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Welcome to the latest update from Clyde & Co's corporate insurance team. This update summarises recent developments with links to further reading.

What are the changes of London becoming a world centre for ILS'?

As we now enter the final stages of the UK general election campaign, it seems that it was a political age ago that in mid-March the Chancellor, George Osborne, delivered his final budget of the current government. It was in that Budget report that Osborne noted that the insurance linked securities (ILS) market represents an important growth opportunity for the UK and that the government would work with the industry and regulators to develop a new competitive corporate and tax structure for allowing ILS to be domiciled in the UK and thereby making greater use of so-called alternative capital.

This announcement was widely welcomed, not least because it signalled that the government was listening to the market. Indeed, embracing the rise of alternative capital was one of the things mentioned by the London Market Group (LMG) to government, the LMG being the body set up to create and articulate a vision for the London insurance market and to identify areas in which proactive action may be taken to improve London's competitive position.

Possible issues

A number of issues are, however, raised by this announcement, including what the consequence would be should there be a new government (be it a majority, minority or coalition government) after the general election on 7 May. Will the new government be as committed to delivering on this? Time will, of course, tell on this.

Leaving this aside, another issue to consider is what are the barriers to be overcome in order to establish the UK as a leading ILS centre and how manageable that will be. Key barriers are likely to include the following:

– The speed and ease with which the insurance special purpose vehicle (ISPV), which will form part of the ILS arrangement (in the form of, for example, a "side-car" or the issuer of cat bonds or some other security), can be set up and the regulatory impact under Solvency II (which will be applicable in the UK from 1 January 2016) of such ISPVs on ceding companies (ie the extent to which ceding companies can recognise arrangements with, and investments in, ILS vehicles in, for example, determining their own capital requirements)

- Making the tax regime more attractive for ILS investors – some may downplay this issue, but it is likely to be a key factor for potential ILS investors – what the government's appetite may be for this, set against a background of continuing austerity and spending cuts, will have to be seen
- Developing the right expertise, know-how and transaction documentation – this barrier should be the most easy to overcome as the expertise around the components parts of an ILS transaction already exists in the market

Regulatory concerns

The UK regulators, in particular the PRA, are likely to have a number of concerns which they will want to see addressed. These will include ensuring the following:

- That the collateral which typically backs the ILS arrangements is sufficient and will respond in the circumstances envisaged
- That the ILS capital market investors understand the underlying risks which they are taking on and that they have sufficient know-how, including access to modelling capability, to properly assess these risks
- That the ceding company appreciates the extent to which risk is actually being transferred by it pursuant to the ILS arrangement
- The wider impact on traditional re/insurers as a result of participating in an ILS arrangement (such as with regard to concentration of risk, impact on returns on capital, and possible changes in business model etc)

Challenges… and opportunities

To deliver on this announcement, the political will and vision will need to be there. It is quite interesting to note that Gibraltar has just announced its first ILS transaction only 12 months after first announcing its intention to get involved in the ILS space.

In addition, the regulatory processes will need to be sufficiently streamlined so as to expedite the time in which an ILS arrangement can be launched. To an extent, the UK's hands in this respect will be somewhat constrained by the Solvency II rules.

However, ILS also presents an opportunity – indeed, potentially a significant opportunity. As we have reported previously, there is an increasing recognition that alternative capital is here to stay. To not work with it would be to potentially miss out in a big way. The real prize is not so much ensuring that an ILS vehicle is domiciled in the UK but that there is an active ILS market in the UK and that ILS deals are transacted in the UK. This will provide easier access to the capital markets for European based re/insurers, and it will allow them to operate within a jurisdiction with tried and tested and robust legal and regulatory regimes, and which has a very deep talent pool of expertise.

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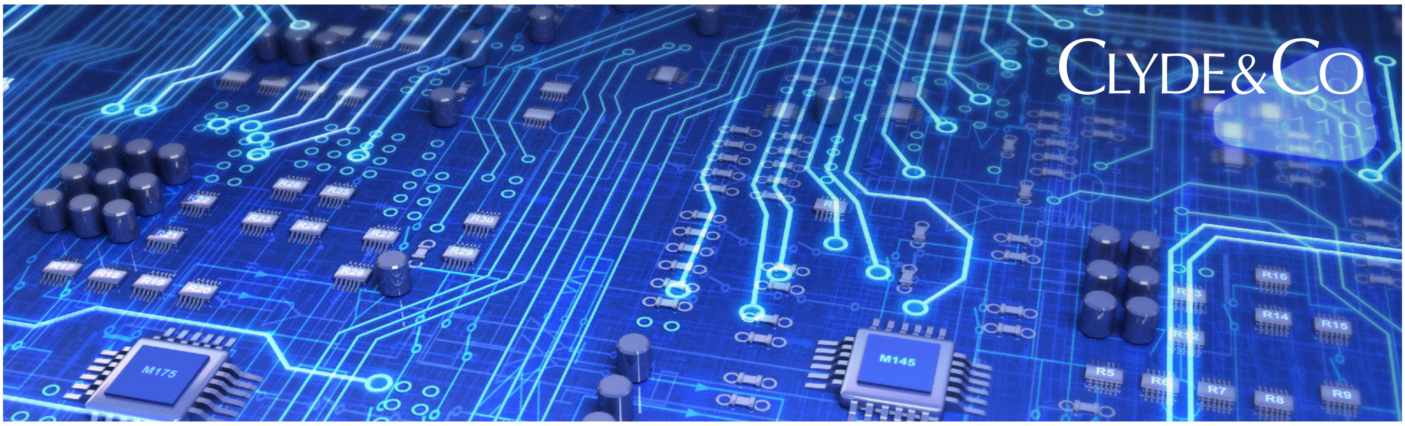

