Bank of England PRA

The Prudential Regulation Authority's approach to insurance supervision

July 2023

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Foreword by the CEO

Following the global financial crisis, the Prudential Regulation Authority (PRA) was formed in April 2013 as the UK's prudential regulator of deposit-takers, insurers and major investment firms.

The PRA has two primary objectives: a general objective to promote the safety and soundness of the firms it regulates, focusing on the adverse effects that they can have on the stability of the UK financial system; and an objective specific to insurance firms, to contribute to securing an appropriate degree of protection for policyholders. The PRA also has two secondary objectives – to act, in so far as reasonably possible, in a way which (i) facilitates effective competition in the markets for services provided by PRA-authorised firms, and, (ii) under the Financial Services and Markets Act 2023 (the 2023 Act), facilitates, subject to alignment with relevant international standards, the international competitiveness of the UK economy, and its growth in the medium to long-term.

The resilience of the UK banking and insurance sectors is based on a strong foundation of robust regulatory standards that we have established since the PRA was founded. In order to maintain and build on this safety and soundness, we must continue to evolve our approach to account for changes in the world around us. This approach document sets out how we pursue these objectives in respect of the supervision of insurers (a second document sets out our approach for deposit-takers and investment firms). Our approach documents were originally published in 2012, and while our approach has evolved, it continues to be underpinned by three core principles established at the outset of the PRA: our supervisors rely on judgement in taking decisions; we assess firms not just against current risks, but also against those that could plausibly arise further ahead; and we focus on those issues and firms that are likely to pose the greatest risk to our objectives. Across these three principles we continue to apply proportionality to ensure that our interventions do not go beyond what is necessary in order to achieve our objectives.

Most of the changes from the original versions of these documents are evolutionary in nature, and aim to capture the ways in which our approach has developed over the last ten years in light of experience. For example, we have aimed to make our approach more risk-based and flexible, updated our potential impact and risk assessment frameworks so that they can better accommodate the risks we now face, made greater use of horizontal supervisory work to assess the risks posed across sectors, and continued to embed the use of horizon-scanning to identify areas of potential vulnerability. Each of these is underpinned by ongoing improvements in our data capabilities.

But in one important area the context for our approach as set out in these documents has changed more significantly. Under the 2023 Act, the PRA's rulemaking role has been

significantly expanded in order to replace functions which were largely carried out for the UK by EU institutions prior to Brexit. The focus of this document is on supervision rather than policymaking, however this will happen against a backdrop of changes to our approach to policymaking in response to this reform, including enhanced accountability arrangements to Parliament and how we will deliver the new competitiveness and growth objective given to the PRA under the 2023 Act.

This document is intended to provide an articulation of what we think effective supervision looks like, and how we intend to deliver it. The financial services sector and the context within which we supervise are constantly changing, and we will continue to evolve our approach in response to this. Therefore this document will, like its forbear, likely evolve over the next decade. However, we are confident that the essential ingredients, including our three core principles as established at the outset of the PRA, will endure.

Sam Woods

July 2023

Introduction

We, the Prudential Regulation Authority (PRA), as part of the Bank of England (the Bank), are the UK's prudential regulator for deposit-takers, insurance companies, and designated investment firms.

1. This document sets out how we carry out our role in respect of insurers. It is designed to help regulated firms and the market understand how we supervise these institutions, and to aid accountability to the public and Parliament. A second document relates to our supervision of deposit-takers and designated investment firms.[1] The document acts as a standing reference that will be revised and reissued in response to significant legislative and other developments which result in changes to our approach.

2. This document serves three purposes. First, it aids accountability by describing what we seek to achieve and how we intend to achieve it. Second, it communicates to regulated insurers what we expect of them, and what they can expect from us in the course of supervision. Third, it meets the statutory requirement for us to issue guidance on how we intend to advance our objectives. It sits alongside our requirements and expectations as published in the PRA Rulebook and our policy publications.[2]

1 The Prudential Regulation Authority's approach to banking supervision, July 2023. Available at: www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.

2 The way we make policy and links to our policy publications are available on the Bank's website at: www.bankofengland.co.uk/prudential-regulation/policy.

1: Our objectives

Our governing statute is the Financial Services and Markets Act 2000 (as amended) (the Act).

Our primary objectives

3. Under the Act, we have two primary objectives: (i) a general objective to promote the safety and soundness of all of the firms we regulate; and (ii) an objective specific to our regulation of insurers to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders.

4. The Act requires us to advance our general objective primarily by seeking to:

- ensure that the business of the firms we regulate is carried on in a way that avoids any adverse effect on the stability of the UK financial system; and
- minimise the adverse effect that the failure of one of the firms we regulate could be expected to have on the stability of the UK financial system.

Our secondary objectives

5. We have two secondary objectives. The first is to act, so far as is reasonably possible, in a way that facilitates effective competition in the markets for services provided by the firms we regulate when they carry on regulated activities. The second requires the PRA (so far as reasonably possible) to facilitate, subject to aligning with relevant international standards, (i) the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA authorised persons), and (ii) its growth in the medium to long-term. Both of these secondary objectives apply when we are making policies, codes, and rules in pursuit of our primary objectives.

Effective competition

6. Effective competition can be said to exist where suppliers offer a choice of products or services on the most attractive and sustainable terms to customers; where customers have the confidence to make informed decisions; and where firms enter, expand, and exit from the market.

7. Cases may exist where some options available to us would not deliver the maximum benefits to safety and soundness, but would deliver significantly greater benefits to competition. The secondary competition objective means that we should consider (but are not required to adopt) those options that may deliver greater benefits to competition. This

approach recognises that we may have limited policy choices, for example where we are bound by other domestic or international law.

8. Regulation designed to improve financial stability can facilitate effective competition. For example, regulation can ensure that firms' and investors' decision making appropriately reflects the social cost of risk-taking, reducing incentives to compete in a way that harms others in the financial system such as taking unsustainable levels of risk only to expose others to losses through failure and loss of confidence. A robust minimum prudential regulation standard can also provide customers with greater confidence in the financial soundness of new banks, enabling entrants to gain a foothold in the market and to expand.

International competitiveness

9. The introduction of our secondary objective relating to UK competitiveness and growth means that these factors will carry greater weight in our decision-making than when we were taking these considerations into account as matters to which we must 'have regard'. The formulation of the objective recognises the role that the international competitiveness of the UK financial sector can play in contributing to economic growth. The financial sector can support the international competitiveness of the UK economy and contribute to growth in the medium to long-term when: (i) UK firms successfully compete to win business around the world; (ii) the UK is a top tier global financial hub where firms from around the world choose to do business; and (iii) the financial sector supports growth by meeting the needs of the wider national economy.

