



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

The PRA's response to the Independent Evaluation Office's evaluation of the PRA's approach to its insurance objective

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1 Introduction

1.1 The Prudential Regulation Authority (PRA) welcomes the Independent Evaluation Office's (IEO's) assessment of its approach to its insurance objective¹ and is reassured that the IEO *"found clear evidence, from multiple sources and in a wide range of settings, of supervisors taking meaningful and appropriate actions to advance policyholder protection"*.

1.2 The IEO report makes a number of recommendations for the PRA to consider. The passage of time since the establishment of the PRA and Financial Conduct Authority (FCA), the implementation of Solvency II and the recent cutover to the Prudential Regulation Committee (PRC) makes this an opportune time to refresh how the PRA interprets, implements and communicates the insurance objective. The PRA will take forward the IEO's recommendations and is committed to addressing them in a manner consistent with its aim of being an open and accountable regulator that delivers forward-looking, judgement-based supervision.

2 The IEO's recommendations and the PRA's response

2.1 The IEO has set out four high-level recommendations:²

- (a) articulate more fully the PRA's strategy and approach with respect to its policyholder protection responsibilities;
- (b) communicate the PRA's preferred strategy and approach, both internally and externally;
- (c) implement the PRA's preferred strategy and approach effectively, including via a clear and consistent approach to firm categorisation; and
- (d) enhance the PRA's framework for co-ordination with the FCA in respect of policyholder protection.

2.2 The PRA agrees that there is benefit in articulating more fully - both for its own staff and for the insurers the PRA supervises - how the PRA interprets the policyholder protection objective, and what sort of protection the PRA seeks to achieve. The PRA will therefore use the IEO's recommendations as the basis for a discussion with the PRC on the PRA's interpretation of its insurance objective, including:

- (a) how the PRA determines what an 'appropriate' degree of protection is, what level of protection it deems appropriate, and whether that determination varies by type of policyholder; and
- (b) the relationship between the degree of policyholder protection the PRA aims to deliver through its own actions and the protection provided by the Financial Services Compensation Scheme (FSCS), considering in particular how policyholders are protected when insurers fail or go into solvent run-off.

2.3 The IEO notes in its report that there is a range of understanding among PRA supervisors about the insurance objective, and its relationship with the PRA's general objective. The PRA will therefore provide training for staff when it has agreed a fuller interpretation of the

¹ Available at: www.bankofengland.co.uk/about/Pages/ieo/default.aspx.

² A summary of the PRA's response, including the detailed recommendations underlying the high-level ones are available in the appendix.

policyholder protection objective with the PRC. The PRA will also update 'The PRA's Approach to insurance supervision'¹ to include additional clarity on its approach to the insurance objective.

2.4 The PRA notes that the IEO found that the PRA's approach to firm categorisation is an effective way of delivering policyholder protection that varies according to the level of risk posed. The PRA will review its approach to firm categorisation in light of the discussion with PRC described above, but does not expect to make wholesale changes.

2.5 To enhance the PRA's relationship with the FCA, the IEO recommends that the PRA considers how best to mitigate the risk of PRA supervisors being drawn in to areas which are ultimately the FCA's responsibility. However, the IEO observed that the probability of PRA legal overreach is very low, with which the PRA agrees. It is nearly four years since the formation of the PRA and FCA, and the onset of twin peaks regulation for insurers. The PRA agrees that now is an appropriate time to review its processes for interacting with the FCA and the memoranda of understanding (MoUs) that govern those interactions.² If necessary, the PRA will revise the MoUs to reflect the good practice and experience that has emerged.

2.6 The PRA will take a paper to the PRC by September 2017 on the legal interpretation of the objective, the interaction of the insurance objective with the general objective and the definition of regulatory failure. Following this, dependant on the PRC's decision, the PRA will update the approach document as appropriate and communicate the approach to staff.

2.7 The PRA will consider and present a paper to the PRC by December 2018 on the appropriate levels of protection between different types of policyholders, the extent to which supervision should take the compensation scheme into account, the approach to firm categorisation and the co-ordination arrangements with the FCA. The delay in taking forward this paper until 2018 reflects prioritisation given other work demands.

3 Conclusion

3.1 The PRA welcomes the IEO's evaluation, which it considers an informative and balanced assessment of its approach to its insurance objective, and will take forward a set of actions in response. The PRA is reassured that the IEO's assessment found clear evidence of supervisors advancing policyholder protection and no evidence of supervisors stepping beyond their responsibilities.

