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Strengthening accountability in insurance – Senior Managers & Certification Regime

Background

The Senior Insurance Managers Regime (“SIMR”) of the Prudential Regulation Authority (“PRA”) provides a regulatory framework for standards of fitness and propriety, conduct and accountability to be applied to individuals in positions of responsibility at insurers. It sets out a list of senior insurance management functions (“SIMFs”) where individuals within those functions require the PRA’s pre-approval to perform, and various other associated regulations.

The Financial Conduct Authority (“FCA”) has a similar Approved Persons Regime (“APR”). Some executive and other functions that do not require PRA pre-approval under SIMR are considered as controlled functions under the APR.

The FCA’s Senior Managers and Certification Regime (“SM&CR”) is in place for banks, but does not currently cover insurers. The SM&CR aims to reinforce and clarify the expectations of individuals within their governance structure. The PRA and FCA are now obliged to extend the SM&CR to insurers and replace their current respective regimes and this will be implemented on 10 December 2018.

The FCA proposals for implementing and moving to SM&CR were set out in 2017 in consultation papers CP17/26 and CP17/41, whilst those from the PRA were in CP14/17 and CP28/17. In July, the FCA published PS18/15 containing feedback on the consultations, some additional clarification and near-final rules on the SM&CR. The proposals will go ahead as set out in the consultation papers. This was closely followed by CP18/18 in July and CP20/18 in September, which set out the proposed changes to the PRA rules.

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The FCA has also published SM&CR: Guide for Insurers, which is a very helpful guide to the new regime and the transition process. Firms should review the Guide to ensure they understand the requirements as significant changes will be required for many firms.

Significant
changes
affecting all
insurers

In addition, the PRA's consultation paper CP8/17 in June 2017 set out proposals to amend SIMR and to strengthen governance through requiring insurers to take steps to encourage diversity. PS1/18 was published in February 2018 with almost no changes from the consultation and then updated in July 2018 to give the same implementation date of 10 December 2018 for amendments to the SIMR. The requirement for insurers to have a diversity policy for their boards came into force in April 2018. The PRA's SS35/15 has also been updated to reflect the changes.

Who does this apply to?

The changes affect all insurers including Solvency II firms, Insurance Special Purpose Vehicles ("ISPVs"), branches of non-UK firms and non-directive firms ("NDFs"). They affect most staff within a firm and all approved individuals (except those within firms' Appointed Representatives).

Within the firm classifications, there are the following additional splits:

<i>Large Firm</i>	those with gross annual premium income of £1 billion or more in each of the previous three financial years, or with assets of £10 billion at the end of each of the last three financial years
<i>Large NDF</i>	NDF where the value of assets relating to all regulated activities carried on by the firm as included in its two most recent reported annual accounts is more than £25m, where an NDF is an insurer that is not a UK Solvency II insurer, a UK ISPV or a third country branch
<i>Small NDF</i>	NDF that is not a large NDF
<i>Small Run-off Firm</i>	a firm with less than £25m technical provisions that no longer has permission to write or acquire new business

Senior Managers Regime

The FCA will be required to approve the most senior people performing key roles (if the roles already exist) within an insurance firm. These controlled functions are defined as Senior Management Functions (“SMFs”) and are held by persons defined as Senior Managers (“SMs”). SMFs are those functions with the greatest potential to cause harm. The FCA SMFs are shown below:

	Solvency II & Large NDFs	Small NDFs & Small Run-off Firms	EEA Branches	Non-EEA Branches	ISPVs
Executive Director	✓	✓		✓	✓
Other Overall Responsibility	✓				
Compliance Oversight	✓	✓		✓	✓
Money Laundering Reporting Officer	✓	✓	✓	✓	
Chair of Nominations Committee	✓				
Chair of the With-Profits Committee	✓				
Conduct Risk Oversight Officer (Lloyd’s)	✓				
Partner		✓		✓	✓
EEA Branch Senior Manager			✓		
Other Local Responsibility				✓	

However, there is no requirement for any of the FCA SMF roles to exist; the regime just requires that, if a person does hold any of the roles above, they are approved by the FCA under SM&CR.



The PRA will be maintaining its current SIMFs (but they will now also be called Senior Management Functions), but there will be the following amendments:

<i>change</i>	<i>applies to</i>	<i>detail</i>
new SMF24 – the Chief Operations function	Solvency II Insurers and Large NDFs	<p>This function will be the most senior individual responsible for managing the internal operations and technology of a firm. The SMF recognises the importance of operational continuity, resilience of operational systems on the safety and soundness of firms.</p> <p>The SMF may be split between two or more individuals provided that the split reflects the overall responsibility for operations and technology.</p>
new Prescribed Responsibility (PR) for the firm’s performance of its obligations in respect of the outsourced operational functions and activities	All insurers except Small Run-Off Firms	<p>Firms will be required to allocate the PR to an individual approved by the PRA or by the FCA for a relevant senior management function.</p> <p>For a third country branch, the PR will only apply to the activities of the UK branch.</p>
new PRA SMF6, the Head of Key Business Area Function for individuals who are responsible for large business areas or divisions within a firm.	Large business areas or divisions	<p>For this purpose, a large business area or division is defined as having gross total assets equal to or in excess of £10 billion and accounting for more than 20% of the firm’s gross revenue. In addition, the individual does not report to an individual within a SMF6 role in the same division.</p>
separation of the Chairman (SMF9) and Chief Executive Officer (SMF1) functions	Large Firms	Both roles cannot be held by a single individual.
separation of executive and oversight roles within a group	Large Firms within a group	An executive within one part of the group cannot take on a NED oversight SMF role for any Large Firm within a group, to avoid possible significant conflicts of interest.

