Policy briefing

UPDATE: November 2015

Strengthening individual accountability in insurance: SIMR, conduct rules and approved persons

Summary

The PRA and FCA have published a number of policy statements and consultation papers relating to the forthcoming Senior Insurance Managers Regime (SIMR). These latest publications seek to provide greater clarity by outlining the final rules on most aspects of the new regime, as well as further proposals to introduce a streamlined approach for smaller insurers.

The new regime, first put forward in consultations launched in November 2014, is the result of changes required by the Solvency II regime and the regulators' intention to bring insurance into line with new banking supervision rules (SM&CR). The insurance regime (SIMR) is aligned with the banking one (SMR) for the most part.

The August 2015 announcements cover:

- **The scope of the SIMR**, the identification of key functions, and the allocation of responsibilities to individuals.
- **A consultation on PRA rules for non-Solvency II firms**, including small insurers.
- **Changes to the scope of the FCA's approved persons regime**. These will ensure robust oversight and continued enforcement power over key individuals who can significantly impact the FCA objectives, whilst maintaining a proportionate approach.
- **Changes to the fitness and propriety assessments** of candidates for FCA regulated Significant Influence Function (SIF) roles to reflect the Solvency II framework and EIOPA guidelines.
- **New Conduct Rules** for approved persons in Solvency II firms to encourage appropriate behaviour by staff, in particular through an enhanced focus on treating customers fairly and responsible delegation by senior staff.
- **A timeline for the introduction of the changes.**

UPDATE In October 2015, the Treasury announced its intention to extend the SM&CR to insurers (from 2018). This will mean insurers will be subject to a similar regime as banks – the biggest change to SIMR being the introduction of the Certification Regime.

Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and CEO of the PRA said:
"The simple principle that you can delegate tasks and work, but you cannot delegate responsibility for the safety and soundness and conduct of your firm must become embedded at all levels of banks and insurers. (These latest) publications provide the certainty for firms to implement all necessary changes to achieve this objective."
Links: http://www.bankofengland.co.uk/pra/Pages/supervision/strengtheningacc/default.aspx

This briefing is designed to provide a general overview of the changes for CII members but there are a number of links to key documents for those who want more detailed technical content.

A new regulatory framework for insurance - background

The financial regulators - the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) - have announced near final rules for the new regulatory framework for insurance. The process began back in November 2014 with the publication of their initial plans for a new regime. Since then the regulators have been refining their plans via policy statements and further consultations.

This move to strengthen accountability in insurance is a result of a number of developments: Solvency II requirements, European Insurance and Occupational Authority (EIOPA) requirements and a move to bring insurance into line with new banking conduct rules. There is the need to incorporate legal requirements under the Solvency II Directive implementation of the 'fit and proper' requirement for relevant individuals. In parallel with this is the regulators' wish to align the insurance sector with changes made to banking supervision as a result of the Banking Act and the belief that the existing 'approved persons regime' is no longer fit for purpose for any part of financial services. The main impact of the proposed changes is to strengthen the regulatory regime applicable to individuals and to toughen the governance and vetting regime at firm level. The new regime reflects the regulators' increased focus on greater personal responsibility.

The new regime aims at identifying and approving those senior persons responsible for running an insurer or who has responsibility for a key function. It will also require **new governance maps** to confirm the allocation of these responsibilities and will introduce **new conduct standards** and **fitness requirements**. SIMR seeks to ensure those holding senior responsibility '*behave with integrity, honesty and skill.*'

The new regime will impact insurers who fall within the scope of Solvency II and apply to the Society of Lloyd's and Lloyd's managing agents, the UK branches of third country insurers and Insurance Special Purpose Vehicles. Variations of the new regime have also been proposed for non-Solvency II insurers, so-called non-Directive firms (NDFs). Those NDFs with assets over £25million from regulated activities would apply a similar SIMR regime to Solvency II firms, while NDFs with fewer assets than this would apply a streamlined version of the SIMR regime. Consultation ended on 12 October, with final rules expected to be published later this year.

UPDATE In October 2015, the Treasury announced its intention to extend the Senior Managers and Certification Regime (SM&CR) to insurers (from 2018). SIMR is seen by the Treasury as 'paving the way' for SM&CR. The biggest change for insurers will be the introduction of the Certification Regime. See page 7 for further details.

