

Policy Statement | PS4/18

International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision

March 2018



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Contents

1	Overview	5
2	Feedback to responses	6
	Appendix	9

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 30/17 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision'.¹ The PRA received 24 responses to the CP. One material change has been made to the draft supervisory statement following consultation.

1.2 The new Supervisory Statement (SS2/18) 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision'² is included as a link in the Appendix. SS2/18 introduces new factors to be considered alongside the PRA's current requirements for third-country branch authorisation. SS44/15 'Solvency II: third-country insurance and reinsurance branches'³ remains unchanged.

1.3 This statement is relevant to all existing and prospective insurance firms carrying out regulated activities, but not headquartered, in the UK that are not able to benefit from passporting rights. The new SS does not apply to Swiss General Insurers, as defined in the PRA Rulebook, to which different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC).

Background

1.4 CP30/17 set out two additional factors that would be considered in combination with the factors described in SS44/15 and 'The PRA's approach to insurance supervision'⁴ when reviewing an application to authorise a firm to operate a third-country branch in the UK. The new factors the PRA proposed it also considers were the:

- scale of UK branch activity covered by the Financial Services Compensation Scheme (FSCS) with a view to being satisfied that the protected amount covered by the FSCS can be absorbed by insurers liable to contribute to the FSCS. The PRA proposed a threshold of £200 million of FSCS-protected liabilities over which a firm would be expected to operate as a subsidiary rather than conducting business through a third-country branch; and
- impact of the failure of a firm with a UK branch on the wider insurance market and financial system.

1.5 The new approach comes into effect from 29 March 2018. For European Economic Area (EEA) firms currently branching into the UK under 'passporting' arrangements and intending to apply for PRA authorisation in order to continue operating in the UK after the UK's withdrawal from the European Union (EU), this approach would be relevant to authorisations for this purpose.

1.6 The PRA will keep the policy under review to assess whether any changes will be required due to changes in the UK financial system or regulatory framework, including those arising once any new arrangements with the EU take effect.

1 Available on page 2: www.bankofengland.co.uk/prudential-regulation/publication/2017/international-insurers-pras-approach-to-branch-authorisation-and-supervision.

2 March 2018: www.bankofengland.co.uk/prudential-regulation/publication/2017/international-insurers-pras-approach-to-branch-authorisation-and-supervision-ss.

3 November 2015: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-third-country-insurance-and-pure-reinsurance-branches-ss.

4 www.bankofengland.co.uk/prudential-regulation/publication/2016/pras-approach-documents-2016.

Changes to proposals

1.7 The PRA has made one material change to the draft SS following the consultation which is to increase the FSCS-protected liabilities threshold from £200 million to £500 million. Compared with the cost benefit analysis set out in the CP, this change will reduce the cost to the industry. The risk to the FSCS will rise, however the cost of a single firm with a UK branch failing remains below the maximum FSCS levies that could be absorbed by the industry having regard to the caps on FSCS annual levies. These changes do not affect mutuals or other firms differently from the original proposal and in the PRA's opinion, the impact of SS2/18 on mutuals is expected to be no different from the impact on other firms.

1.8 The PRA has made a number of minor amendments to the draft SS in light of the feedback received to add further clarity. These changes are explained in the following chapter.

2 Feedback to responses

2.1 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, and to publish an account, in general terms, of those representations and its response to them.

2.2 The PRA received 24 responses to CP30/17. The respondents made a number of observations and requests for clarification which are set out below. Respondents were broadly positive towards the overarching principle that international insurers should be able to branch into the UK. Respondents' feedback particularly focussed on the proposed FSCS-protected liabilities threshold.

2.3 The next section summarises the responses received from industry participants together with feedback from the PRA. They note amendments to the text of the draft SS.

The scale of UK branch activity covered by the FSCS

2.4 Some respondents proposed alternative metrics to a threshold based on all FSCS-protected liabilities:

- Narrow the scope of the threshold and exclude employer's liability insurance (or all policies where the direct policyholder is a commercial firm) from the FSCS-protected liabilities threshold.
- Narrow the scope of the threshold and exclude liabilities that are reinsured from the FSCS-protected liabilities threshold.
- Replace the metric with a threshold based on the size of a firm's Solvency Capital Requirement.