10. Robust standards contribute to economic growth by reducing the frequency and severity of financial crises and by creating trust in the UK as a global financial centre, which makes the UK an attractive place to do business. The PRA is proactive in its approach to the secondary competitiveness and growth objective and looks for opportunities to advance it. PRA rule making can (i) harness the UK's strengths as a global financial centre; (ii) maintain trust in the UK as a place to do business; and (ii) tailor regulations to UK circumstances. Competitiveness and growth can be facilitated through regulation that is not only stable, predictable, and transparent, but also proportionate and open to innovation.

Safety and soundness, and the stability of the UK's financial system

11. 'Safety and soundness' involves insurers having resilience against failure, now and in the future, and avoiding harm resulting from disruption to the continuity of financial services. In discharging our general objective we will focus, in particular, on the risk of disruption to the continuity of critical economic functions.[3] This is because a stable financial system, that

[3] Economic functions are defined as the broad set of services the financial sector provides to the UK economy, and hence an aggregation of business services that one, or more, firms or Financial Market Infrastructure (FMI) provides. For example, the economic function of retail mortgages and secured lending

maintains continuity of access to critical economic functions, is a necessary condition for a healthy and successful economy.

12. We are required by statute to promote safety and soundness by seeking to avoid adverse effects on financial stability. The financial services that insurers provide are essential in supporting the pooling and transfer of risk and savings, and so wider economic activity. Insurers do not, however, present the same risks for financial stability as banks. For instance, they do not typically undertake maturity transformation and so are less vulnerable to sudden losses of confidence, unanticipated withdrawals, and contagion than banks. Their failure, nevertheless, has the potential to disrupt the continuity of financial services and so financial stability, for example if insurance services were withdrawn on a scale sufficient to lead to a direct impact on economic activity, through operational disruptions in the services they provide, or indirectly through the impact on other financial institutions.

13. We aim to identify risks to financial stability that can be generated by insurers and, together with the Financial Policy Committee (FPC) with its macroprudential responsibilities, where appropriate, we look to mitigate such effects.

Appropriate protection of policyholders

14. We have a specific primary insurance objective of 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'. Safety and soundness and policyholder protection are complementary objectives in respect of insurance supervision. Our action to promote the safety and soundness of an insurer will typically have the effect of protecting policyholders, by ensuring that the insurer's liabilities to them can be met both now and in the future.

15. The insurance objective recognises that we are a contributor to, rather than the sole body responsible for, policyholder protection. The Financial Conduct Authority (FCA) also has a role in policyholder protection. The FCA seeks to ensure that consumers are treated fairly in their dealings with insurers. Our focus is to ensure that insurers are able to meet their obligations to policyholders, which, in the case of some policies, may only emerge after many years. Our action to advance policyholder protection will usually operate through factors that affect the safety and soundness of firms.

16. Subject to the requirements placed on us by law, it is for us to decide the degree of protection that is appropriate. The appropriate degree can vary according to the type of product, type of policyholder, their current or future interests, the location of the insurance entity and the risk, or other factors we consider relevant.

17. Our priorities for protecting policyholders vary according to: (i) the significance to the policyholder of the risk insured, (ii) the potential for significant adverse effects on

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would comprise a number of individual business services. If sufficiently significant in terms of both size and function, these economic functions can become critical to the UK economy.

policyholders if cover were to be withdrawn or policies not honoured, and (iii) the ability of policyholders to influence prudent behaviour by their insurer, either individually or collectively.

18. Some types of insurance provide individuals and companies with protection against significant risks where the withdrawal of cover could have a very material impact on those policyholders and the economy more generally. For example, certain activities require, either contractually or as a matter of public policy, insurance cover to be maintained, for example employers' liability insurance or professional indemnity cover. Similarly, disruption to life insurance policyholders caused by any delay in the receipt of, or the absence of, annuity income could be important in cases where, as is likely, such payments form a significant source of income.

19. We take a forward-looking approach to assessing an insurer's ability to meet its obligations. In particular an insurer's ability to deliver on obligations to existing policyholders can be affected by the terms on which it deals with new policyholders. As a consequence, we expect insurers not to write new business where the terms on which it is written would expose either existing or new policyholders in aggregate to an unacceptable level of risk.

20. We interpret the definition of 'policyholders' in a broader sense than simply the person who takes out the policy to include those who are the beneficiaries of insurance contracts (for example, third parties under motor policies and employers' liability policies).

21. Our duties arising from the insurance objective extend only in relation to the carrying out of a 'PRA-regulated insurance activity' or firms that are 'PRA-authorised persons' carrying out that activity. The appropriate degree of protection for policyholders and the tools we can use to achieve that may vary depending on the factors described above.

Firm failure

22. Contributing to an appropriate degree of policyholder protection and promoting resilience against failure does not mean protecting all policyholders in full in all circumstances, nor does it mean preventing all instances of failure. Under our prudential regulation regime, insurers must maintain a certain level of resilience against failure. This is essential to ensuring confidence in general in the resilience of the insurers that we supervise for us to deliver on our objectives. However, the Act is explicit that it is not our role to ensure that no insurer fails. Therefore, a key principle underlying our approach is that we do not seek to operate a zero-failure regime.

23. Insurers should be allowed to fail, and we will work to ensure where possible that their failure is orderly. This includes working to ensure continuity of cover for the failed insurer's policyholders is maintained (including by transfer to another firm). The PRA's expectation is insurers should be resolvable such that, if they fail or are likely to fail, they can exit the market in an orderly manner, without systemic disruption, impairing continuity of cover for

policyholders or significant recourse to public funds. Prudential regulation can help to manage these risks.

24. In the event that an insurer's financial position comes under stress, policyholders can be protected through mechanisms by which insurers can exit the market in an orderly way, eg through the removal of permission to undertake new business, and orderly run-off of existing business. If insurers do fail, the Financial Services Compensation Scheme (FSCS) policyholder protection scheme protects eligible policyholders, subject to certain limits.

Threshold Conditions

25. The Threshold Conditions are the minimum requirements that firms must meet at all times in order to be permitted to carry on the regulated activities in which they engage. They are designed to ensure that firms conduct their business in a prudent manner and are managed by persons with adequate skills, experience and propriety, which are necessary to promote safety and soundness. We expect firms not merely to meet and continue to meet the letter of these requirements, but also to consider the overriding principle of safety and soundness. We assess insurers against the Threshold Conditions on a continual basis.