If a firm is seeking approval from the PRA for a candidate to perform a PRA-designated SMF and also intend this candidate will perform an FCA SMF, the Overlap Rule will be applied, which means only one application needs to be made, to the PRA, provided that it also states

the individual will be performing an FCA SMF. The FCA role will not be listed on the register, but the Statement of Responsibilities (see below) for the PRA SMF must include those responsibilities relating to the FCA SMF.

Certification Regime (“CR”)

Firms will need to identify certification functions, which are defined as functions where it is possible to cause significant harm to a firm or to any of its policyholders but which are not also FCA or PRA SMFs or non-executive director (“NED”) roles.

The individuals covered by the PRA changes depend on the type of firm as specified in the following table:

		Large Firms	Other Solvency II insurers, Large NDFs and ISPVs	Small NDFs	Small run-off firms
(1)	PRA or FCA SMF	no	no	no	no
(2)	non-executive directors	no	no	no	no
(3)	other key function holders	yes	yes	if also in categories 4 or 5	no
(4)	members of governing body other than NEDs	if also in categories 3, 6 or 7	if also in categories 3 or 7	yes	no
(5)	employees reporting directly to governing body	if also in categories 3, 6 or 7	if also in categories 3 or 7	yes	no
(6)	material risk-takers (“MRTs”)*	yes	yes for Large NDFs only	no	no
(7)	others, such as those working in investment management, claims management, underwriting and pricing of products, reinsurance, capital management, liquidity management, operational systems and controls, information technology and managing MRTs	consider if appropriate to include	consider if appropriate to include	no	no

* MRTs are defined as employees of insurers whose professional activities have a material impact on the firm’s risk profile.

Implementation
date of 10
December 2018



Firms will need to identify certification functions

The functions covered by the FCA Certification Regime are:

- Significant Management Function
- proprietary traders
- CASS oversight function
- functions subject to qualification requirements
- Client Dealing function
- algorithmic traders
- material risk takers
- anyone who supervises or manages a person performing a Certification Function

Fit and Proper requirements

A person carrying out a certification function does not require regulator approval, but firms must provide certificates to individuals in certification functions at least annually and keep a record of these certificates. This is to show that the firm is satisfied the individual is fit and proper. A firm must propose steps in relation to an individual if the decision is not to issue a certificate.

Regulatory references

Firms will be required to obtain regulatory references before appointing individuals to SMFs and certification functions.

All regulatory references rules as they currently apply to other insurers will be extended to small NDFs as well. In particular, these firms will need to request references going back six years for all individuals being appointed to a SMF or a certification function (new employees or existing employees moving roles) at the NDF and include mandatory information in the references provided to other firms.

Conduct rules

Individuals in certification functions will be subject to the relevant PRA and FCA conduct rules.

The five FCA generic conduct standards of integrity, due skill, care and diligence, openness with the regulator, considering customers and treating them fairly and observing market conduct standards currently apply to all employees within an FCA certification function or SMF. They will in future apply to all employees other than ancillary staff (such as catering and reception staff). These rules will also apply to employees performing a SMF role on a temporary basis or someone who should have been an approved SMF.

The PRA will apply the first three generic conduct standards, referred to above, to a PRA certification function or SMF along with the additional relevant conducts standard required for the particular type of firm. The conduct rules will also continue to apply to an individual in a governing or compliance oversight senior management function approved by the FCA. Key function holders will still be required to observe the additional Senior Insurance Manager conduct standards.

Where appropriate the FCA and PRA will be able to take enforcement action for material breaches of the standards.

Firms must take reasonable steps to ensure that persons in certification functions (and anyone else to whom the conduct rules apply) understands the conduct rules including the provision of suitable training.

Notification of disciplinary action

Firms will be required to notify the PRA and FCA if they take disciplinary action for a reason set out in the Financial Services and Markets Act 2000 or if the firm believes there are grounds where an approval should be withdrawn. Notification to the PRA should be within seven business days.

Duty of responsibility

This applies to all firms.

The new duty of responsibility, established through the addition of a fourth element to s66B(5) of FSMA, applies to senior managers and directors of insurers. The PRA will be able to take action for misconduct if:

- the individual has at any time performed as a senior manager at a firm;
- the firm contravenes, or has contravened, a regulatory requirement;
- at the relevant time, the senior manager was responsible for the management of any of the firms activities in relation to which the contravention occurred; and;
- the senior manager did not take such steps as a person in the senior manager's position could reasonably be expected to take to avoid the contravention occurring (or continuing).