Senior Insurance Manager Regime (SIMR)

Senior Insurance Management Functions

The PRA's SIMR will focus on those holding critical high level roles within Solvency II insurers. The result is a narrower set of Control Functions, meaning fewer individuals coming under the remit of the new regime. However, those who are covered by SIMR will face greater scrutiny from the PRA. This narrower set of control functions will be known as Senior Insurance Management Functions (SIMFs), and individuals will require pre-approval by the PRA before assuming responsibility for one of them. From January 2016 firms will need to submit a Scope of Responsibilities document with each individual's application for PRA approval. It may be possible for a SIMF to be shared by two people, though only when it is "*appropriate and justified*".

The list of SIMFs is as follows:

New PRA Control Function	Title
Chief Executive function	SIMF1
Chief Finance function	SIMF2
Executive Director	SIMF3
Chief Risk function	SIMF4
Head of Internal Audit	SIMF5
Group Entity Senior Insurance Manager function	SIMF7
Third country branch manager function	SIMF19
Chief Actuary function	SIMF20
With-Profits Actuary function	SIMF21
Chief Underwriting function	SIMF22
Underwriting Risk Oversight function (Lloyd's only)	SIMF23

Key Functions

The Solvency II Directive requires firms to have "*an effective system of governance*". This includes a risk-management function, a compliance function, an internal audit function and an actuarial function. In addition the PRA has identified a number of other functions that firms might want to consider as 'key'. These are: investment, claims management, IT, and reinsurance. However, this list is not exhaustive and firms will be required to identify their own key functions, depending on their business.

As with those holding a SMIF, key function holders will require pre-approval by the PRA.

There is scope for overlap between SIMF and key function holders. Where this occurs firms will need to show how conflicts of interest are minimised and that the individual is competent to undertake both roles.

Significant Influence Functions (SIFs)

There are a number of control functions that are beyond the scope of the PRA regime, but that instead require FCA approval. These will be known as FCA Significant Influence Functions (SIFs).

- Directors (CF1) not otherwise approved by the PRA
- Apportionment and oversight function (CF8)
- Compliance function (CF10)
- CASS Operational Oversight function (CF10a)
- Money Laundering Reporting Officer (CF11)
- Significant Management function (CF29) not otherwise approved by the PRA
- Customer function (CF30)

Overlap

Given the nature of the PRA and FCA regimes there is scope for regulatory overlap. If an individual was to perform a FCA SIF and was already approved by the PRA to hold a SIMF, the FCA function would be included with the PRA function. Therefore the individual will need to provide information on the FCA function they are looking to perform in their Scope of Responsibilities document.

Prescribed Responsibilities

Firms are required to allocate a number of prescribed responsibilities between those who hold a SIMF or SIF, or in some cases Non-Executive Directors. In practice, the PRA expects firms will generally allocate prescribed responsibilities to the function to which they are most closely linked. These can be summarised as follows:

(i) ensuring that the firm has complied with the obligation to satisfy itself that persons performing a key function are fit and proper;

(ii) leading the development of the firm's culture and standards;

(iii) embedding the firm's culture and standards in its day-to-day management;

(iv) production and integrity of the firm's financial information and regulatory reporting;

(v) allocation and maintenance of the firm's capital and liquidity;

(vi) development and maintenance of the firm's business model;

(vii) performance of the firm's Own Risk and Solvency Assessment (ORSA);

(viii) induction, training and professional development for all the firm's key function holders;

(ix) maintenance of the independence, integrity and effectiveness of the whistleblowing procedures, and the protection of staff raising concerns; and

(x) oversight of the firm's remuneration policies and practices.

For NDF firms with assets of less than £25 million, the PRA is currently consulting on a reduced set of prescribed responsibilities.

Fit and proper assessment

A key element of the new regime is the focus on personal responsibility. Individuals will need to show that they possess the necessary level of competence, knowledge and experience, as well as hold the requisite qualifications and be able to demonstrate integrity. There is a greater emphasis on technical and personal characteristics in the pre-approval process.

As is the case at present, it is the responsibility of firms to carry out fit and proper tests. They will need to be satisfied that individuals looking to hold roles that are SIMFs or SIFs meet the requirements before seeking approval from either the PRA or FCA. This will include requesting references from previous employers.

Conduct standards

A key element of the new regime is a new set of Conduct Standards – for SIMF and SIF holders. It is likely that the regulators will rely on these standards when taking enforcement action against individuals.

The PRA's standards for SIMF holders is similar to the current Approved Persons conduct standards but with a new responsibility for the oversight of the discharge of any delegated responsibilities, along with a responsibility related to the PRA's insurance objective. Anyone performing a key function will need to observe standards 1-3. SIMFs and Key Function Holders will, in addition, be required to observe standards 4-8.