Fundamental Rules

26. The Fundamental Rules are high level rules that collectively act as an expression of our general objective of promoting the safety and soundness of regulated firms. Firms must ensure they are compliant with all applicable PRA rules, including the Fundamental Rules, as set out in the PRA Rulebook.[4]

27. A failure to comply with the Fundamental Rules may be relevant to a firm's ongoing compliance with the Threshold Conditions and may result in enforcement or other actions.

Regulatory principles

28. In designing our policies, issuing codes, and making rules, we have regard to a number of regulatory principles set out in the Act. These cover: using our resources efficiently; proportionality; senior management responsibility in firms; recognising differences in the nature and objectives of authorised persons; transparency; disclosure of information relating to persons on whom requirements are imposed by or under the Act; and the general principle of customers taking responsibility for their decisions. The 2023 Act requires the PRA to 'have regard' to the need to contribute towards achieving compliance by the Secretary of State with the government's 2050 net-zero emissions target and environmental targets where the exercise of our functions is relevant to the making of such a contribution.

4 PRA Rulebook; available at **www.prarulebook.co.uk**.

Investigations into regulatory failure

29. The Financial Services Act 2012 requires us to investigate and report to HM Treasury (HMT) on events which indicate possible regulatory failure. We have set out, in a policy statement, how we will judge whether and when such failures have occurred.[5] Consistent with our statutory objectives, we are clear that firm failures will not automatically indicate regulatory failure.

5 Conducting statutory investigations, April 2013; available at **www.bankofengland.co.uk/prudential-regulation/publication/2013/conducting-statutory-investigations**.

2: Our approach to advancing our objectives

To advance our objectives, our supervisory approach follows three key principles – it is: (i) judgement-based; (ii) forward-looking; and (iii) focused on key risks.

Judgement-based

30. Our approach relies significantly on judgement. Supervisors reach judgements on the risks that an insurer is running, the risks that it poses to our objectives, whether the insurer is likely to continue to meet the Threshold Conditions, and how to address any problems or shortcomings.

31. Our supervisory judgements are based on evidence and analysis. It is, however, inherent in a forward-looking system that, at times, the supervisor's judgement will be different to that of insurers'. Furthermore, there will be occasions when events will show that the supervisor's judgement, in hindsight, was wrong. To minimise such outcomes, our strategies and judgements are subject to regular review by those independent from supervising the insurer in question, and our major judgements and decisions involve our most senior and experienced staff and directors.

32. We also engage with the boards and senior management of insurers, when merited, in forming our judgements, using this dialogue both to ensure that we take account of all relevant information, and to clearly communicate the rationale for our judgements. Insurers should not, however, approach their relationship with us as a negotiation.

Forward looking

33. Our approach is forward-looking. Through our horizon-scanning work, we assess insurers not just against current risks, but also against those that could plausibly arise further ahead. And where we judge it necessary to intervene to mitigate the risks an insurer is creating; we seek to do so at an early stage. To support this, insurers should be open and straightforward in their dealings with us, taking the initiative to raise issues of possible concern also at an early stage. We will respond proportionately. In this way, trust can be fostered on both sides.

Focused on key risks

34. We focus our supervision on those issues and those insurers that, in our judgement, pose the greatest risk to the stability of the UK financial system. Consistent with our objectives, we aim to concentrate on material issues when engaging with insurers. As outlined further in Section 3 below, our assessment of the risk that any insurer poses will take

into account both the gross risk derived by their relative scale, complexity and business model, and any mitigating factors and controls that have been put in place. Our assessment is based on a set of supervisory core assurance activities (the frequency and depth of which are proportionate to the potential impact assessment of any given insurer). This can include both insurer-specific reviews and horizontal assessment of risks across a sector or peer group.

Box 1: Engagement with other Bank of England functions

Our work is informed by, and connected to that done by the Bank of England's other functions, including primarily the FPC, and the area of the Bank responsible for oversight of financial market infrastructure.

An effective regulatory framework for financial stability needs to combine deposit-taker and investment firm-specific supervision with work to protect and enhance the resilience of the financial system as a whole. We therefore work closely with the Bank's FPC, which has statutory responsibility for reducing risks to the financial system as a whole, and the areas of the Bank responsible for overseeing financial market infrastructure, given the interconnectedness of FMIs and the stability of the firms that we prudentially regulate. Our respective work is in turn informed by the Bank's broader work on market intelligence and financial sector resilience as a whole.

The PRC must report to the Chancellor of the Exchequer on an annual basis the extent to which the exercise of the PRA functions is independent of the Bank's other functions. We operate an independent decision-making framework.

The FPC

The FPC can make recommendations and give directions to us on specific actions that should be taken to achieve the FPC's objectives. We are responsible for responding to FPC recommendations which may be made on a 'comply or explain' basis, and for complying with the FPC's directions in relation to the use of macroprudential tools, specified by HM Treasury in secondary legislation.

There is a frequent two-way flow of information and exchange of views between us and the FPC. We provide firm-specific information to the FPC, to assist its macroprudential supervision and the FPC's assessment of systemic risks influences our judgements in pursuit of our own objectives.

Box 2: Working with other authorities

Co-ordination with other authorities is essential to our success.

Financial Conduct Authority (FCA)

The FCA is the conduct regulator for firms prudentially regulated by the PRA. We have a statutory duty to co-ordinate with the FCA in the exercise of our statutory functions under the Act, including policymaking and supervision. A Memorandum of Understanding (MoU) between the PRA and the FCA describes how we fulfil this duty to co-ordinate in a way that supports each of our ability to advance our own objectives.[6]

A key principle for this co-operation, given the regulators' separate mandates for prudential and conduct regulation of PRA-authorised firms, is that each authority should focus on the key risks to its own objectives, while being aware of the potential for concerns of the other.

Conclusions and key information from supervisory activity that is materially relevant to the other regulator's objective(s) will be exchanged. In order to ensure that both the PRA's and the FCA's supervisory judgements about a firm reflect relevant information, we will share information on dual-regulated firms and firms within dual-regulated groups between us.

To support this process, domestic 'supervisory colleges' for individual firms and groups are established as appropriate, with a view to identifying which risks and mitigating actions might have a material effect on the ability of the other regulator to advance its objectives. The frequency of these colleges will reflect the importance of the firm to the other regulator's objectives.

Co-ordination between us and the FCA is assisted by the membership of the PRA CEO on the FCA Board, and reciprocal membership of the FCA CEO on PRC. This role focuses on areas of overlap and discussions of material relevance to each CEO's own organisation. Co-ordination between the organisations is also assisted by common membership of CEOs on the FPC.