Further US Insurance Regulatory Developments regarding Cyber Security

As reported in the previous edition of Corporate Insurance In-Sight, US insurance regulators have increased their scrutiny of cyber security measures of insurance companies in light of significant cyber attacks against businesses including insurance companies.

On 16 April 2015, the NAIC Cybersecurity Task Force adopted twelve "**guiding principles**" for effective cyber security by insurance companies. This adoption followed the inaugural meeting of the NAIC Cybersecurity Task Force at the NAIC Spring 2015 National Meeting on 29 March 2015. The guiding principles are brief and relatively broad. For example, Principle 2 provides that "Confidential and/or personally identifiable consumer information data that is collected, stored and transferred inside or outside of an insurer's, insurance producer's or other regulated entity's network should be appropriately safeguarded"; similarly, Principle 4 provides that "Cyber security regulatory guidance for insurers and insurance producers must be flexible, scalable, practical and consistent with nationally recognized efforts such as those embodied in the National Institute of Standards and Technology (NIST) framework."

In addition to the guiding principles, the NAIC Cybersecurity Task Force's work plan includes development of a "Consumer Bill of Rights" that will set forth consumers' rights following a data breach at an insurance company; work on NAIC model laws regarding health information privacy, consumer financial and health information, safeguarding of consumer information, and insurance fraud prevention; and survey of states on cyber security measures.

Beyond the NAIC's work in this area, various US state insurance regulators have independently been focusing on cyber security issues. In particular, the New York Department of Financial Services (NYDFS) has raised heightened concerns regarding cyber security at entities that it regulates. Following upon its February 2015 *Report on Cyber Security in the Insurance Sector*, NYDFS issued an information request on 26 March 2015 to the largest insurers in New York requesting a confidential report on their cyber security measures by 27 April 2015. The request is quite detailed in the types of information regarding the insurers' informational technology/cyber security framework that it demands. It covers issues ranging from the qualification requirements for an insurer's chief technology officer and information risk management policies (including with respect to third-party vendors) to specific points such as multi-factor authentication and adherence to the NIST framework.

The answers to the request will be used by NYDFS to undertake a "comprehensive risk assessment of each institution" under its supervision. This request follows on the announcement NYDFS made when it released its February report on cyber security that it will "integrate regular, targeted assessments of cyber security preparedness at insurance companies as part of [its] examination process" going forward.

The current pronounced and increasing regulatory focus on cyber security in the insurance industry means that insurance companies, insurance producers and any service providers or vendors for the insurance industry should review their cyber security processes and procedures and prepare for increasing scrutiny and regulation in this area.

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US NAIC's Spring 2015 National Meeting

The National Association of Insurance Commissioners (NAIC) held its Spring 2015 National Meeting in Phoenix, Arizona from 26–31 March 2015. Set forth below are highlights from the meetings of certain NAIC groups:

Reinsurance

The Reinsurance Task Force received an update on the status of implementation by the states of the 2011 amendments to the NAIC Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation, which allow for non-US reinsurers that are highly rated and meet other criteria to become "certified" and therefore qualify to post less than the usually required 100% collateral for their US ceding companies to receive credit for reinsurance. Only 26 states (representing approximately 60% of direct written insurance premiums in the United States) have adopted these amendments thus far. Various parties (including reinsurers, trade groups and other regulators, especially from the European Union) have expressed frustration at the slow progress and lack of uniformity in the United States with respect to non-US reinsurers and have advocated entry into a "covered agreement" by the United States with other countries' regulators on reinsurance matters. The US Treasury Secretary and the US Trade Representative could enter into covered agreements on behalf of the United States without involving the state insurance regulators. (On this issue, on 21 April 2015, the European Union gave a mandate to its executive European Commission to negotiate such a pact with the United States.)

Cybersecurity

The Cyber security Task Force held its inaugural meeting and considered its work plan. (See previous article regarding this task force's work.)

