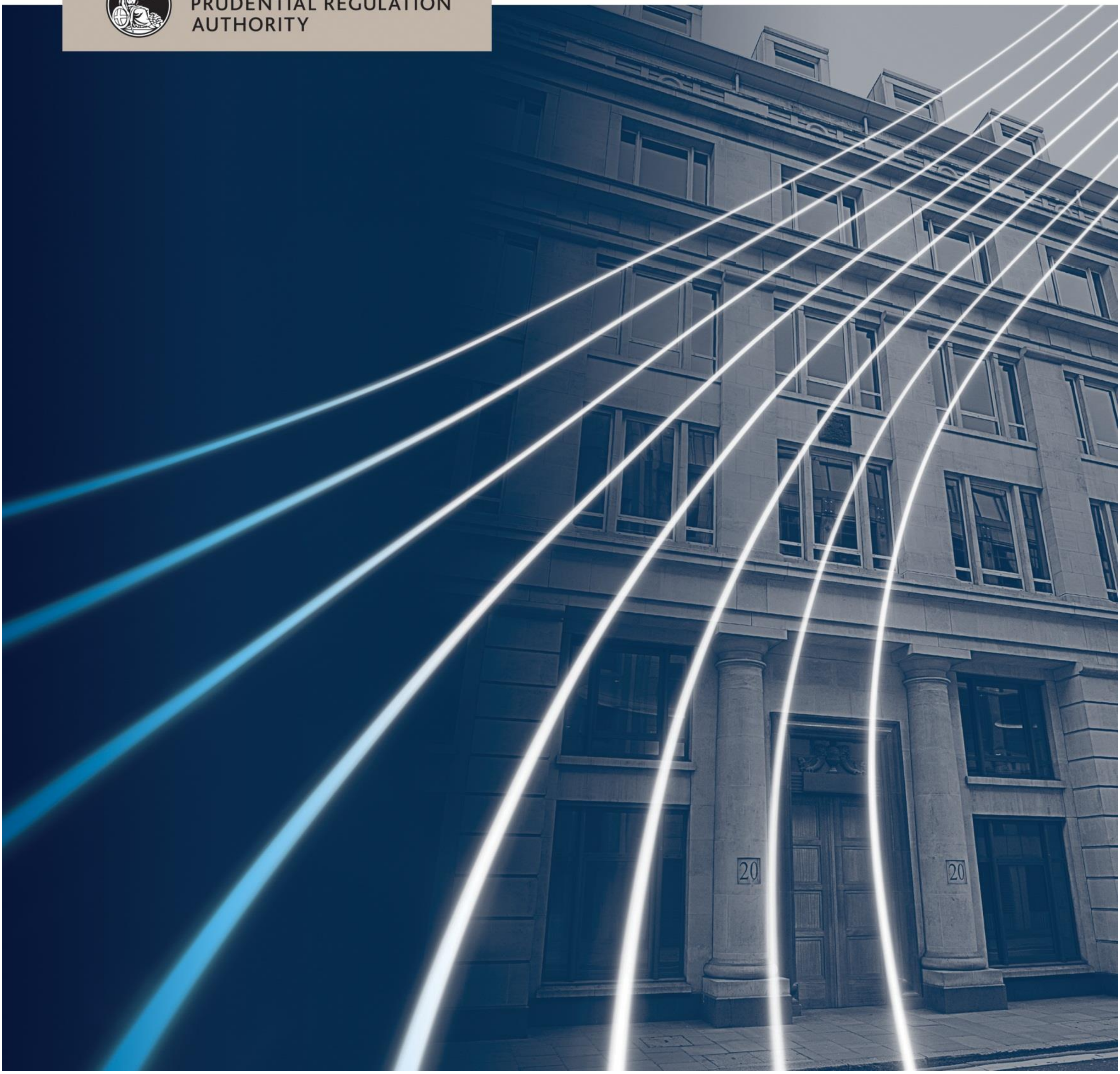
Policy Statement | PS1/18

Strengthening individual accountability in insurance: optimisations to the SIMR

February 2018

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Chapters 2 and 3 of Consultation Paper (CP) 8/17 'Strengthening individual accountability in banking and insurance: optimisations to the SIMR and changes to forms'.[1] It also provides:

- the final rules amending the Senior Insurance Managers Regime (SIMR) (Appendix 1); and
- an updated Supervisory Statement (SS) 35/15 'Strengthening individual accountability in insurance' (Appendix 2).