Firms will be required to consider whether a person has observed the conduct standards as part of ongoing assessment of their being considered 'fit and proper'. This can be done through firms' performance management cycles. The PRA has indicated that firms will need to keep records of the extent to which individuals are following necessary conduct standards.

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

The FCA's standards follow the PRA's conduct rules but with the addition of treating customers fairly. The first tier rules will apply to all FCA and PRA approved persons in Solvency II firms. The second tier ones relate to those holding a SIF.

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

Grandfathering

Both the PRA and FCA have set out transitional arrangements for insurers. Grandfathering will apply to all approved persons who are performing the corresponding role under the existing regime immediately prior to 7 September 2016, whose function will become a PRA SIMF or FCA SIF under the reformed regime on 7 September 2016, and who have complied with the notification requirements.

Governance Maps

Under the new regime, firms subject to SIMR will be required to develop a '**Governance Map**' detailing the positions of senior personnel and key functions. Its purpose will be to confirm the firm's allocation of the aforementioned responsibilities. The map will be used by the PRA in its supervision of the firm. It will also form part of enforcement cases against individuals as evidence of individual responsibility. This must be kept up-to-date on at least a quarterly basis.

NEDs

Certain 'Prescribed' Responsibilities can only be assigned to Non-Executive Directors (NEDs) who have been approved by the PRA or FCA to perform a governing function. These relate to policies on remuneration and whistleblowing (see *Prescribed responsibilities* above).

The responsibilities for which NEDs are accountable for are more limited than SIMF or SIF holders. Their accountability is restricted to activities they are responsible for, such as ensuring the board or committees they chair meet regularly, fostering open and challenging discussion; and providing independent oversight of executive decisions.

Non-Solvency II firms

Non-Solvency II firms, also known as 'non-directive firms' (NDFs) will be affected by the new regime. NDFs with assets of over £25 million from regulated activities will be expected to apply a similar SIMR regime to Solvency II firms, while NDFs with fewer assets than this would apply a streamlined version of the SIMR regime. The PRA's consultation on this closed on 12 October.

Useful Links

PRA: http://www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp2615.aspx
FCA: https://www.fca.org.uk/news/cp15-25-changes-to-the-approved-persons-regime-for-insurers-not-subject-to-solvency-ii

UPDATE In November 2015, the PRA published its response to the consultations relating to NDFs. See page 7 for further details.

October 2015 update

Extension of the Senior Managers and Certification Regime

In October 2015 the Treasury announced that the Senior Managers and Certification Regime (SM&CR) will be extended to all sectors of financial services with the aim of creating a "*fairer, more consistent and rigorous regime for authorised financial services firms*".

Although the insurance sector will be covered by SIMR from March 2016, it now appears that this will be updated by the SM&CR in 2018. The Treasury acknowledges that SIMR "*paves the way for the application of the SM&CR to insurers"* given that SIMR incorporates many of the banking regime's principles.

There are some significant differences between SIMR and the SM&CR regimes which insurers will need to be aware of ahead of 2018:

- SIMR has no equivalent of the Certification Regime that applies to the banking sector. Under SIMR insurers will not be required to provide certification for their employees (see below for more details).
- The new criminal offence of reckless misconduct in the management of a bank does not apply to insurers.
- The SIMR conduct standards apply directly only to individuals in insurers who require pre-approval by the PRA or FCA to perform a controlled function, whereas the SMCR conduct standards apply to almost all of a bank's staff.

As a result of the move to SM&CR in 2018 these three points will apply to insurers as well as banks.

The Certification Regime

The Certification Regime (CR) will apply to individuals who do not carry out SIMFs (expect these to be renamed SMFs in 2018 in line with the banking regime) but are employed in positions where they could pose a risk of significant harm to their firm or any of its customers. This component of the new regime will cover the next level of management and any "material risk takers" to ensure that anyone with the ability to cause "significant harm" within a firm is fit and proper. The CR requires firms themselves to assess the fitness and propriety of individuals allocated "significant harm functions", both at the recruitment stage and on an annual basis. Unlike the SIMR/SMR, appointments for certified function holders will not be subject to prior regulatory approval.