Financial Services Compensation Scheme (FSCS)

The FSCS is the UK's compensation fund of last resort for individual and SME customers of authorised financial services firms. It can safeguard the rights of claimants, secure continuity of insurance cover, pay claims as they fall due, and pay compensation to eligible

6 PRA/FCA Memorandum of Understanding; available at www.bankofengland.co.uk/about/governance-and-funding.

claimants. The MoU between the PRA and the FSCS details how the two authorities co-operate and co-ordinate.[7]

We work closely with the FSCS to assess and enhance the resolution framework for insurers to discharge our primary objectives. We will seek to ensure that, through the Proactive Intervention Framework (PIF) (see Section 4), the FSCS has reasonable notice of activity where we may require significant involvement of the FSCS.

Other UK bodies

We often need to work with other UK regulators, and other UK government agencies either to pursue our own objectives or to assist them in theirs. This may also include other enforcement agencies.

We have agreements to support the sharing of information and judgements and the co-ordination of actions. Our general approach to these arrangements and the relationships they underpin is focused on:

- enabling all parties to focus on their own objectives;
- the substantive issues of the potential co-ordination;
- avoiding, where possible, a detailed, prescriptive approach, to ensure that judgement and flexibility are not lost; and
- provisions for regular review, ensuring that MoUs remain current.

International co-operation

Insurance is an international industry. Many UK firms have operations overseas, and many firms domiciled overseas have subsidiaries or branches in the UK. Insurers are therefore supervised on a co-operative international basis.

We participate actively in global supervisory forums and seek to be an influential participant in international policy debates, seeking to achieve agreement at the global level to the reforms necessary for a strong, balanced and coherent prudential framework.

We actively participate in the work of the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS), and other global forums. We support in particular IAIS initiatives to strengthen the supervisory framework for internationally active insurers, through the development of the international capital standards. This reflects the view that for these insurers, the group supervisor should be ready and able to conduct effective consolidated supervision of all activities (regulated and unregulated) within a

[7] PRA/FSCS Memorandum of Understanding; available at www.bankofengland.co.uk/about/governance-and-funding.

group. We welcome the endorsement of the Holistic Framework by the FSB, which provides a key pillar of the macroprudential assessment and supervisory framework.

3: Identifying risks to our objectives

The intensity of our supervisory activity varies across insurers. The level of supervision principally reflects our judgement of an insurer's potential impact on the stability of the financial system, its proximity to failure (as outlined in the Proactive Intervention Framework), its resolvability, and our statutory obligations. Other factors that play a part include the complexity of the firm's business and organisation.

Our risk framework

35. We take a structured approach when forming our judgements. To do this we use a risk assessment framework – see Figure 1. The framework assesses the risk posed by firms to the PRA's objectives, assessing gross risks and mitigating factors. The starting point is to assess the impact an insurer could have on the stability of the UK financial system and the external context and business model risks which an insurer is exposed to. This is then overlaid with mitigating factors which are the actions a firm takes to offset the gross risk. When taken together, this helps us to make an assessment of the net risk that any given firm poses to the PRA's objectives. The risk assessment framework for insurers is the same as for banks, but is used in a different way, reflecting our additional objective to contribute to securing appropriate policyholder protection, the different risks to which insurers are exposed, and the different way in which insurers fail.

Figure 1. The PRA's Risk Element Framework

Gross Risk			Mitigating Factors					
Potential impact	Risk context		Operational mitigation		Financial resilience		Operational resilience	Structural mitigation
Potential impact	External context	Business risk	Management and governance	Risk management and controls	Capital	Liquidity	Operational resilience	Resolvability
We consider the potential impact a firm could have on financial stability alongside how the external context and business risk it faces (together, its risk context) might affect the firm's viability. This gives us an assessment of gross risk.			We also consider a firm's operational mitigation covering management and governance and its risk management and controls.		Financial resilience is an important part of our assessment.		Firm's operational resilience capabilities and any areas of vulnerability that are outside of tolerance are assessed.	Structural mitigations to the potential risk that a firm poses to financial stability – namely the ease with which a firm is resolvable, and our assessment of their operational preparedness for a resolution scenario is another key element of our approach.

36. Much of our proposed approach to the supervision of insurers is designed to deliver the supervisory activities under Solvency II.[8] The key features of Solvency II are:

- market-consistent valuation of assets and liabilities;
- high quality of capital;
- a forward-looking and risk-based approach to setting capital requirements;
- minimum governance and effective risk management requirements;
- a rigorous approach to group supervision;
- a Ladder of Intervention designed to ensure intervention by us in proportion to the risks that a firm's financial soundness poses to its policyholders; and
- strong market discipline through firm disclosures.

37. Some insurers fall outside the scope of Solvency II (known as Non-Solvency II firms), mainly due to their size. These firms should make themselves familiar with the requirements for Non-Solvency II firms.

Potential impact

38. Our starting point for any insurer's risk assessment is the potential impact assessment in which we assess the significance of an insurer to the stability of the UK financial system. This 'potential impact' reflects a firm's potential to affect adversely the stability of the system by failing, coming under operational or financial stress, or because of the way in which it carries out its business.

39. We divide all insurers that we supervise into the four 'categories' of impact below:[9]

Table 1. Potential Impact Categories

Category 1	The most significant insurers whose size, interconnectedness, complexity, and business type give them the capacity to cause very significant disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on their business in an unsafe manner.
Category 2	Insurers whose size, interconnectedness, complexity and business type give them the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on their business in an unsafe manner.

8 For more information on Solvency II, see: **www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii**.

9 In 2023, the PRA moved from five to four categories of potential impact: **www.bankofengland.co.uk/prudential-regulation/letter/2023/insurance-supervision-2023-priorities**.

Category 3	Insurers whose size, interconnectedness, complexity, and business type give them the capacity to cause minor disruption to the UK financial system by failing, or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption.
Category 4	Insurers firms whose size, interconnectedness, complexity, and business type give them almost no capacity individually to cause disruption to the UK financial system by failing, or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption.

40. We also consider the substitutability of the services that the firm provides, and the extent to which this could mitigate the impact of failure, including in stressed circumstances.

41. We use quantitative and qualitative analysis to allocate insurers to categories. Numerical scoring based on regulatory reporting provides an indicated categorisation which supervisors then review in light of qualitative analysis to confirm that it presents a full picture of an insurer's potential impact. We consider the lines of business and risks insured by the insurer, and whether these have the potential for significant adverse effects on policyholders if continuity of cover were not to be maintained or obligations not paid. If so, consideration will be given to whether these justify the insurer being placed in a different category from that suggested by the initial quantitative analysis. This categorisation process is reviewed annually.