1.2 The updated SS35/15 also incorporates the changes that were proposed in CP14/17 to remove gender-based language and terminology from SS35/15, as none of the respondents included comments on those proposals.

1.3 This PS is relevant to all Solvency II insurance firms (ie UK Solvency II firms; the Society of Lloyd's and managing agents; and third country (re)insurance branches), and to large non-Directive firms (large NDFs)[2] (collectively referred to as 'insurers').

Responses to CP8/17

1.4 Before making any proposed rules or establishing its general policies and practices, the PRA is required by the Financial Services and Markets Act 2000 (FSMA) to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its response to them.

1.5 The PRA received seven responses to the proposals in Chapter 2 of CP8/17, and seven responses to the proposals in Chapter 3 of CP8/17:

- Chapter 2 of this PS summarises feedback on the proposed optimisations to the SIMR and the PRA's final policy.
- Chapter 3 of this PS summarises feedback on the PRA's proposals for diversity at boards of insurers and the PRA's final policy.
- Chapter 4 sets out the various timelines for implementing the rules and expectations in this PS.

Statutory obligations

1.6 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, FSMA[3] requires the PRA to publish:

- details of the difference (and the PRA's response to representations made to it regarding those changes) together with a cost benefit analysis; and
- a statement setting out, in the PRA's opinion, whether or not the impact of the rule on mutuals is significantly different to that for other PRA authorised firms.

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1 June 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-accountability-in-banking-and-insurance.
2 These are insurers out of scope of Solvency II for which the value of assets in respect of regulated activities, as included in their two most recent annual reports, is more than £25 million. Large non-Directive insurer is defined in the PRA Rulebook Glossary at www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/77326/22-03-2017.
3 www.legislation.gov.uk/ukpga/2000/8/contents.

1.7 The final rules relating to the implementation of the amendments to the SIMR do not differ significantly from those proposed in CP8/17. Most respondents supported the relevant proposals in CP8/17 and feedback to a number of specific comments has been addressed via clarifications in SS35/15.

1.8 In response to consultation feedback, the PRA has made one slight modification to the final rules relating to the new Head of Large Business Area function (SIMF6) proposed in CP8/17. The definition of this function has been revised so that the proposed quantitative criterion that the business area has gross total assets of £10 billion or more, has been amended to a criterion that either the value of assets, or the amount of technical provisions, relating to that business area are £10 billion or more.

1.9 The PRA has also updated SS35/15 to clarify its expectations on the implementation of the amendments to the SIMR, including the new Chief Operations function (SIMF24) and the new prescribed responsibility (PR) for the oversight of outsourced operational functions and activities.

1.10 The above slight modification to the rules, and the additional material in SS35/15, enhance the clarity, flexibility and proportionality of the relevant requirements, relative to the original proposals in CP8/17, and will therefore lessen the burden on firms, including mutuals.

Next steps

1.11 The timelines and relevant measures for the implementation of these final rules are as set out in Chapter 4 of this PS.

1.12 In July, the PRA also published CP14/17 'Strengthening individual accountability in insurance: extension of Senior Managers and Certification Regime to insurers',[1] (simultaneously with the Financial Conduct Authority (FCA)) which consults on its proposals for the extension to all insurers of the Senior Managers and Certification Regime (SM&CR), that would be introduced by amendments to the Financial Services and Markets Act 2000 (FSMA) through the Bank of England and Financial Services Act 2016 ('the 2016 Act'). HM Treasury has recently announced that the extension of the SM&CR to insurers will come into effect on 10 December 2018.[2]

1.13 This was followed in December 2017 by CP28/17 'Strengthening accountability: implementing the extension of the SM&CR to insurers and other amendments',[3] published simultaneously with the FCA, that included the proposed set of forms that will be applicable from 10 December 2018, for the extended SM&CR. The proposed forms encompass the changes proposed in CP8/17 and finalised in this PS.

1.14 The PRA intends to publish a PS to provide feedback to the responses to CP14/17, and to CP28/17, along with final rules, forms, and a further update to SS35/15, in the summer of 2018.

1 www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-individual-accountability-in-insurance-extension-of-the-sm-cr-to-insurers.
2 www.gov.uk/government/news/new-accountability-rules-for-insurers.
3 www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-accountability-implementing-the-extension-of-the-smcr-to-insurers-and-other-amendments.