"This expansion of the SM&R to all financial services firms will enhance personal responsibility for senior managers as well as providing a more effective and proportionate means to raise standards of conduct of key staff more broadly, supported by robust enforcement powers for the regulators." HM Treasury paper on Senior Managers and Certification Regime October 2015

HM Treasury on extending SM&CR: https://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons

November 2015 UPDATE

The PRA has set out final rules for the replacement of the current approved regime with SIMR for firms that are outside the scope of Solvency II; the prudential regime for those insurance firms that are outside the scope of Solvency II; and other consequential amendments to the PRA Rulebook that relate to all insurance firms. Following the above consultations there has been one change of policy: this is to modify the period over which the asset threshold is assessed for the purpose of distinguishing large "non-Directive" firms from small ones.
http://www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps2615.aspx

Timeline

1 January 2016

- Governance maps required to be in place.
- Scope of responsibilities form required for new SIMF applications.

8 February 2016

- Closing date for submission of grandfathering notifications to the PRA and FCA (for SIF holders).

7 March 2016

- SIMR comes into force.
- Grandfather existing Control Functions holders in NDFs into the reformed regime.

7 September 2016

- Closing date for submission scope of responsibilities form for grandfathered individuals to the PRA.
- Notification required for those 'transitional' key function holders at 1 January 2016 (who are not grandfathering). These are key function holders who do not need to be pre-approved by the PRA, but have to be notified to the PRA (for its assessment).

7 March 2017

- Small NDFs required having Scope of Responsibilities documents in place for all SIFs.

2018

- Senior Managers and Certification Regime (SM&CR) for all sectors of financial services.

Links

PRA: http://www.bankofengland.co.uk/pra/Pages/supervision/strengtheningacc/default.aspx

FCA: http://www.fca.org.uk/news/ps15-21-changes-to-the-approved-persons-regime-for-solvency-ii-firms

CII action

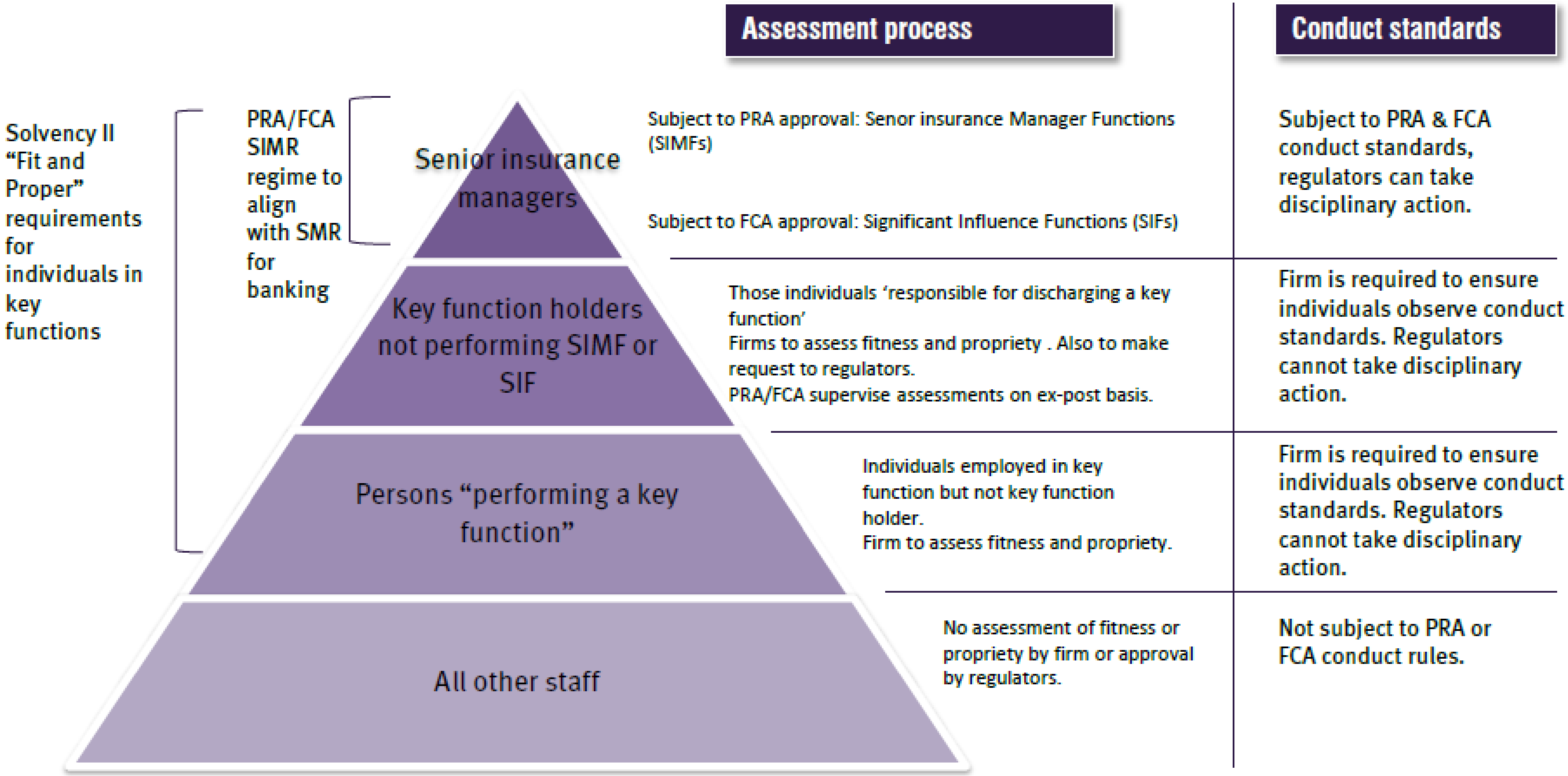
The CII's exams, training courses and CPD materials are in the process of being amended and or developed to take into account the development of the new regime. The CII will continue to work to support individuals in terms of training and competence as SIMR develops.