Responses to International Developments

The International Insurance Relations (G) Committee and the ComFrame Development and Analysis (G) Working Group continue to monitor and assess development of global insurance capital standards and supervisory requirements. The NAIC is preparing position statements setting forth US insurance regulators' views regarding the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) of the International Association of Insurance Supervisors' (IAIS) as well as the development by IAIS of a risk-based global insurance capital standard (ICS) for internationally active insurance groups (IAIGs) and basic capital requirements (BCR) and higher loss absorbency (HLA) requirements for global systemically important insurers (G-SIIs).

Private Equity

The Private Equity Issues (E) Working Group adopted guidance to be included in the NAIC's Financial Analysis Handbook regarding issues and considerations for insurance regulators when reviewing an application from a party seeking to acquire control of a domestic insurer. Although the guidance is not specific to private equity acquirers, it was developed due to concerns that were raised by insurance regulators when faced with private equity acquirers seeking to make insurance acquisitions particularly following the 2008 financial crisis.

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Tightening Australia's foreign bribery laws - amendments presented to Parliament

In late March, the Australian Government presented the Crimes Legislation Amendment Bill 2015 to the House of Representatives. The Bill includes a significant amendment to the offence of bribing a foreign official but only partially addresses criticisms of Australia's bribery laws, thereby raising the issue of whether further reforms are likely.

On 19 March 2015, the Australian Minister for Justice, The Hon Michael Keenan MP, presented the *Crimes Legislation Amendment (Powers, Offences and Other Measures) Bill 2015* (the **Bill**) to the House of Representatives. The Bill includes amendments to the offence of bribing a foreign official under the Commonwealth Criminal Code.

The offence of bribing a foreign public official and the proposed amendment

Division 70 of the Criminal Code currently provides that it is an offence to offer or provide an undue benefit to another person in any circumstance where:

- The benefit is not legitimately due
- It is provided with the intention of *influencing an individual in the exercise of their duties as a foreign public official*, in order to obtain business or an undue business advantage (emphasis added)

The term 'foreign public official' is very broadly defined, the law can apply to conduct taking place entirely outside Australia and the penalties for corporations and individuals are severe. This offence was inserted into the Criminal Code in 1999 to give effect to Australia's obligations under the OECD Anti-Bribery Convention.

Although it will be possible in some circumstances to establish that a bribe has been offered or provided with the intent to induce a government agency to grant business or some other benefit not legitimately due, this element of the offence has come under criticism as there are many situations where it will be difficult to identify the specific official who the offender influenced (or attempted to influence). Foreign bribery is frequently committed through intermediaries such as local agents or contractors and thus there will be instances where even the individual offering the bribe will never know the identity of the target of the bribe.

The proposed amendment to Division 70 clarifies that when proving that a benefit was offered or provided with an intention to influence a foreign public official, it will not be necessary to prove an intention to influence a particular official.

Is there a need for further reform?

The proposed amendment to Division 70 will remove a significant loophole in Australia's foreign bribery offence. However, the Bill has overlooked a number of other aspects of Division 70 which have been the subject of persistent and robust criticism by the OECD Working Group on Bribery and Transparency International, academics and prosecutors. Arguably the two most significant aspects overlooked are the requirement to disregard the value of the benefit and the facilitation payment defence.

Disregarding the value of the benefit

When considering whether a benefit offered or provided to a person is legitimately due, Division 70 states that a court is to disregard the value of the benefit. The intention of those who drafted the legislation was presumably to ensure that bribery is an offence irrespective of the value of the benefit offered or provided. However, this provision may prevent a court considering the value of a benefit in circumstances where the value alone may suggest that a benefit is not legitimately due. By way of example, there may be situations where a public official would be legitimately due a modest fee for providing a particular service related to obtaining business. However, in the same

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situation a very large fee may be highly improper and not legitimately due. Accordingly, it has been suggested that Division 70 should be amended to clarify that bribery remains an offence irrespective of the value of the benefit offered or given, but a court may consider the value where value alone suggests a benefit is not legitimately due.

The facilitation payment defence

A number of arguments have been advanced in favour of removing this defence, including:

- Consistency with Australian Commonwealth and state laws regarding bribery of public officials in Australia, which do not include a facilitation payment defence or anything comparable
- Consistency with foreign laws which can, or may, impact upon Australian corporations and individuals, and which expressly outlaw facilitation payments
- The need to ensure compliance with international treaty obligations (by retaining a facilitation payment defence, Australia is currently in breach of its treaty obligations in relation to the UNCAC Convention)
- Increasing legal certainty by removing the need to draw a distinction between a bribe and a facilitation payment

A public consultation process was undertaken on this issue at the end of 2011 but, as yet, the Government has not issued its response.