2 Optimisations to the SIMR

2.1 In CP8/17, the PRA consulted on a range of optimisations to the SIMR, namely:

- a new Chief Operations function (SIMF24);
- a new PRA PR for the firm's performance of its obligations in respect of outsourced operational functions and activities;
- a new Head of Key Business Area function (SIMF6);
- requiring that the Chair function (SIMF9) and CEO function (SIMF1) roles may not be held by a single individual at 'large firms' (for which there was a proposed new definition to be included in the PRA Rulebook Glossary); and
- requiring that a non-executive director (NED) oversight SIMF role at a 'large firm' that is part of a group may not be performed by a group executive.

Chief Operations Senior Management Function

2.2 The PRA proposed to create a new Chief Operations function (SIMF24) for the most senior individual responsible for managing the internal operations and technology of a firm.

2.3 A number of respondents sought clarity about the circumstances under which the PRA would expect this role to be allocated for insurance firms, and requested that the PRA should be proportionate in its approach, especially for smaller firms. They also asked that the PRA take fuller account of the different business structures of firms, as well as the differences in structures between insurance and banking firms.

2.4 The PRA has considered these requests, and included some additional text in paragraphs 2.22H and 2.22J in its updated SS35/15, to clarify its expectations for insurers in relation to this new SIMF24. This includes a clarification that SIMF24 is not intended to encompass relatively junior managers, nor to encompass individuals with only an incidental responsibility for aspects of technology and operations. The PRA also confirms that the issue of whether there may be an individual performing the Chief Operations function for a firm will be influenced by the nature, scale and complexity of a firm's internal operations.

2.5 The PRA is proceeding with the introduction of the new SIMF24, and does not expect that insurers would have to change their business or operating models as a result of this introduction.

Prescribed Responsibility (PR) for Outsourced operations

2.6 To complement the proposed Chief Operations function, the PRA proposed to create a new PR for insurers for the firm's performance of its obligations in respect of outsourced operational functions and activities.

2.7 Some respondents requested that this PR could be split where necessary to ensure that individuals with the necessary skills and expertise are responsible for the material oversight of outsourced operations.

2.8 Consistent with its approach for banking firms, the PRA does not consider it would be appropriate to provide for a split of this PR in PRA rules. The PRA has proposed in CP14/17 some updated text for SS35/15 to explain how this issue might be addressed in practice through the use of the Scope / Statement of Responsibility (SoR) records that are maintained by senior managers at firms. The relevant text for this update to SS35/15 will be finalised when the PS to CP14/17 is published (see paragraph 1.14).

2.9 Respondents asked for further clarification on the PRA's expectations of the functions and activities it would be appropriate to include under this PR. One respondent also requested that this PR should apply only in respect of operational effectiveness and continuity at an outsourced firm.

2.10 The PRA does not agree that this PR should be limited to operational effectiveness, and is clarifying in the updated SS35/15 that it would expect individuals holding this PR to be accountable for the firm's overall policy and strategy in respect of outsourced operational functions and activities; as well as for compliance with the outsourcing requirements for operational functions and activities, that are set out in the PRA Rulebook, the EU regulations, and European Insurance and Occupational Pensions Authority (EIOPA) guidelines.

2.11 The PRA is proceeding with the introduction of this PR and clarifies in the updated SS35/15, that this PR would not encompass either external or internal audit activities (mentioned by some respondents), and therefore this PR would not overlap with the recently introduced PR for those non-significant firms that outsource their internal audit. The PRA also does not expect this PR (through the application of PRA rules) to encompass any responsibilities that are applied by FCA rules (eg for how claims are handled).

Head of Key Business Area function (SIMF6)

2.12 In CP8/17 the PRA proposed to introduce a new Head of Key Business Area function (SIMF6) for those individuals who are responsible for the management of large business areas and divisions and who do not report to a more senior SIMF6 holder. For the purpose of defining such large business areas, the PRA proposed to apply a quantitative threshold (based on revenue income and assets held in relation to that business area) similar to that which applies for banking firms.

2.13 One respondent said that the proposed quantitative threshold would be overly prescriptive and impractical. They said that the allocation of gross assets to a business area or division is a complicated task, given that divisions typically run on a profit and loss basis. Therefore, they would prefer a more principles-based approach to the identification of large business areas (eg through a reference to those areas that could have an impact on the safety and soundness of firms), with the quantitative requirements as guidance.