42. Insurers are told which category they have been assigned, providing a broad indication of the level of supervisory interaction to expect.

Risk framework elements

43. Following the Potential Impact Score calculation, we consider a series of further gross risk elements and mitigating factors to overlay this assessment, as set out in Figure 1 above. Each risk element is explored in further detail below.

External context

44. External context refers to any external factors that could pose a threat to the viability of an insurer. Any assessment of the risks facing insurers, including their financial and operational risk, requires an appreciation of the external context in which they operate. Our assessment therefore includes consideration of system-wide risks; from general economic

and market conditions or the political and physical environment, to sectoral risks; for example operational risks arising from concentration of outsourcing within a sector.

45. We draw on work by other parts of the Bank, including the views of the FPC on the macroprudential environment. Sectoral analysis to understand key market developments over the medium term draws upon both market intelligence and, where appropriate, standardised information from insurers. We also consider actions by other regulators, including the FCA that might materially affect the prudential soundness of PRA-authorised insurers.

Business risk

46. Business model analysis forms an important part of our supervisory approach. We examine threats to the viability and sustainability of an insurer's business model, and the ways in which an insurer could create adverse effects on other participants in the system by the way it carries on its business. The analysis includes an assessment of where and how an insurer makes money, and the risks it takes in doing so. Business model analysis is conducted at the level of the firm or the sector as appropriate.

47. For those insurers posing greater risk to policyholders or the stability of the system, the analysis is more detailed; it includes a review of the drivers of profitability, risk appetite, performance targets and underlying assumptions, and an insurer's own forecasts and their plausibility. We use this analysis to form a projection of the insurer's ability to achieve its business and capital plans and associated risks over the medium term. This projection, and the general picture that supervisors form of the nature of the business, guide our work in assessing the adequacy of the management actions the insurer has available to mitigate risk. If we believe that mitigating measures alone cannot adequately reduce material risks to safety and soundness and policyholder protection, we will expect the insurer to review its plans.

48. Peer analysis forms an important part of this assessment, providing a diagnostic tool to highlight where individual institutions may be outliers relative to their sector and so in need of further analysis. Such analysis also supports an understanding of common sectoral risks that have the potential to affect the stability of the system.

Management and governance

49. It is the responsibility of each insurer's board and management to manage the firm prudently, thereby contributing to the continued stability of the financial system.

50. The board should articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goals. The PRA expects the culture to be embedded with the use of appropriate incentives, including but not limited to remuneration, to encourage, and where necessary require, the behaviours the

board wishes to see, and for this to be actively overseen by the board. The non-executives have a key role to play in holding management to account for embedding and maintaining this culture.[10] This includes following our policies, and any other applicable laws and regulations in line with their spirit, and embedding the principle of safety and soundness in the culture of the whole organisation.

51. We do not have any right culture in mind when making our assessment; rather we focus on whether accepted practices are challenged, and whether action is taken to address risks on a timely basis. In particular, we want to be satisfied that designated risk management and control functions carry real weight when challenging the business decisions made within insurers and that consideration is given to the wide range of risks facing insurers.

Design and effectiveness of the Board and Senior Management

52. In order to provide effective challenge across the full range of the firm's business and rigorously explore key business issues, the board must have diversity of skills, approach and experience.[11] As an insurer grows and evolves, and as the challenges it faces change (including through technology and new risk types), it may need different board members and management, including those with experience in other sectors.

53. The Senior Managers and Certification Regime (SM&CR) establishes the link between seniority and accountability by strengthening individual accountability. Accordingly, we expect insurers to allocate clear responsibilities to individuals performing Senior Management Functions (SMFs) and to document them in a clear, concise and effective manner (and to hold those individuals to account against those expectations). SMFs are subject to a 'duty of responsibility' whereby they are required to take reasonable steps to prevent or stop regulatory breaches in their area of responsibility; and a requirement to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility effectively.

54. We expect insurers to have in place sufficient controls to minimise incentives for excessive risk-taking by management and staff. To this end, remuneration and incentive structures should reward careful and prudent management, by seeking to align better the interests of senior executives (and others who may have material influence over an insurer's profile) with the maintenance of safety and soundness and the long-term interests of their employers. A consequence of this is that downward adjustments to variable pay should be

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[10] SS5/16 – Corporate governance: Board responsibilities sets out further information for the boards of PRA-regulated firms on those aspects of governance to which we attach particular importance and may devote particular attention in the course of our supervision. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss**.

[11] SS5/16 – Corporate governance: Board responsibilities sets out further information for the boards of PRA-regulated firms on those aspects of governance to which we attach particular importance and may devote particular attention in the course of our supervision. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss**.
General Organisational Requirements Part: PRA Rulebook. Available at: **www.prarulebook.co.uk**.

considered in response to financial losses, poor performance, and inadequate risk and control environments.

55. Individuals intending to hold SMF positions, and their respective firms are required to apply for our approval before taking up their position. Approval is granted only if we, as prudential regulator, and the FCA, as conduct regulator, are both satisfied that an individual is fit and proper. Insurers themselves should carry out appropriate checks and satisfy themselves that individuals seeking to perform an SMF are fit and proper for their intended roles before applying to us and the FCA for approval on their behalf and should continue to satisfy themselves of the fitness and propriety of their SMFs on an ongoing basis for as long as they hold those roles.[12]

56. Diversity and inclusion plays an important role in promoting good governance. It does so by bringing different perspectives and experiences together, which promote constructive challenge and debate, and thereby helping to guard against groupthink. There is a risk that groupthink undermines good governance in firms, leading to decisions that weaken their safety and soundness. Insurers should consider diversity when recruiting members to the management body, and more broadly in their employment practices. They should also cultivate an inclusive firm culture that allows concerns to be raised and decisions to be challenged effectively.

Structures

57. We expect insurers to have in place clear structures of accountability and delegation of responsibilities for individuals and committees, including checks and balances to prevent dominance by an individual. Senior individuals remain accountable for the actions of those to whom they delegate responsibilities, including where insurers use third parties in respect of outsourced functions. Insurers within the scope of Solvency II are required to have a clear, unambiguous, and effective structure of responsibility with a clear Management Responsibilities Map that shows the responsibilities for each senior individual, as well as their lines of reporting and accountability both within the insurer and the wider group, where applicable.

58. Not all legal entities within a group are necessarily directly regulated. Nonetheless, unregulated group entities can be important to the functioning of the group as a whole (for instance, by providing important support services), or can undertake activities which have the potential to create risks for the group as a whole and so for authorised insurers. As a result of the responsibilities of their holding companies and their regulated entities, we expect all boards of regulated legal entities within groups to have proper regard to our objectives.