2.5 The PRA has considered the proposed alternatives, and has assessed that the original proposal of a threshold based on all FSCS-protected liabilities is most appropriate to meet its objectives. The PRA does not consider that the alternatives proposed would necessarily meet the policy's objectives to contribute to securing an appropriate degree of protection for policyholders and mitigate the risk of a call on the FSCS that is beyond what can be safely absorbed by the industry in levies therefore promoting the safety and soundness of firms. The PRA is concerned with both the likelihood and impact of failure, and considers that alternatives

suggested by respondents may obscure the scale of the potential call on the FSCS from branch failure.

2.6 Some respondents proposed as an alternative to subsidiarisation that the PRA should take into account arrangements which firms might voluntarily put in place to ring-fence assets in the UK or to put in place some forms of contingent capital support (eg from a parent). The PRA does not consider ring-fencing assets in the UK, or using contingent capital, as a viable alternative as it does not provide the PRA with increased supervisory oversight and could not be relied upon to reduce the potential risk of disruption to the market and FSCS-covered policyholders in the event of an insurer default.

2.7 Some respondents proposed increasing the level of the threshold from the proposed £200 million, with a number suggesting £500 million as a more appropriate level. Respondents argued this would be more aligned to the PRA's approach in banking. The PRA does not consider a direct comparison with the banking branch policy as appropriate due to the differences in the industries and the nature of their FSCS protection. For example, protected deposits must be made available within seven days.

2.8 However, taking account of the capacity to absorb levies in the insurance industry and the potential impact on firms, the PRA agrees that a higher threshold would be appropriate. In particular, the PRA accepts that calls on the FSCS made as claims fall due could be over a longer time period than one year. Therefore the threshold has been amended to £500 million of FSCS-protected liabilities in paragraph 2.6 in SS2/18.

2.9 More broadly, some respondents asked how the PRA proposed to assess the FSCS-protected liabilities threshold when reaching a judgement on the appropriateness of a firm operating through a subsidiary. Respondents asked whether the PRA intended to:

- take into account business plans and strategies and the impact on a branch's expected profile of FSCS-protected liabilities (eg if a firm was likely to fall below the threshold or rise above it in the medium term); and
- consider the FSCS threshold alongside other factors in the round.

2.10 As stated in SS2/18 in paragraph 2.6, the PRA does not intend for the FSCS-protected liabilities threshold to be a hard threshold. The PRA will consider all factors set out in SS2/18 together when assessing the risks of a third country branch in the UK. The PRA has clarified how it will assess firms against the threshold in SS2/18 in paragraph 2.8.

2.11 Most respondents asked for clarity on the PRA's definition of 'FSCS-protected liabilities'. After considering responses, the PRA agreed that additional clarity on its definition on FSCS-protected liabilities would be beneficial. This has been amended in paragraph 2.7 in SS2/18.

2.12 Some respondents queried how the threshold on FSCS-protected liabilities will apply to pure reinsurance branches. The threshold will apply to all third country branches, however it should be noted that for some firms the level of FSCS-protected liabilities could be zero. This is likely to be the case for pure reinsurance branches.

2.13 Some respondents queried whether, in cases where the PRA concluded that operating through a subsidiary was appropriate, the PRA would agree a time period to allow firms to restructure and subsidiarise. The PRA is aware that the process of converting from a branch to a subsidiary requires planning and preparation, and will consider with firms a reasonable time period to restructure, where appropriate, taking into account the operational steps involved

and the risks to the PRA's objectives. This may be particularly relevant for firms that currently operate in the UK under passporting rights.

Other responses

2.14 The PRA received a number of questions specific to individual firms which have not been addressed in this feedback as they do not relate to the proposals set out in CP30/17. This included requests for clarity on the PRA's existing third-country branch policy. For example, some respondents asked about the Senior Insurance Managers Regime and the authorisation of composites. Firms should get in touch with their usual supervisory contact to address these concerns.¹

2.15 Most respondents asked for additional clarity on the impact of the UK leaving the EU. For example, changes to the PRA's rules on the localisation of branch assets and how an assessment of broad equivalence will be applied to EEA jurisdictions. The PRA will keep the policy under review to assess whether any changes will be required due to changes in the UK financial system and regulatory framework, including those arising once any new arrangements with the EU take effect.

¹ Where a firm does not have a supervisory contact, enquiries can be submitted using contact details available on the Bank of England website at www.bankofengland.co.uk/contact.

Appendix

Supervisory Statement 2/18 'International insurers: the PRA's approach to branch authorisation and supervision' available at: www.bankofengland.co.uk/prudential-regulation/publication/2018/international-insurers-pras-approach-to-branch-authorisation-and-supervision-ss.