2.14 The PRA acknowledges that the relevant business area would need to have been identified as a 'key function' (ie of specific importance to the sound and prudent management of the firm). However, the PRA does not consider it satisfactory to leave the quantitative requirements only as guidance, as this would provide firms with too much discretion in their identification of which individual managers need to be pre-approved. Nevertheless, the PRA recognises that insurers have a different business structure from banks, and that there may be practical difficulties for some insurance firms in quantifying the value of assets that relate to each business area.

2.15 Therefore, the PRA is amending the threshold in its final rules for the identification of a large business area or division, so that this is referenced to the gross revenue income, as well as to the value of either the assets or the technical provisions held by the firm, that relate to the business area or division. This will enable an insurance firm to apply this threshold by reference to the value of the technical provisions (rather than the value of assets) attributable to a business area, which should be more practicable for general insurance firms in particular. The PRA is then clarifying its expectations in SS35/15, so that insurers are expected to make a reasonable estimate for this purpose of the value of: (a) the assets; and/or (b) the technical provisions, unless one of (a) or (b) is not relevant and/or readily available for that business area.

2.16 As the value of assets should broadly correspond to (and will normally slightly exceed) the value of technical provisions relating to each business area, and insurers would be expected to have sufficient information available to be able to make a reasonable assessment of the value of either the assets or of the technical provisions relating to that business area, this change will not have any significant effect on the number of business areas that would come within the scope of SIMF6, but will make the rule more practicable to apply.

Separation of CEO and Chair of governing body roles

2.17 In CP8/17, the PRA proposed to make a rule requiring that the CEO and Chair of governing body roles should not be combined at large insurance firms. For this purpose, the PRA proposed to define a 'large firm' through a premium income and asset threshold related to the firm's entire insurance business. Respondents agreed with the intent of this proposal.

2.18 One respondent requested that a different measure or threshold for the definition of a 'large firm' should be applied for life insurance firms conducting unit-linked business (which is akin to discretionary investment management business). This was to ensure a proportionate approach is applied through setting governance requirements relative to the risk profile of the firm.

2.19 The PRA considers there are still a number of risks present in relation to how an insurer writing unit-linked insurance business is run (including liquidity, use of internal reinsurance, and the application of the prudent person principle for investments, as well as unit pricing risks), such that some suitable degree of independence of the firm's board is still warranted. The PRA does not consider that the nature of the governance issues faced by firms writing unit-linked business is sufficiently different to outweigh the practical difficulties that could arise if it were to seek to apply some separately calibrated threshold for firms writing such business. The PRA therefore considers that it would be proportionate to apply the same threshold to firms writing such business, and not to introduce separate thresholds for different types of business.

2.20 Another respondent requested that the PRA should apply its new separation rules in Insurance – Senior Insurance Management Functions 13, to all Category 1 and Category 2 firms, rather than introduce a definition of a 'large firm'. The PRA considers that a quantitative criterion for the application of rules is more appropriate and so is maintaining its proposed definition of a 'large firm' for all insurance firms. The definition of 'large firm' should result in a similar outcome to that if the rules were to apply to Category 1 and Category 2 firms. The final rules require separation of the Chair of the governing body and CEO roles at all such 'large firms'.

Separation of NED oversight roles at subsidiaries from group executive roles

2.21 In CP8/17, the PRA proposed to make a rule requiring that a non-executive director (NED) oversight SIMF role at a 'large firm' that is part of a group may not be performed by a group executive (ie an individual performing some executive function within that same group). For this purpose, the PRA proposed to define a 'large firm' (as in paragraph 2.17 above) through a premium income and asset threshold related to the firm's entire insurance business.

2.22 Respondents agreed with the intent of this proposal. However, one respondent commented that enabling groups to draw on their existing talent pool for these roles is also important to promote individual personal development via exposure to different regulated activities and associated considerations. They added that the proposal would increase the demand for NEDs, and that there is already a limited pool of individuals with the knowledge, expertise and willingness to take up NED roles. They considered that this proposal would be likely to put a further strain on that pool, making it harder for firms to source NED candidates that the PRA will be minded to approve. The preference then of two respondents was that, instead of a general rule, cases should be looked at individually, and allowances made where the relevant firms can provide comfort that the risk of increased conflicts of interest will not arise or can be adequately mitigated.