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[12] We set out our expectations of firms and individuals in PS15/18 – Strengthening individual accountability in insurance: Strengthening individual accountability in insurance: Extension of the Senior Managers and Certification Regime to insurers. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2018/strengthening-individual-accountability-in-insurance-extension-of-the-smcr-to-insurers**.

59. These requirements on the boards and executive management of legal entities within groups apply equally to overseas insurers that establish separately incorporated entities within the UK. In particular, we expect boards and senior management of these insurers to have proper regard to our objectives, both for the group as a whole and for individual insurers (and subgroups) in the UK, since issues at the parent or group level could have an effect on the PRA-authorised entity and our objectives more generally.

60. Insurers are able to operate in the UK as branches of overseas legal entities, meaning that there is no separate legal entity in the UK. We expect all UK branches, like UK subsidiaries, to act responsibly in a manner that is consistent with safety and soundness and the appropriate protection of policyholders. We expect branches to appoint a senior individual as SMF 19 – Head of a third country branch with authority to act as a primary contact with us in relation to their affairs. This individual should also act as a channel for communication with the head office.

Disciplinary action against individuals

61. We may prohibit any individuals, not just those who currently hold an SMF, from performing functions in relation to a regulated activity carried out by a PRA-authorised insurer. We may only do this where it appears to us that an individual is not a fit and proper person to perform such functions.

62. We have specific disciplinary powers over individuals approved to perform an SMF by us or an equivalent function by the FCA (eg as a member of the governing body) and we are empowered to use these where an individual fails to comply with our Conduct Rules, or has been knowingly involved in a contravention by their firm of a requirement imposed by us. The powers enable us to, among other sanctions, impose financial penalties, censure an individual publicly, withdraw approval from individuals holding SMFs, and prohibit individuals from holding SMFs in the future.

63. We will take disciplinary action where it is appropriate to do so. In assessing whether to take disciplinary action against a senior manager or director, we consider a variety of factors, including:

- the impact the individual's behaviour has had, is having, or could have on us advancing our objectives, including the behaviour of other persons in the firm over whom the individual should exercise control, and whether that behaviour calls into question the person's fitness and properness (be it an isolated incident or a course of conduct);
- whether taking action will serve to deter the person who committed the breach, and others who are subject to our requirements, from committing similar or other breaches; and

- the individual's behaviour towards us, including the level of co-operation and openness with which the individual deals with us, and the appropriateness of the individual's actions in response to concerns raised.

Risk management and controls

64. Firms should have robust frameworks for risk management, including for financial and operational risks. A robust risk management framework enables firms to effectively identify, measure, monitor, manage and report risks. Controls should be commensurate with the nature, scale, and complexity of their business, and promote the firm's safety and soundness. Competent and, where appropriate, independent control functions should oversee these frameworks. Boards should ensure they receive adequate and timely information on key risks and variances from the insurer's agreed risk appetite to enable them to monitor and challenge executive management. This mechanism can be reinforced by setting appropriate responsibilities under the SM&CR.

65. We expect insurers to articulate for themselves the amount of risk they are willing to take across different risk types within different business lines to achieve their strategic objectives. This risk appetite should be consistent with our objectives, and the insurer should pay appropriate attention to identifying, measuring, monitoring, and controlling risks, including those arising in unlikely but very severe scenarios.

66. Despite appropriate scenario planning, it is always the case that a situation may come along that tests financial or operational resilience in way that had not been anticipated. As such, we do not expect firms to be able to withstand all such events. We consider it important, however, for firms' senior management and boards to understand the circumstances in which their firm might fail and have effective processes to identify, manage, monitor, and report the risks to which it is, or might be, exposed. In addition, they should have a clear understanding of what steps they would need to take if such an event were to crystallise. Moreover, boards and senior managers need to be alert to past instances of firm and compliance failure within the industry and apply these lessons to their own circumstances to help support a sound risk culture.

67. Risks should be reported to the board and senior management on a timely basis, with risks outside the agreed risk appetite and key sensitivities highlighted.[13] We expect key decisions, both on assuming new risks and managing existing ones, to be taken at the appropriate level, including, where they are sufficiently important, at the level of the board.

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[13] SS4/18 – Financial management and planning by insurers sets out our expectations concerning the development and maintenance of a risk appetite statement; how to apply their risk appetite when developing and monitoring medium-term business plans; and the assessment of the suitability and sustainability of capital distribution plans in the context of this risk appetite. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss**.

68. Climate change, and society's response to it, present financial risks which are relevant to the PRA's objectives. While the financial risks from climate change may crystallise in full over longer time horizons, they are also becoming apparent now. We expect firms in scope of SS3/19 – Enhancing banks' and insurers' approaches to managing the financial risks from climate change, which detailed our supervisory expectations for firms' management of climate-related financial risks, to be able to demonstrate how they are responding to our expectations and set out the steps being taken to address barriers to progress.[14] The PRA is aware of the need to be proportionate, and smaller firms should determine how these capabilities might map to the nature, scale, and complexity of their business.

Control framework

69. An insurer's control framework encompasses the processes, delegated authorities and limits that put into effect an insurer's approach to risk management and control. We expect an insurer's control framework to be comprehensive in its coverage of the whole firm and all classes of risk, to be commensurate with the nature, scale, and complexity of the insurer's business, and to deliver a properly controlled operating environment (including, for example, through segregation of duties and reconciliations or through the processes to report and act on any breaches of limits).

70. We expect insurers to have available the information needed to support their control frameworks. This information should be of an appropriate quality (current and consistent), integrity (that data is correct), and completeness to provide a reliable basis for making decisions and to control the business within agreed limits and tolerances and should be produced in a sufficiently timely manner. It should be able to be accessed and analysed in aggregate for the business as a whole, across the group, and for each business line and legal entity within it, to facilitate understanding and swift management of the risks to which the insurer is exposed.

71. In addition to having an appropriate risk culture embedded across their organisation, insurers should have in place separate risk management and control functions (notably risk management, finance, and internal audit) to the extent warranted by the nature, scale, and complexity of their business. We expect these functions to support and challenge the management of risks across the business as a whole by expressing views on the appropriateness of the level of risk being run and the adequacy and integrity of the associated governance, risk management, financial, and other control arrangements. Given this, the variable remuneration of employees engaged in such control functions in Solvency II firms must be independent of the performance of the business areas that they control.[15]

14 SS3/19; available at **www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss**.

15 SS10/16 – Solvency II Remuneration Requirements. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency-2-remuneration-requirements-ss**.