Increased enforcement and the importance of compliance

It remains to be seen whether steps will be taken to address some of the other contentious aspects of Australia's present foreign bribery laws which have been overlooked in the Bill. However, the proposed amendment to Division 70 of the Criminal Code, if enacted, is likely to encourage the Australian Federal Police (AFP) to launch more prosecutions for foreign bribery and thus reinforces the importance of implementing and maintaining comprehensive compliance programs. As to the second of these matters, a corporation will not be liable for bribery (or any other offence under the *Crimes Act* where intention, knowledge or recklessness is an element of the offence) if it is able to prove that it exercised due diligence to prevent the commission of the offence.

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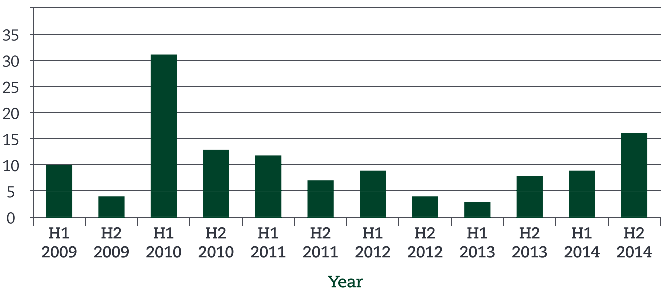
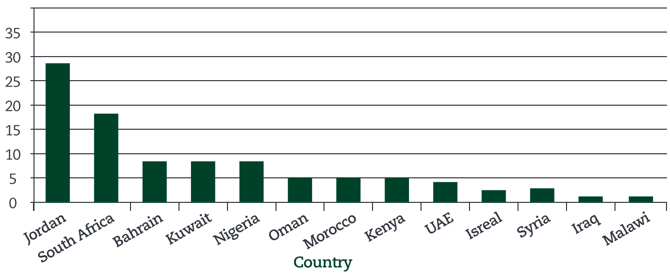
Africa Leads the way in M&A

Deal-making in the Middle East and Africa has been on something of a roll in recent months. There were 25 deals in the region in 2014 – up from 11 in 2013 – with a noticeable pick-up in activity in the second six months of the year, with 16 transactions completed. The bulk of the mergers and acquisitions (M&A) during this period took place in Africa, underlining the suggestion that the insurance industry is finally waking up to the continent's tremendous potential. Swiss Re bought a minority stake in Kenyan insurance group Apollo Investments Limited for an undisclosed fee while in the same country the UK's Prudential bought out life insurer Shield Assurance Co Ltd. Meanwhile France's Axa paid almost US$250 million to acquire Nigeria's Assur Africa Holding Ltd. AXA´s presence in Africa now consists of operations in Cameroon, Gabon, Ivory Coast, Morocco, Senegal and Algeria.

Volume of deals in MEA





Activity in North Africa is also increasing. Morocco has seen a combination of domestic consolidation and outbound transactions into Nigeria. As befits its status as one of the MINT countries, Turkey continues to attract interest from international players. In one example, Dutch company Kibele completed the purchase of Aviva Sigorta A.S. in December as the British insurer shifts its strategy to narrow its focus on businesses where it has a leadership position and Volume of deals in MEA.

In the Middle East insurance M&A continues to be limited. The only significant transaction in the second half of 2014 involving an entity based in the Gulf Cooperation Council was the acquisition of Dubai's Visionary Underwriting Agency by Bermuda's Ironshore International. This is not indicative of a lack of interest in the region on the part of international players; economic prospects are bright and a number of factors point towards a healthy future for the insurance industry. Rather it is due to the fact that

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a number of barriers to transactions remain, including structural issues as well as often mismatched price expectations between buyers and sellers.

However, inbound investment is continuing; one increasingly common tactic to navigate around some of these challenges is participation in the reinsurance market. International players have been looking at coming into the Dubai International Financial Centre (DIFC), the federal financial free zone situated in the UAE, where 100% foreign ownership of reinsurance entities is permitted. In December, Beazley announced it had opened an office in the DIFC, following similar moves by Catlin and XL earlier in 2014. The trend is continuing: just last month specialist insurer Markel International became the latest to gain a local presence in Dubai.

The DIFC has become the regional hub for reinsurance in this region, precipitated largely by the formal decision of Lloyd's to set up a platform in the emirate. Growth in the insurance sector is expected to continue over the coming year; DIFC currently has 72 insurance sector entities and is planning to increase this to around 100 by the end of 2015. The factor that the regulator is reviewing its rule book with a view to clarifying the role of Lloyd's and the regulation of managing general agents will streamline the licensing process and spur further interest in setting up operations in the region.

Link to update.

The FCA's Business Plan 2015/16

On 24 March 2015, the Financial Conduct Authority (**FCA**) published its business plan for 2015/16 (the **Business Plan**).

In this article, we highlight some of the FCA's "*key priorities*" for the coming year which could have a significant impact on insurers and insurance brokers. We examine the FCA's upcoming work in the "*general insurance and protection*" sector and assess the potential implications for FCA-regulated firms.