CII Group Policy & Public Affairs
November

The CII is the world's leading professional organisation for insurance and financial services, with over 115,000 members in 150 countries. We are committed to maintaining the highest standards of technical expertise and ethical conduct in the profession through research, education and accreditation. In 2012 we are celebrating our Centenary as a Chartered body.

For more information on the CII and its policy and public affairs function, including examples of the range of issues in financial services and insurance that we cover, please see: www.cii.co.uk/policy.

Appendix A



Adapted from Linklaters
http://www.linklaters.com/Insights/Publication1386Newsletter/Insurance-Update-December-2014/Pages/Senior-insurance-managers-regime.aspx

Appendix B

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Senior Insurance Managers Regime (SIMR) – what firms need to know and do

What is the SIMR? In summary, the Senior Insurance Managers Regime provides a regulatory framework for **similar standards of fitness and propriety, conduct and accountability** to be applied to individuals in positions of responsibility at insurers, as for banks and large investment firms. The dedicated Strengthening Accountability webpage includes the background, key changes, policy development, the implementation timetable and activity including a link to forms and guidance.

How does the SIMR differ to the Approved Persons Regime?

- A **new more focussed set of senior insurance management functions** (SIMFs, previously Controlled Functions (CFs)) that individuals will need the PRA's pre-approval to perform, including the CEO, CFO, CRO, Chief Actuary, Head of Internal Audit, and for GI firms, the Chief Underwriting Officer.
- A **new function for senior executives and directors of a parent (or group) company who have a significant influence on the management or conduct of a firm's affairs**.
- **Eleven 'Prescribed Responsibilities'** to be allocated to senior insurance managers.
- Firms will have to maintain a '**Governance Map**' showing the responsibilities of senior insurance managers, and lines of accountability, within the firm and any associated group.
- A **new set of Conduct Standards**, similar to current APER conduct standards but with a new responsibility for the oversight of the discharge of any delegated responsibilities, along with a responsibility related to the PRA's insurance objective. The Conduct Standards will be **directly enforceable against PRA SIMFs** (and certain FCA SIFs).

How does the SIMR relate to Solvency II?

- The SIMR is a natural extension of Pillar 2 under Solvency II. As part of governance and risk management, firms will be required to make an ongoing assessment of the fit and proper status of all persons performing key functions.
- Solvency II introduces 'Key Function Holders' (KFHs) (who are currently neither PRA or FCA CFs) that will need to be notified to the PRA for both solo firms and groups, and then assessed by the regulator for fitness and propriety. More information about SII KFHs appears in Supervisory Statement SS35/15, published on 13 August and available on the Strengthening Accountability webpage.

How does the SIMR differs from the banking SMR?

1. No presumption of responsibility for senior managers.
2. No criminal sanctions for managers of failed institutions.
3. No 'certification' required from firms for their employees.
4. Not a condition of grandfathering for firms to submit Scope of Responsibilities for individuals.

What do firms need to do now? Firms will need to consider, and discuss with their supervisor as appropriate:

- If Solvency II applies, who will be their KFHs at 1 Jan 2016 and which of the KFHs are not currently approved under the APR and need to be for the SIMR?
- Which of the currently approved individuals will need to be grandfathered and to which SIMF?

August 2015