Capital

72. Capital is required to ensure firms can absorb losses without falling below regulatory minima and to allow for uncertainty over the valuation of both liabilities and assets. Having enough capital of sufficiently high quality reduces the risk of an insurer becoming unable to meet the claims of its policyholders and creditors. It is therefore crucial for maintaining their level of protection.

73. The Solvency II regime compares the level and quality of capital held by an insurer (including the firm's ability to raise more capital if needed) with the capital requirements applicable to that firm. These requirements are calculated to ensure that the business of the insurer could be transferred to another insurer and therefore still pay out to policyholders after the occurrence of a 1-in-200 year stress event, where the stress event used in the calculation reflects the risk profile of the particular insurer.

74. Our supervisory process also seeks to consider whether an insurer has plausible recovery and resolution actions that it could take, including in times of general market stress.

Application of the Own Risk and Solvency Assessment (ORSA)

75. We expect insurers to take responsibility for maintaining an appropriate level of capital at all times, and the preparation and application of an appropriate ORSA is expected to be central to this.

76. The PRA expects insurers to set a risk appetite for the levels of capital that are to be maintained in reasonably foreseeable market conditions: for example, as assessed through stress and scenario tests, or through some suitable alternative approach, to provide no more than a '1 in x' probability that the Solvency Capital Requirement (SCR) coverage might fall below 100%.[16] If an insurer's capital management policies are calibrated such that frequent or foreseeable breaches of the SCR are likely to occur, the PRA may consider whether the insurer is meeting the requirement to have in place an effective system of governance. Similarly, if the level of capital of an insurer regularly or persistently falls outside of its risk appetite, or an insurer makes frequent changes to its risk appetite for its planned levels of capital, the PRA may consider whether this indicates failings in the governance process by which the insurer sets its risk appetite.

77. The ORSA should help to ensure there is an effective link between a firm's business plan, risk appetite, and capital management plans. It should include an analysis of the firm's risk profile, as well as a series of financial projections, along with suitable stress and scenario

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[16] SS4/18 – Financial management and planning by insurers for further information on setting a risk appetite for SCR coverage. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss**.

tests showing how the firm would plan to maintain adequate financial resources in changing conditions.[17]

Quality of capital

78. We expect all capital to be capable of absorbing losses in the manner indicated by its place in the capital structure. Solvency II sets out the types and quality of capital which can be recognised as permissible capital instruments for insurers. We will object to insurers issuing regulatory capital instruments that are deliberately structured to meet the letter but not the spirit of these criteria, notably where their incentive is to minimise issuance cost and promote the attractiveness to investors at the expense of genuine loss-absorbing capacity.

79. Lower-quality capital (for example, Tier 2 debt), and other forms of loss-absorbing capital, may not prevent a firm's failure, but they can play a role if an insurer has failed. Since costs incurred by the FSCS are mutualised, an insurer's capital, including subordinated loan capital, can help reduce the impact of failure on other insurers. Such capital can also be valuable in the event of an insurance business being transferred from an insurer that has entered, or is about to enter, an insolvency proceeding.

Location of capital

80. We are mindful that capital resources are not always freely transferable around a group when it matters most. Therefore, we expect capital to be located in the regulated entities where it is needed. Policyholders', creditors' and counterparties' claims are on specific legal entities, not on groups, and should an insurer fail, its orderly resolution will be facilitated if individual legal entities, and UK groups, hold capital commensurate with their risks. We expect groups to assess the extent to which capital resources of entities in a group would be available to absorb losses elsewhere in the group and for groups to be adequately capitalised on a group basis after taking account of our views on availability.

The framework for determining regulatory capital

81. We expect insurers to take responsibility for maintaining at all times an adequate level and quality of capital, taking into account the risks to which they are exposed, and consistent with their safety and soundness and the protection of policyholders. Capital should be sufficient to absorb unexpected losses, including those arising from uncertainties about provisions and valuations, in a wide range of severe but plausible stresses, both market-wide and firm-specific.

82. We expect insurers, in scope of Solvency II, to manage their capital such that the SCR and the Minimum Capital Requirement (MCR) are not breached in the absence of a severe stress event. This overall approach is designed to maintain the confidence of an insurer's creditors and ensure the protection of its policyholders, even in stressed circumstances.

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[17] Further guidance on the ORSA is available at: **www.bankofengland.co.uk/prudential-regulation/publication/2016/solvency2-orsa**.

83. We form judgements about how insurers appropriately reflect their risk profile in determining their SCR, given the risks to which they are exposed and uncertainties about the values of assets and liabilities. We assess the extent to which the insurer has considered life and non-life underwriting risks and credit, market, and operational risks adequately in its assessment of capital adequacy, and also assess the scale of other risks which the insurer faces. We expect insurers to take responsibility for determining the appropriate method for the calculation of their SCR, and to ensure the appropriateness of that methodology over time.

84. We expect Solvency II insurers to develop, as part of their ORSA, a framework for stress testing and solvency assessment. This framework should include financial projections that enable them to monitor the assumptions underlying their assessments, and the significance of any volatility in their earnings or in their capital. The projections should encompass a range of severe yet plausible scenarios. In assessing risk, we expect insurers and insurance groups to employ a range of stress-testing techniques proportionate to the nature, scale and complexity of their business. In support of this, we expect all insurers to ensure that assets and liabilities are appropriately valued and that technical provisions are adequate.

85. We expect insurance groups to consider the cash flow implications of these financial projections, including under stressed conditions. In particular, groups should assess whether they will still be able to generate sufficient available cash flows in the stress scenario (eg from surpluses or dividends from other subsidiaries). These cash flows should cover any payments of interest, or capital on loans to finance new business and to meet proposed group dividends, along with any other anticipated group liabilities as they fall due.

86. Insurers and groups are expected to develop, as a matter of routine, planned management actions in response to stress scenarios that are realistic, credible, consistent with regulatory expectations, and achievable, and which should be approved by their boards. They should also consider whether any of the actions identified should be taken in advance as precautionary measures, or whether they would be relevant or desirable only in the stress scenario. Such plans, designed to return insurers to a stable, sustainable position following firm-specific or market-wide stress, should include options to address capital shortfalls through generating capital internally and externally. Plans to generate capital internally should include restricting dividends and variable remuneration. We assess the appropriateness of insurers' plans in terms of the adequacy of the recovery options identified and the triggers and governance to activate them.[18]

87. We analyse a firm's financial strength to assess the adequacy of its solvency position on a forward-looking basis, including in times of stress when asset valuations may become strained and the adequacy of technical provisions may, in consequence, come under stress.