Key Priorities

The FCA's Business Plan lists seven key priorities which will form the basis of its regulatory work over the coming year. The areas of most interest to insurers and insurance brokers are:

1. Anti-Bribery and Corruption

Last year the FCA examined insurance broker's anti-bribery and corruption (**ABC**) systems and controls and published a thematic review of its findings called "*Bribery and Corruption in Commercial Insurance Broking*" (for further details see http://www.clydeco.com/insight/newsletters/view/corporate-insurance-newsletter-january-2015). The review found some regulated firms had good ABC policies on paper, but that their implementation in practice was not as strong as expected. The FCA identified gifts and corporate hospitality as an area in which most firms could improve.

Firm's ABC controls will continue to be an area of focus for the FCA in the coming year, with visits to other smaller firms already scheduled for 2015.

2. AML and Sanctions

In 2014, the FCA published its findings on its study of anti-money laundering (**AML**) systems and controls at small banks.

Last year saw rapid changes to sanctions regimes. The adoption of the Fourth Money Laundering Directive is now on the horizon. Against this background, the FCA has stated that it will continue to focus on the effectiveness of all firm's AML systems and controls. The Business Plan states this will include how regulated firms manage the risks posed by terrorist financing and sanctions.

3. Financial Crime

Both ABC and AML reviews mentioned above were published at the same time as the FCA opened a consultation on its "*Financial Crime Guide*". The FCA will continue its work on firms' systems and controls for preventing financial crime in the coming year, expressing concerns that:

Technology may have outstripped firms' investment in their systems and controls; and

Firms may be operating from policies and procedures which have not been updated to reflect the changed regulatory landscape.

4. Culture

"*Changing culture*" at regulated firms is another key area of focus for 2015/16. The FCA's Business Plan highlights the fundamental role of individual accountability for senior managers in complying, and fostering a culture of compliance, with the expanding regulatory framework which includes the FCA's rules. The importance to the regulators of improving senior management's individual accountability in changing culture at regulated firms is demonstrated by other recent proposals being implemented alongside the PRA, such as to:

- Expand the scope of the Senior Insurance Managers Regime
- Introduce a new regulatory regime for Independent Non-Executive Directors at insurers
- Adopt new "*fit and proper*" tests for approved persons
- Significantly change the requirements for whistleblowing procedures at regulated firms

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Insurance Work

The FCA Business Plan also sets out its proposed projects for 2015/16 which will solely target insurers, which include:

- Publishing the results of their review of the effectiveness of distribution chains and systems and controls where authority is delegated. The FCA's findings are expected to be available in the latter half of 2015
- Reviewing the role of principals and the robustness of their systems and controls in overseeing the distribution of general insurance products by their Appointed Representatives (**ARs**). This will include a review of ARs' sale practices and the provision of post-sales services to customers
- Conducting a market study of how insurance firms use "Big Data", including analytics and behavioural data, and the potential risks and benefits for customers

Conclusion

Given the emphasis in the FCA's Business Plan on the importance of fighting financial crime as an ongoing policy objective, it would appear that ABC and AML will remain at the top of the FCA's agenda not only for the coming year, but well into the future.

The FCA's proposals in relation to individual accountability are not likely to take effect until 2016 at the earliest, giving insurers some breathing space to assess how to best implement proposed changes in their businesses.

The seven key priorities in the Business Plan cover a wide range of regulatory and compliance issues. The FCA's insurance focused work will no doubt give rise to developments and guidance in the future.

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Further proposals on senior management responsibility

A slew of policy statements and consultation papers were issued in March on the proposed new approval and fitness and propriety regimes for senior managers in insurance firms:

1. PRA Policy Statement PS3/15 "Strengthening individual accountability in banking and insurance". This follows on from CP14/14 "Strengthening accountability in banking: a new regulatory framework for individuals"; and CP26/14 "Senior insurance managers regime: a new regulatory framework for individuals" (http://www.clydeco.com/insight/newsletters/view/corporate-insurance-newsletter-february-2015). The Policy Statement contains feedback and final rules on the scope of the new regime, allocation of responsibilities, and assessing fitness and propriety (other than rules on the provision of references)
2. A joint FCA/PRA consultation, FCA CP15/16 and PRACP13/15, which deals with forms, consequential changes and transitional arrangements and the FCA's proposed governance arrangements for Solvency II firms, as well as feedback to responses on the FCA's November consultation on changes to the approved persons regime (APR)
3. PRA CP12/15: Senior Insurance Managers Regime: a streamlined approach for non-Solvency II firms
4. FCA CP15/15: Changes to the Approved Persons Regime for insurers not subject to Solvency II

Key points – PS3/15

Maintaining governance maps: The PRA has acknowledged concerns about the potential burden of maintaining a single up to date document at all times. It will therefore allow a series of documents to be maintained as long as these are presented in a coherent and clear manner, which will only need to be updated quarterly, and whenever there is a significant change in governance structure, allocation of responsibilities or the reporting lines or lines of responsibility for a key function holder.