2.23 The PRA considers that there are many ways in which individuals may achieve personal development, and that the proposed rule would not unduly limit those options. The points about the potential demand for NEDs were also considered when the PRA developed the guidance on subsidiary boards in its SS5/16 'Corporate governance: Board responsibilities'[1] and following further consideration of those points raised in CP8/17, the PRA reiterates in this PS that it wishes to see large insurance firms provided with some independence and autonomy from their parents. What is good for the group or parent is not necessarily in the best interests of the subsidiary. The PRA is keen to see that the subsidiaries have some ability to ensure that decisions on key items – eg dividends, cost reductions, board/senior management appointments – are in the best interests of the firm and not driven unduly by group considerations. The PRA considers that in times of stress, it would be helpful for the subsidiary to have its own Chair who would not be distracted by wider group challenges at the same time.

2.24 The PRA considers that the required separation of NED oversight and group executive roles at 'large firms' is a measured approach to ensure that such conflicts of interest can be properly addressed. As the separation is only required at 'large firms', this should not have the effect of unduly reducing the potential pool of NED candidates. As explained in PS22/15 'Strengthening individual accountability in insurance: responses to CP26/14, CP7/15 and CP13/15',[2] the PRA assesses the fitness of NEDs in scope of PRA approval only in respect of their competence for an oversight role and for being a Chair, along with complementary experience or knowledge that is relevant to the remit of the committee (or board).

3 Diversity at boards of insurers

3.1 In CP8/17, the PRA proposed to require Solvency II insurers and large NDFs to have a policy to consider a broad set of qualities and competences when recruiting board members and to have a policy to promote diversity among board members. These requirements are designed to promote a diverse board composition. This should help to improve the effectiveness of the board, enabling it to run the business more prudently and to ensure the firm's safety and soundness and better protection of the firm's policyholders. The proposals complement existing industry initiatives to improve diversity on boards;[3] the Organisation for Economic Co-operation and Development (OECD) guidelines for insurers;[4] and the Financial Reporting Council's Corporate Governance Code.[5]

3.2 The PRA is not proposing to make any changes to the policy that was consulted on in CP8/17. Seven respondents commented on the diversity policy proposal. All of the responses

1 March 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss.
2 August 2015: www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-responses.
3 Such as HM Treasury's Women in Finance Charter: www.gov.uk/government/publications/women-in-finance-charter.
4 www.oecd.org/finance/insurance/oecdguidelinesoninsurergovernance.htm.
5 www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code.

recognised the value of diversity and many specifically referenced groupthink and risk taking. Six were supportive of the proposal and one respondent commented that requiring firms to put in place a policy to promote diversity on the board alone was not enough, and that the PRA should require firms to meet targets for diversity.

3.3 As set out in paragraph 3.4 of the CP '[T]he PRA considers firms are best placed to determine themselves the details of their policy to promote diversity'. This is because the areas requiring greater representation will differ across firms, and because the needs of firms will also vary. As another respondent pointed out, organisations are still experimenting with new approaches to promote diversity and so crystallising a set approach in prescriptive requirements could be counterproductive. It would also require the PRA to make a judgement on the factors of diversity most important to firms, which will differ. Although measurable factors such as gender, age, tenure and race are important, diversity of approach, skills and experience are just as important to combat groupthink.

3.4 Another respondent highlighted the importance of personality types in ensuring effective challenge on a board. There will be other aspects of diversity that are important to firms that they will be best placed to identify in relation to their own activities and business practices. A number of respondents mentioned the important role of leaders within firms being responsible for promoting diversity within their firm, and also being accountable for it. This is an element of best practice that has been highlighted by HM Treasury's Women in Finance Charter.[1] Although the SIMR does not include an explicit PR for promoting diversity, the promotion of diversity can be relevant to other PRs such as those pertaining to culture and to the induction, learning and development of members of the firm's governing body.

3.5 Two respondents asked for clarification and consistency of the 'large firms' to which the new requirements would apply. The scope, as proposed in paragraph 1.2 of the CP is that the rule applies to all Solvency II insurance firms, and to large NDFs.[2]

3.6 One respondent commented that the PRA should monitor the unintended consequences of the introduction of the SIMR as it placed additional requirements on individuals taking up senior positions within firms and this increased the risk of the restriction of the talent pool, particularly for NEDs. It was suggested this would make it harder to create diverse boards. The PRA recognises that this could cause additional difficulty; part of the rationale for requiring firms to put in place a policy to promote diversity was to ensure diversity of skills, approach and experience were considered when recruiting new board members.

3.7 Another respondent noted that the PRA and FCA have at times indicated a preference for candidates with more traditional skill sets, which can prevent firms improving diversity when hiring new board members. Individuals seeking approval are assessed on their individual suitability for that role. The PRA values a variety of skills, experience and approach to provide effective challenge as outlined in SS5/16.