1 March 2016: www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx.

2 Memoranda of Understanding: www.bankofengland.co.uk/about/Pages/mous/default.aspx.

Appendix: Summary of PRA Response

High-level recommendation	Detailed recommendations	PRA actions proposed
<p>1. Articulate more fully the PRA's strategy and approach with respect to its policyholder protection responsibilities.</p>	<p>(A) The PRC to articulate more fully the PRA's policyholder protection responsibilities, taking account of:</p> <ul style="list-style-type: none"> (i) the interaction of the general and insurance objectives; and (ii) the relationship between the PRA's policyholder protection objective and the FCA's complementary responsibilities. <p>(B) The PRC to articulate more fully the level and nature of policyholder protection that it is seeking to achieve, taking account of:</p> <ul style="list-style-type: none"> (i) the degree to which 'appropriate' levels of protection differ between different types of policyholders; (ii) the meaning of non-zero failure within the context of insurance, and the PRA's appetite for failure; and (iii) the extent to which PRA supervisors should explicitly take into account the existence of the FSCS. 	<p>The PRA will set out its interpretation of the PRA's policyholder protection objective for the PRC, and seek the PRC's agreement of that interpretation. The PRA will, as part of that interpretation, consider each of the questions the IEO raises in Section 3 of its report. In particular, the PRA will ask the PRC:</p> <ul style="list-style-type: none"> • how the PRA determines what an 'appropriate' degree of protection is, what level of protection it deems appropriate, and whether that determination varies by type of policyholder; • the relationship between the degree of policyholder protection the PRA aims to deliver through its own actions and the protection provided by the FSCS, considering in particular how policyholders are protected when insurers fail or go into solvent run-off; and • the degree to which the regulatory framework established under the Solvency II Directive supports or restricts the PRA from delivering its preferred approach to policyholder protection.
<p>2. Communicate the PRA's preferred strategy and approach, both internally and externally.</p>	<p>(A) The PRA Executive to communicate the fuller articulation under Recommendation 1:</p> <ul style="list-style-type: none"> (i) Internally, through an update to guidance for supervisors, reinforced by training for new and existing staff. (ii) Externally, including through an update of the PRA's published approach document for insurance supervision, and other vehicles for external communication (eg speech, <i>Quarterly Bulletin</i> article). 	<p>In light of the discussion with PRC about how the PRA interprets its policyholder protection objective, the PRA will consider whether it is necessary to revise the PRA's supervisory framework and guidance for supervisors, including the allocation of supervisory resourcing to firms with different types of policyholders.</p> <p>Following the PRC discussion, the PRA will provide internal communications and a staff training programme to ensure that staff understand the interpretation of the policyholder protection objective.</p> <p>The PRA will revise its insurance approach document, including also more information about what failure means for insurers (and their policyholders) and the role played by run-off. In addition, the PRA will explain its interpretation of the policyholder protection objective through speeches and discussions at industry and other stakeholder forums.</p>

<p>3. Implement the PRA's preferred strategy and approach effectively, including via a clear and consistent approach to firm categorisation.</p>	<p>(A) Building on Recommendation 1, the PRA Executive to ensure that the PRA's wider resourcing strategy is aligned with the preferred approach to policyholder protection, including considering any wider implications for the supervisory strategy and operating model.</p> <p>(B) The PRC to consider the extent to which it prioritises protection for some policyholders via the firm categorisation framework, and the PRA Executive to implement this as appropriate through clear guidance for supervisors.</p>	<p>The PRA notes that the IEO found that the approach to firm categorisation, and consequent resource allocation, is an effective way of delivering policyholder protection that varies according to the level of risk posed. The PRA will review its overall resource allocation model in light of discussions with the PRC about its interpretation of the policyholder protection objective and any consequent revisions to the supervisory approach and framework.</p>
<p>4. Enhance the PRA's framework for co-ordination with the FCA in respect of policyholder protection.</p>	<p>(A) The PRC to consider – in conjunction with the FCA as appropriate – how best to mitigate the risk of PRA supervisors being drawn in to areas beyond the scope of responsibility of the prudential regulator. This should include consideration of whether:</p> <ul style="list-style-type: none"> (i) there should be some formalisation of existing working practices; and (ii) an update of the relevant Memoranda of Understanding with the FCA is needed. 	<p>The PRA notes the variety of methods the IEO observed for how PRA staff have interacted with the FCA. The PRA will therefore review what supervisors have learned about best practices for interacting with the FCA since legal cutover. In particular, the PRA will review whether the PRA/FCA MoUs have operated as originally intended and whether the practicalities of running a twin-peaks regulatory regime means that the MoUs should be updated. However, the PRA's view is that the PRA/FCA relationship works well and that PRA resources are better directed into other higher-priority areas at this time, rather than engaging in a wholesale revision to the PRA/FCA relationship.</p>