Identifying key functions: The PRA has suggested a number of functions which firms may consider are key functions, depending on the nature and complexity of the firm's business. These are: investment functions; claims management function (especially for general or health insurance firms); IT functions; and reinsurance functions (if separate from the other key functions e.g. other risk management).

Assessing fitness and propriety: The PRA believes that most firms have a regular cycle of appraisals and performance reviews that provides a base line for these assessments, although additional checks may be appropriate taking account of the nature and level of an individual's responsibilities. The PRA expects firms and groups to take all reasonable steps to gather and consider information which may be relevant to an individual's business conduct, including possibly using pre-employment questionnaires. Where a firm becomes aware of past business conduct that might be relevant to an assessment of fitness and propriety, it will expect the firm to make reasonable enquiries to establish the circumstances of that conduct and its relevance. It expects regulatory references and the Financial Services Register to be a source of information that firms will use.

Group Entity SMF: Despite concerns about duplication between the PRA's fit and proper requirements and those of other regulators, the PRA has maintained its stance that firms should seek approval for individuals elsewhere in the group exerting a significant influence on their management, to ensure those individuals take account of the interests of the firm and not just the wider group. However, the PRA may take into account assessments of fitness by other regulators.

Prescribed Responsibilities: The wording of some of the prescribed responsibilities has been amended to bring it in line with the corresponding responsibilities in the SMR regime for banks. In insurance groups with several regulated entities, responsibilities may be allocated to the Group Entity Senior Management function holder. This allocation must be clearly set out in governance maps and any potential conflicts of interest addressed properly. The firm will need to ensure each individual has the necessary time and resources to perform their role.

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Compliance function: The Solvency II compliance function is different to the current CF10 approved by the PRA. An individual responsible for Solvency II compliance who is not also performing another controlled function will need to be notified for this Solvency II key function role to the PRA.

Third country branches: At least one person must be approved for the Third Country Branch Manager function. The key functions in respect of the branch's operations, including at least the four minimum key functions specified in Solvency II, must also be identified.

Final supervisory statement material on the scope of the SIMR and the allocation of responsibilities is to be issued later in 2015, together with final rules and supervisory statements relating to the provision of references and conduct rules and standards.

The rules on fitness and propriety of those performing or responsible for key functions will have effect from the 1 January 2016, in line with the deadline for implementation of Solvency II. The remaining rules introducing the SIMR, which are designed to align the insurance regime with the new regime for banks, will have effect from 7 March 2016, when the Financial Services and Markets Act 2000 (Banking Reform) Act 2013 comes into force.

Key Points - FCA CP15/16 and PRA CP13/15

Transitional arrangements: The two stage implementation for the proposals makes the transitional arrangements particularly byzantine in their complexity.

From 1 January 2016:

1. Applications for approval for a controlled function must include information on assessing fitness and propriety and the candidate's proposed scope of responsibilities, including any prescribed responsibilities allocated under the new allocation of responsibilities rulebook
2. Subject to point 3 below, for Solvency II key function holders (including those in post at 1 January 2016) who are not performing PRA controlled functions, the firm must submit a notification form so that the PRA can assess fitness and propriety, together with a scope of responsibilities document. For proposed appointees, these documents should be submitted as soon as the candidate has accepted the terms of his/her appointment
3. However, if the Solvency II key function holder is in or is applying to be in a FCA controlled function, it is currently proposed that firms do not need to submit the PRA notification form.

From 7 March 2016:

1. Existing approved persons performing a function that will become a PRA or FCA controlled function at 7 March 2016 will be grandfathered across to the appropriate function, provided the firm submitted a grandfathering notification form in respect of those individuals by 8 February 2016. The form must include individuals going through the approval process under the existing regime, to cover the eventuality that their application may be determined before 7 March
2. New applications, together with a scope of responsibilities document, must be submitted for key function holders who will be performing a new PRA controlled function from 7 March 2016, by the rule-making date. They will not need to submit the key function holder notification form as well
3. Applications for approval under the existing regime made before 7 March 2015 which have not been determined by that date will be treated as if they had been made for the relevant controlled function under the new regime. Firms will be required to update the application to make it clear which PRA Significant Insurance Management Function (**SIMF**)/FCA Significant Influence Function (**SIF**) will be performed
4. The new PRA conduct rules will apply to PRA approved persons and FCA approved persons who are in a relevant senior management function i.e. those performing FCA CF1, CF7, CF10, CF28 or CF51 who have responsibility for activity directly relating to the sound and prudent management of the firm
5. The new FCA SIF conduct rules will apply to SIF holders and SIMF holders.