3.8 Both of the points raised in paragraphs 3.6 and 3.7 were considered when the PRA developed the diversity proposals. The PRA are mindful that misconceptions about the operation of the SM&CR and SIMR could potentially result in increased lack of diversity on firm boards, including skills diversity, and it may be that the PRA will need to consider additional outreach if these points materialise.

1 See footnote 3 on page 10.
2 As defined in footnote 2 on page 5.

3.9 Aligning the diversity requirements for banks and insurers will further enhance the consistency of the PRA's supervision of governance. The PRA considers that its expectations of firms relating to diversity are reasonable and proportionate, and ensures flexibility for firms to consider their own unique circumstances in setting their policy. Nonetheless, the PRA takes on board the view that there could be more done in the future.

4 Timelines and relevant measures for implementation

Timeline for implementation

4.1 Some respondents questioned the need for these changes to the SIMR to be implemented in advance of the extension of the SM&CR to insurers. They commented that a piecemeal rollout of the new rules to the SIMR and the SM&CR adds to the complexity of implementation plans, requiring ongoing reviews and restructuring.

4.2 One respondent added that within the European Union, the increase in regulation appears only to be taking place in the United Kingdom. They believed that this will add unnecessary regulation to the UK insurance sector and, given the imminent departure of the United Kingdom from the European Union, could be detrimental to firms retaining, or establishing, business activity in the United Kingdom. The respondent then encouraged some further thinking about the timing of the introduction of the proposals if the PRA believes the changes are necessary.

4.3 In relation to the specific proposal for the separation of NED oversight chairing roles at subsidiaries from group executive roles, one respondent requested that a pragmatic approach should be applied regarding the transition and timeline for firms looking to secure a NED of the required calibre and fit for the firm.

4.4 The PRA considers that the direction of travel is consistent across all UK-regulated firms, and will help to ensure the United Kingdom continues to be recognised as a sound location with a high reputation for the operation of financial service activities. The PRA acknowledges the concerns expressed by some respondents about the timelines proposed in CP8/17 for the implementation of the rules for the optimisations to the SIMR (as set out in Chapter 2), and will implement these rules alongside the implementation of the extension of the Senior Managers & Certification Regime to insurers on 10 December 2018.

4.5 The PRA does not consider that firms will need so long to commence development of a diversity policy in respect of their board membership. The PRA consulted to implement the diversity requirements two months after publication of the final rules, and proposes to go ahead with this timeline for these rules (in Chapter 3).

Implementation measures

4.6 Respondents requested some clarification on the approval processes for the new SIMF6 and SIMF24 functions, and some asked for the PRA to consider another 'conversion' process without the need for re-approval of the relevant individuals (similar to the process that applied for the implementation of the SIMR in early 2016).

4.7 The PRA considers that there would be a number of logistical difficulties for such a 'conversion' process, and in any event, the PRA would still need some type of notification from firms about the relevant individuals who would be in the new SIMF6 and SIMF24 roles.

4.8 The PRA considers that the submission of a Form E (or Short Form A if appropriate) would be relatively straightforward for both firms and the PRA to operate, and the procedure would correspond to that applied for the implementation of the analogous SMF24 role for banking firms. Currently approved persons seeking to be approved for a SIMF6 or SIMF24 role, would complete and submit a Form E (or Short Form A), along with an up-to-date copy of their Scope of Responsibilities (SoR). The relevant updates to the forms are expected to be published in the summer of 2018 (see paragraphs 1.13-1.14); and firms should submit the relevant forms for the approval of individuals who will perform the Chief Operations function (SIMF24), or the Head of Large Business Area function (SIMF6) from 10 December 2018.

Summary

4.9 In summary:

- the rule requiring insurers to have a diversity policy for their boards will become effective on Monday 9 April 2018;
- the rules to implement the optimisations to the SIMR will become effective on Monday 10 December 2018; and
- firms should submit the forms for the approval of individuals who will perform the Chief Operations function (SIMF24), or the Head of Large Business Area function (SIMF6), from Monday 10 December 2018.

Appendices

1	**PRA RULEBOOK: SOLVENCY II FIRMS, NON-SOLVENCY II FIRMS: SENIOR INSURANCE MANAGERS REGIME (AMENDMENT) INSTRUMENT 2018, available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-accountability-in-banking-and-insurance**
2	**Supervisory Statement 35/15 UPDATE 'Strengthening individual accountability in insurance' available at: www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss**