisational structure** – firms will need to review their current organisational structure ensuring that they have incumbents serving in each of the CFs and have identified Key Function Holders (including those individuals whose roles cover group activities but continue to carry out key functions for the UK subsidiary).

- **Apportioning responsibilities and defining reporting lines** – once incumbents for the PRA CFs are established, firms will need to assign the PRA responsibilities to incumbents as appropriate, based on their role requirements and relative skills ensuring that the allocation does not breach those requirements in the Solvency II Delegated Acts which require certain CFs to be performed independently of other functions. Responsibilities and reporting lines should then be mapped, including clearly documenting any shared responsibilities, delegated and/or outsourcing arrangements (as Key Function Holders will ultimately be responsible for actions carried out by these parties). Firms will be expected to have appropriate and well defined governance arrangements, and to be able to clearly demonstrate to regulators how they work in practice.

- **Efficient flow of management information** – individuals captured by the regime should be able to demonstrate effective control over their areas of responsibility and will therefore require timely and accurate information from relevant departments to evidence such control on an ongoing basis. Further, the FCA guidance on complying with the proposed conduct standards specifically refers to failure to require adequate reporting as an example of a breach of conduct.

- **Fit and proper assessments** – firms will need to be satisfied that individuals are fit and proper prior to applying for regulatory approval (or submitting notifications should the regulators propose grandfathering of existing Approved Persons in the next technical consultation). Should regulatory approval not be granted, it is likely that the robustness of compliance processes will be questioned and come under additional supervisory scrutiny. Firms should also have appropriate compliance processes to ensure they are able to conduct regular fitness and propriety checks for PRA CF incumbents and Key Function Holders. Any questionnaires utilised for such checks should be mapped back to the PRA fit and proper provisions to ensure, at a minimum, those factors listed by the PRA are assessed. Preparation will be required to ensure sufficient resources are available to support the transition and appropriate linkages between relevant operating units, such as compliance and human resources, are maintained.

- **Monitoring and evidencing conduct** – firms are expected to have suitable procedures for monitoring the conduct of individuals captured under the regime and to take all reasonable steps to gather and consider information which may indicate the extent to which individuals are in compliance with conduct standards. We also expect remuneration committees to include these conduct considerations as part of their decision-making processes. In the banking sector, after a period of focus on customer outcomes, we have seen banks place greater emphasis on the ability to evidence compliance with regulatory rules as part of the response to the Senior Managers Regime.

  Many insurers have performed extensive work on conduct already, particularly in relation to customer outcomes. However, the list of illustrative conduct breaches provided by the FCA include governance-related examples such as implementing confusing or uncertain reporting lines, authorisation levels or job descriptions. These should be drawn to the attention of individuals in the scope of the regime.

- **Increased documentation requirements** – under the new framework, relevant firms will be required to maintain even more extensive documentation of governance arrangements to demonstrate their ongoing compliance with the regime. The 'governance map' is intended to be a 'living' document for continuous reference rather a static framework, and firms will need to be able to provide an up-to-date version to the PRA upon request.

- **Difficulty finding and retaining the right people** – the new regime will place increased regulatory scrutiny upon senior individuals. Firms will need to invest in improvements to their governance arrangements, documentation, performance management processes and training. Firms have the opportunity to differentiate themselves in the war for talent through the robustness of the arrangements they put in place to minimise risks and uncertainty for individuals captured by the new regime.

- **Managing multiple regimes** – while the regulators' stated intention is to bring some degree of consistency between the Senior Insurance Managers Regime and the Senior Managers Regime, there are a number of differences in the requirements. Firms which do not fall within the scope of either of the two new regimes will continue with the existing APR. Groups which operate in multiple sectors (banking, insurance and asset management for example) could therefore potentially face the need to comply with up to three different regimes, leading to additional complexity for compliance arrangements.

Comparison to the Senior Managers Regime

There are a number of elements from the proposed Senior Managers Regime for banks, building societies and other firms as set out in the PRA and FCA July 2014 CP which will not apply to insurers.

- The new criminal offence relating to the Senior Managers Regime (where taking a decision which causes a relevant firm to fail is punishable by up to seven years in prison and/or an unlimited fine) will not apply to insurers;
- Insurers will not face the reversed burden of proof, whereby individuals under the Senior Managers Regime will be presumed culpable if a firm breaches a regulatory requirement for which they were responsible, unless they can demonstrate otherwise.

The areas where the regimes are most similar is in the introduction of new Controlled Functions, the need to allocate prescribed responsibilities, the need to document responsibilities and governance arrangements and the introduction of new Conduct Rules. A number of banks have conducted an initial gap analysis against the proposed Senior Manager Regime rules and are planning for implementation.

Insights from initial work include the following:

- Firms that lacked basic organisational documentation (e.g. role profiles and delegated authorities) have found the process of defining and mapping organisation wide responsibilities extremely challenging. We encourage insurance firms to begin preparing for the new regime with a level of urgency commensurate with the maturity of their internal governance structure.
- Firms have given a lot of consideration to group-entity interactions, in particular the need to identify a Group Entity Senior Manager (equivalent to the proposed Group Entity Senior Insurance Manager) and to document reporting lines (including dual reporting lines to group individuals).
- Efficient programmes have involved collaboration across a number of areas including compliance, HR, company secretariat and operations rather than one department working on the programmes in isolation. In a number of banks, ownership of the programme to drive the changes was undecided for some time and shifted between these functions. In many organisations, the ownership of the on-going business as usual management of the new regime has yet to be decided. Some firms have appointed their CEO as the programme owner with support from the functions listed above.

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Timing and next steps

The consultation period closes on 2 February 2015 for both CPs.

The PRA expects to release a technical CP covering transitional arrangements and a separate CP on the regulatory framework for NEDs within the Senior Insurance Managers Regime early this year. The FCA expects to release a CP early in 2015 on specific changes to the Significant Influence Functions pre-approval form.

Regulators are required to transpose Solvency II by 31 March 2015 to give firms lead time to meet the requirements by 1 January 2016. It is not yet clear from when the Senior Insurance Managers Regime proposals will apply, however we suggest that firms work towards compliance with the regime in a similar timeframe as their Solvency II compliance, given the synergies between the provisions.

Appendix – Summary of Senior Insurance Managers Regime

Overview and scope
The regulators' proposals aim to enhance the governance structures of insurance firms. The PRA proposals reaffirm standards of fitness, propriety and conduct for individuals that fall within scope of the regime. The FCA proposals are specific to the application of the conduct rules to individuals whose roles may not be covered under the PRA proposals but are of significance to the FCA. The CPs apply to all insurance and reinsurance firms, including third country branch undertakings within the scope of Solvency II, and to the Society of Lloyd's and managing agents. Third country branches and Insurance Special Purpose Vehicles (ISPVs) are entitled to specific exemptions or have additional requirements to adhere to. The final proposals should be read and applied in conjunction with Solvency II regulations (which are applicable to Member States without the need for transposition by a national legal instrument). Further, the regime regarding "Key Function Holders" and notification requirements continue to apply. The PRA expects to release a technical CP covering transitional arrangements and a separate CP on the regulatory framework for NEDs within the Senior Insurance Managers Regime early in 2015. The FCA expects to release a CP on specific changes to the Significant Influence Functions pre-approval form.

Senior Insurance Managers Regime – PRA proposals

Senior Insurance Management Functions/ Controlled Functions

- Provides a narrower set of Controlled Functions (versus the existing categories of Approved Persons) which will require PRA pre-approval:

Chief Executive function	SIMF1
Chief Finance function	SIMF2
Chief Risk function	SIMF4
Head of Internal Audit function	SIMF5
Group Entity Senior Insurance Manager function	SIMF7
Third Country Branch Manager function	SIMF19
Chief Actuary function	SIMF20
With-Profits Actuary function	SIMF21
Chief Underwriting Officer function	SIMF22
Underwriting Risk Oversight function	SIMF23

The following Controlled Functions do not apply to Insurance Special Purpose Vehicles (ISPVs): SIMF4; SIMF5; SIMF19; SIMF21; or SIMF22.
SIMF21 does not apply to the Lloyd's Society or to managing agents.
A third country branch undertaking must have at least one person approved as SIMF19 and will require one person approved as SIMF21 should it transact with-profits business.

Allocation of Responsibilities

- The CP introduces 10 prescribed responsibilities, the last two of which are specific to NEDs, for:
  - ensuring that the firm has complied with its obligation to satisfy itself that every person who performs a key function is a fit and proper person;
  - leading the development of the firm's culture and standards in relation to the carrying on of its business and the behaviours of its staff;
  - embedding the firm's culture and standards in relation to the carrying on of its business and the behaviours of its staff, in the day-to-day management of the firm;
  - the production and integrity of the firm's financial information and regulatory reporting;
  - management of the allocation and maintenance of the firm's capital and liquidity;
  - development and maintenance of the firm's business model;
  - performance of the firm's Own Risk and Solvency Assessment (ORSA);
  - induction, training and professional development of all the firm's Key Function Holders;
  - maintenance of the independence, integrity and effectiveness of the firm's policies on whistleblowing and for ensuring staff who raise concerns are protected from detrimental treatment; and
  - oversight of the firm's remuneration policies and practices.
- The responsibilities must be assigned to a CF having regard to independence, potential conflicts and the skills of the CF incumbent.

Senior Insurance Managers Regime – PRA proposals (cont'd)

Governance Map

- Relevant firms will be required to write and maintain a comprehensive and up-to-date 'governance map' which identifies key functions within the firm, incumbents' names, a summary of significant responsibilities assigned to each incumbent, reporting lines and lines of responsibility for each person and, where relevant, how the firm's governance arrangements fit within broader group arrangements.

Fit and Proper Assessments

- Non-exhaustive set of factors that should be considered by firms when conducting fit and proper assessments.
- Specific requirement to consider past behaviour within and outside the UK when assessing fitness and propriety.
- Additional requirement for employer references and criminal record checks for those to hold CFs including contractors serving in CFs, but firms must also consider whether it is appropriate to obtain similar references and checks for Key Function Holders.
- Reinforces the requirement for fitness and propriety on an ongoing basis.

Conduct Standards

- For reference the PRA conduct standards are set out below.
- Any person performing a key function will need to observe Standards ("Stds") 1 to 3, whilst senior insurance managers and Key Function Holders will need to observe Stds 4 to 8 as well as Stds 1 to 3.

Std 1	You must act with integrity.
Std 2	You must act with due skill, care and diligence.
Std 3	You must be open and co-operative with the FCA, the PRA and other regulators.
Std 4	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
Std 5	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with relevant requirements and standards of the regulatory system.
Std 6	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
Std 7	You must disclose appropriately any information of which the FCA or PRA would reasonably expect to have notice.
Std 8	When exercising your responsibilities you must pay due regard to the interests of current and potential future policyholders in ensuring the provisions by the firm of an appropriate degree of protection for their insured benefits.

- When assessing compliance, the PRA will have regard to whether the individual in question exercised reasonable care when considering information available; reached a reasonable conclusion based on the information; the nature, scale and complexity of the firm's business; the person's role and responsibilities and any knowledge the individual had or should have had of regulatory concerns.

Senior Insurance Managers Regime – FCA proposals

Significant Influence Functions

- The FCA proposes that "Significant Influence Functions" will be subject to their approval and will cover those individuals in executive or other Controlled Functions which the PRA is proposing not to maintain. The FCA is proposing to maintain the following:

  – Directors (CF1s) not otherwise approved by the PRA
  – Compliance (CF10)
  – CASS Operational Oversight (CF10a)
  – Money Laundering Reporting Officer (CF11)
  – Significant Management Functions (CF29s) not otherwise approved by the PRA
  – Customer Function (CF30)

- The FCA will consult on the approach to NEDs (CF2) and the Apportionment and Oversight Function (CF8) at a later date.

Conduct Standards	• The FCA's proposed conduct standards build on the existing Statements of Principles for Approved Persons and are identical to the proposed Conduct Rules for banks and other firms within the scope of the Senior Managers Regime. The first tier of conduct of rules will apply to all FCA and PRA approved persons in Solvency II firms while the second tier of conduct rules places additional requirements on those in positions of particular responsibility.

First tier – Individual Conduct Rules	
Rule 1	You must act with integrity.
Rule 2	You must act with due skill, care and diligence.
Rule 3	You must be open and cooperative with the FCA, the PRA and other regulators.
Rule 4	You must pay due regard to the interests of customers and treat them fairly.
Rule 5	You must observe proper standards of market conduct.
Second tier – Significant Influence Function Holder Conduct Rules	
SI1	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
SI2	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with relevant requirements and standards of the regulatory system.
SI3	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
SI4	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

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