A table mapping the existing controlled functions to the new controlled functions is at Annex 1 to the CP.

FCA governance proposals: The FCA is proposing to amend its handbook to ensure that it has appropriate powers in relation to governance, but also to minimise overlap with PRA governance rules. It is therefore proposing:

1. Rules to ensure that governance maps cover all

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senior individuals of interest to the FCA, so that it can take enforcement action against firms not clearly or appropriately allocating responsibilities of key interest to the FCA

2. To require firms, when amending governance maps to reflect changes to an individual's responsibilities, to update that individual's scope of responsibilities document
3. To require firms to keep records for ten years to enable identification of historic accountabilities if any problems come to light in the future
4. Changes to the SYSC rules to minimise overlap with PRA's rules
5. To remove CF8 (apportionment and oversight) for Solvency II firms, while requiring responsibility for allocation of responsibilities to be allocated to a senior approved person and responsibility for oversight of the establishment of systems and controls to be allocated to the CEO or equivalent.

Key Points – PRA CP12/15 and FCA CP15/15

The PRA is not intending to apply the new SIMR to non-directive firms (other than those with assets of more than £25,000,000) on the basis that it would be disproportionate for firms of that size. Accordingly it is proposing that:

1. The existing director, NED, CEO, director of unincorporated association, and small friendly societies functions will cease to apply and will be replaced by a single small insurer senior management function (**SISMF**) for which one or more individuals must be approved. The current chief actuary and with profits actuary functions will be discussed in a consultation later this year
2. Fit and proper criteria would remain the same but a requirement would be added for criminal record checks to be applied. The proposed scope of an individual's responsibilities would need to be included with each application for approval
3. Firms would have to notify the PRA of any significant change of responsibilities for a senior manager and of any information that would be reasonably material to the fit and proper assessment of the current or former holder of a controlled function
4. Four prescribed responsibilities – business plan and management information, financial resources, legal and regulatory obligation, oversight of proportionate systems and controls, and risk management – must be allocated, contrasting with the eleven required for Solvency II firms. Information on the scope of responsibilities of each individual would be required but no governance map
5. Firms will not be required to comply with the Solvency II requirements to identify key functions, ensure that staff performing these functions are fit and proper and notify the PRA of details of all key function holders so that the PRA can make a fit and proper assessment
6. There will be no group related requirements

The new list of SISMFs will be introduced from 7 March 2016, and rules for assessment of fitness and propriety and the new conduct standards will apply from that date. Rules relating to the allocation of the four prescribed responsibilities will commence 12 months later.

The FCA states in its CP that the PRA's proposed prescribed responsibilities are not wide enough to cover the full range of FCA interests. It is therefore proposing:

1. That individuals in executive governing roles who will no longer be approved by the PRA (the director, CEO, director of unincorporated association and small friendly society functions) should be subject to pre approval by the FCA as significant influence function holders
2. That NEDs performing the chairman or senior independent director role or who chair the remuneration, risk, audit or nominations committees should also be subject to pre-approval by the FCA
3. To require information on the applicant's proposed scope of responsibilities when applying for approval, on the basis that these documents can be useful for supervisory purposes to establish who is responsible for which area of the firm's business. Firms will also be required to update their scope of responsibilities documents and to keep records for 10 years to enable them to identify historic accountabilities.

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The final countdown - Solvency II

The countdown is on to final implementation of the Solvency II regime on 1 January 2016. On 20 March 2015, the Prudential Regulation Authority (PRA) published its final rules for implementing Solvency II in the UK. Solvency II will apply to around 400-500 retail and wholesale UK insurance firms and to the Lloyd's insurance market.

PRA approach

Andrew Bailey, PRA chief executive, said that the finalised rules will provide "clarity for UK firms on how the PRA will implement the new regime – acting in the interests of the wider economy and ensuring an appropriate level of policyholder protection".

While the PRA has chosen to use an 'intelligent copy out approach' to transposing Solvency II, sticking as closely as possible to the Solvency II text, the supervisory statements set out the PRA's interpretation of the rules and how it intends to apply them. It remains to be seen whether the UK's interpretation and approach will differ from that taken by other member states.

As the EU Level 2 delegated acts and technical standards have direct effect in the UK, firms will need to have regard to these, as well as the PRA rules and supervisory statements and the Solvency 2 Regulations 2015 (of which more below).

'A new regime'

The policy statement contains the new chapters of the PRA rulebook transposing Solvency II, as well as 17 supervisory statements. The final rules and supervisory statements in most areas remain unchanged from the draft proposals in the consultation papers.

There are however some changes or clarifications in the following areas:

1. Volatility adjustment: as HM Treasury has decided to exercise the option for supervisory approval of the volatility adjustment (in the Solvency 2 Regulations 2015) the PRA has published a draft supervisory statement in a separate consultation paper (CP 11/15) outlining its approach to supervisory approval for the volatility adjustment
2. Transitional measures on technical provisions: The PRA's proposed rules and supervisory statement have been amended to reflect HM Treasury's decision to transpose the substance of the transitional measures in the Solvency 2 Regulations 2015. The PRA rulebook provisions on this are now quite limited
3. Third country branches: Rule 9 of this part has been amended to clarify which of the reporting rules apply to third country branches and with what modifications. The PRA has confirmed that it will consider applications to waive requirements for branches carrying on only reinsurance business, subject to a basic level of reporting. The proposed rule dealing with restrictions in calculating worldwide financial resources has been deleted
4. Surplus funds for firms carrying on with-profits business: the PRA has made three additions to the surplus funds supervisory statement to enhance clarity
5. National specific templates: changes have been made to a number of the reporting templates
6. With-profits business: amendments have been made to the definitions of "with profits fund" and "with profits policy liabilities" and to the supervisory statement in order to clarify the material regarding affordable and sustainable distribution strategies
7. Actuaries: the PRA has confirmed that the chief actuary function could be performed by an individual in another group company, or an external actuary

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Other related matters

The final rules and supporting supervisory statements are one of the latest in a succession of key materials recently published which include the following:

- **PRA supervisory statement on applying EIOPA's Set 1 Guidelines to PRA-authorised firms SS22/15, 22 April 2015:** explains the PRA's expectation of firms in relation to EIOPA's Solvency II Set 1 guidelines. The statement follows consultation paper CP5/15, Solvency II: applying EIOPA's Set 1 Guidelines to PRA-authorised firms, published on 19 February 2015
- **PRA consultation paper on consistency of UK GAAP with Solvency II CP16/15, 10 April 2015:** relates to a proposed supervisory statement on expectations of firms considering applying the derogation in Article 9 of the Solvency II Regulation (EU) 2015/35, which permits firms to value some assets and liabilities using local GAAP if certain criteria are fulfilled. Comments by 10 July 2015
- **PRA consultation paper on treatment of sovereign debt in internal models under Solvency II CP 14/15, 31 March 2015:** the PRA seeks comments on supervisory statement designed ensure that firms take into account material risks associated with sovereign debt. Comments by 1 May 2015
- **Joint PRA and FCA consultation paper on forms, consequential changes and transitional arrangements for new accountability regime for Solvency II firms, PRA CP13/15 / FCA CP15/16, 27 March 2015:** The proposed amendments to the FCA Handbook and the PRA Rulebook are intended to create a structure within Solvency II firms that will make it more likely that individuals and roles are appropriately matched, and that high standards of conduct are observed. Comments by 15 May 2015 (see page 11 of this newsletter)
- **Approvals and waivers under the Solvency II Directive, 20 March 2015:** provides information to firms wishing to apply to the PRA for a Solvency II approval or a Solvency II waiver and additional information on the transitional measure on technical provisions
- **Solvency 2 Regulations (SI 2015 No. 575) made on 6 March 2015:** The regulations implement certain elements of Solvency II. They can be found on legislation.gov.uk, together with an explanatory memorandum, a final impact assessment and a transposition table

Final countdown

Speaking at the PRA Solvency II Conference in late 2014, Paul Fisher, Deputy Head of the Prudential Regulation Authority, observed that "there is a great deal of work to do, time is short" in terms of getting ready for Solvency II. However, given the amount of time and investment which has gone into preparing for Solvency II over the years, it would appear that most UK insurers are in very good shape.

Among the steps firms will now need to take are:

1. Prepare and submit formal applications for Solvency II approvals, such as exclusion of entities from group supervision, application of "other methods" of group supervision for groups headquartered in third countries, use of the matching adjustment, use of the volatility adjustment, and preparation of contingency plans to address refusal of those applications
2. Analyse existing capital instruments against the required features for basic own funds under Solvency II to determine which instruments can be classified as Solvency II compliant and which will need to be dealt with under transitional measures. Requirements for transitional measures are set out in both PRA rules and Level 2 measures
3. Consider whether their articles of association permit dividends to be declared on a conditional basis, so that ordinary shares can be classified as Tier 1 or Tier 2 capital
4. Consider whether any changes to systems and processes are required in light of the new national reporting templates
5. Ensure necessary applications are made for approval or grandfathering of individuals under the new senior insurance managers regime (see **page 11** of this newsletter)
6. In the case of qualifying run-off firms, inform the PRA of their assessment of the circumstances that mean they meet the criteria for exclusion from the scope of Solvency II

Further information

If you have any comments or queries on anything in the newsletter, please can you contact **Martin Mankabady** or **Chris Hill** (our UK editors) or **Vikram Sidhu** (our US editor) or your usual contact.

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Further advice should be taken before relying on the contents of this Newsletter.

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