Prescribed Responsibilities

These rules apply to all firms except EEA Branches.

Prescribed Responsibilities are specific responsibilities currently defined in the PRA Handbook that a firm must give to SMF holders, or an individual in a governing or compliance oversight senior management function approved by the FCA and, where relevant, to a non-executive director.

The following changes will apply from 10 December 2018:

Solvency II insurers and Large NDFs	amendment of the responsibility to ensure the firm meets certain obligations under Insurance - Fitness and Propriety: <ul style="list-style-type: none">• to encompass all aspects of the operation of the regime, including the new Certification Regime• to be divided into four new prescribed responsibilities
ISPVs	additional requirement to allocate a responsibility to a holder of a PRA SMF, or to the holder of an FCA CF that is a 'relevant senior management function', for the operation of the regime, and for the operation of the new Certification Regime
Small NDFs	additional prescribed responsibility for the operation of the regime, including the new Certification Regime
third country branches and Swiss general insurers	four additional new prescribed responsibilities for risk management, systems and controls, compliance with the UK regulatory system and escalation of correspondence

The FCA is also introducing some FCA Prescribed Responsibilities covering:

- the firm's performance of its obligations under the Code of Conduct (in terms of training and regulatory reporting)
- the firm's policies and procedures for countering the risk that the firm might be used to further financial crime
- Compliance with the Client Assets Sourcebook

The allocation of applicable Prescribed Responsibilities to a firm can be shared between the PRA and FCA or allocated to an individual regulator.

Statement of Responsibilities

This applies to all firms.

The record of the scope of responsibilities is to be renamed as a statement of responsibilities ("SOR"). The rules of the provision of the SOR to the PRA will be amended to include resubmission if there is a significant change to the SOR, as well as submission when applying for approval of a new SM. SORs should include a full list of responsibilities and reflect how the business model, complexity, risk profile and size of a firm affects each senior manager's or key function holder's responsibility. The FCA is developing best practice examples of how firms can prepare their SoRs.

Responsibilities Map

This applies to Solvency II insurers, Large NDFs and third country branches.

Governance maps will be renamed management responsibility maps and should be drafted in a clear and complete way with a consistent structure and an appropriate and proportionate level of detail. Firms are expected to maintain one Responsibilities Map for each legal entity covering PRA and FCA functions and other relevant management and governance arrangements, including any arrangements shared as part of a group.

New duty of responsibility for all senior managers and directors



Overall responsibility required for every area, activity and management function

Handover Procedures

This applies to Solvency II insurers and Large NDFs.

Firms must take all reasonable steps to ensure that a person taking on a Senior Manager role has all the information and materials they could reasonably expect to have in order to do their job effectively. A firm must have a policy in place explaining how it complies with this requirement, and maintain adequate records of the steps it has taken. Most firms will already have handover processes but some may need to formalise the requirements and in particular ensure appropriate documentation of the handover.

Overall Responsibility

This applies to Solvency II insurers and Large NDFs.

A firm must ensure that every area, activity and management function (with regards to regulated and unregulated financial services activities only) has a SM with overall responsibility for it. PS18/15 set out a series of steps for firms putting this requirement into practice. Every Senior Manager must be the most senior person responsible for managing an area overall. They must also be sufficiently senior and credible, and with sufficient resources and authority, to exercise their management and oversight responsibilities effectively. The Other Overall Responsibility Function (SMF18) is only required when an individual with Overall Responsibility for a business area does not hold any other SMF that can be either an FCA or PRA function. Therefore most firms will not need this function.



What do firms need to do?

Each firm will need to assess its senior management roles to see whether any fall under the FCA SMR or the additional PRA SMFs and require FCA or PRA approval. Firms will need to allocate new FCA prescribed responsibilities to any SMs. SMs will be subject to possible FCA or PRA action if they fail to take reasonable steps to stop regulatory breaches. This last point is a major change from the current regimes.

For staff that are already approved by the FCA for their role and the equivalent role exists in the SMR then:

- Solvency II firms and large non-directive forms need to submit a conversion notification form by 3 December 2018. They will also need to submit Statements of Responsibilities and a Management Responsibilities Map.
- Other firms will have their existing controlled functions converted automatically.

The CR is a significant change for many insurers as it will apply to some employees who were unaffected by the current regime. Firms will be required to maintain stringent processes for identifying CFs, providing training and certification, ensuring awareness of conduct standards, drafting and updating SORs and obtaining and providing appropriate regulatory references. However, in some small organisations, all senior managers may already be and continue to be covered by the current APR and therefore the CR will have no effect.

Firms will need to identify certification functions and ensure they meet the Conduct Rules, by 10 December 2018. Fitness and proprietary assessments and certification paperwork for existing employees need to be in place by 10 December 2019. Firms will only need to provide appropriate regulatory reference for new employees, or existing employees moving roles.



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