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18 SS4/18 – Financial management and planning by insurers. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2018/financial-management-and-planning-by-insurers-ss**.

It is important that firms exercise appropriate and adequate oversight of the valuation processes. Underwriting concentrations and performance are also considered, including reviewing sensitivities to longevity and discount rate assumptions.

88. For Solvency II firms, we come to a view on whether the method of calculating the SCR (eg whether using the standard formula, the standard formula with Undertaking Specific Parameters, or a full or partial internal model) adequately reflects the particular risks an insurer is exposed to. Our view is informed by the insurer's own assessments, but also reflects our views of the risks to our objectives.

89. We have particular regard to the idiosyncratic risks facing the insurer, in the context of its business model, the wider circumstances or external context, and the effectiveness of the insurer's governance and of its management of the risks it faces.

Internal capital models

90. Internal capital models should be supported by adequate testing and validation on an ongoing basis. Insurers will be expected to explain any significant changes in capital requirements arising from modelled approaches. Insurers should not use internal modelling as a way to lower capital requirements and, in particular, when assessing changes to be made to the model, insurers should pay attention to risks for which capital need is increasing and avoid a biased focus on risks for which capital need might be decreasing.

91. Senior management and the board should understand the extent of any reliance on models for managing risk, as well as the limitations from the structure and complexity of models, the data used as inputs and key underpinning assumptions. Models, and their output, should be subject to effective, ongoing, and independent validation to ensure that they are performing as anticipated. We expect senior management to have a clear understanding and advise the board of key assumptions supporting the models, the risks that are not adequately captured by them, and the alternative risk management processes in place to ensure that such risks are adequately measured and incorporated into the firm's overall risk management framework.

92. We monitor 'model drift' – the risk that, over time, capital requirements calculated using an internal model no longer reflect the risks that a firm faces - as one of the tools to help ensure that capital requirements continue to reflect the risk to which insurers are exposed. The internal model SCR is compared to other measures of risk including the standard formula SCR, pre-corridor MCR, net written premiums, and best estimate liabilities. Supervisors expect insurers to explain any significant model drift over time.

Liquidity and funding

93. We expect all insurers to take responsibility for ensuring that there is no significant risk that they cannot meet their liabilities as they fall due, and to have appropriate risk management strategies and systems in place for managing their liquidity.

94. Insurers should consider the risk of losing collateral they have posted and the assumptions they make about the ease of replacing trades in managing their liquidity.

95. We also expect insurers to manage the liquidity risks associated with holding material derivative positions appropriately, including demonstrating that they can deal with the requirements of the UK European Market Infrastructure Regulation (UK EMIR).[19] Derivative positions have the potential to cause liquidity shocks to insurers and such shocks may not necessarily have capital implications where extensive hedging is used. A liquidity requirement will arise where the value of the derivative moves against the insurer and may arise if the value of the posted collateral reduces. Particular stress may be caused with derivatives that are centrally cleared, as these will require insurers to post cash variation margin against movements in the derivative value.[20]

96. Liquidity resources are not always freely transferable around a group when it matters most, and also may be transferred away from one area which needs them to support other areas. We therefore expect insurers to ensure that liquidity is available without impediment, including in stressed times, in the regulated entities where it is needed. For life insurers, we expect liquidity to be adequate in the portfolio as a whole and in its component funds. This includes not only the shareholders' funds, non-profits funds and with-profits funds, but also unit-linked funds. Insurers should ensure that the liquidity in these funds is adequate in stressed conditions as well as normal business conditions.

Operational resilience

97. We expect insurers to have high standards in the management of operational as well as financial risks. For example, insurers should have procedures in place to ensure continuity of the important business services they provide, such as the payment of claims to policyholders. Operational resilience refers to the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover from, and learn from, operational disruptions. The PRA's approach to operational resilience is based on the assumption that, from time to time, disruptions will occur which will prevent insurers from operating as usual and see them unable to provide their services for a period.[21]

98. The PRA's primary focus for operational resilience is on firms delivering the important business services that their customers and the wider economy rely upon. As part of this, we expect UK Solvency II firms, the Society of Lloyd's and its members and managing agents to have impact tolerances that acknowledge that disruptive events will happen. Firms need to

19 Regulation 648/2012 on OTC derivative transactions, central counterparties, and trade repositories.

20 SS5/19 – Liquidity Risk Management for Insurers. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2019/liquidity-risk-management-for-insurers-ss.

21 Statement of policy: Operational Resilience, March 2021. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-sop.

be able to remain within their set impact tolerance for a wide range of severe but plausible scenarios.[22]

99. In line with our statutory obligations (see Section 1), we will seek greater levels of assurance around impact tolerances from insurers with a higher potential impact assessment. Insurers' operational resilience is the responsibility of their boards. We require them to have clear lines of accountability for their operational resilience, through responsibility for the internal operations and technology of the firm. Boards should ensure there is sufficient challenge to the executive and that they have access to people within the business with appropriate technical skills.

Resolvability

100. One of the key channels through which insurers can adversely affect our objectives is through disorderly failure which disrupts continuity of critical functions, causes dislocation in financial markets and results in spill-overs to the wider economy.[23] To mitigate this risk, it is important for there to be mechanisms by which insurers can exit the market in an orderly manner: that is, with minimal disruption to the supply of critical functions, including the degree of continuity for policyholders' cover against insured risks (delivered either through continuity of cover or where continuity of cover is less critical, through compensation for premiums paid).

101. An insurer's resolvability reflects the extent to which it can exit the market in an orderly manner, preserving the supply of critical functions and minimising adverse effects on financial stability and the wider economy, consistent with our objectives, and without exposing taxpayers to loss.

102. At present, the UK does not have a specific resolution regime for insurers, although in January 2023 HMT issued a consultation paper setting out the Government's proposal to introduce one.[24] In the absence of such a regime, when insurers fail, or face financial difficulty, they exit the market via:

- **Run-off:** the firm is closed to new business and the liabilities 'run off' over time. Insurers may use a scheme of arrangement/restructuring plan approved by a court under the Companies Act 2006 to agree a compromise with their creditors and to accelerate the process. Accelerating run-off can involve transfers of liabilities to another insurance

22 PS6/21 – Operational Resilience: Impact tolerances for important business services. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper**.

23 More information on the relationship between critical functions and important business services is set out in: **www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution**.

24 Insurer Resolution Regime: Consultation. Available at: **www.gov.uk/government/consultations/insurer-resolution-regime-consultation**.

company through a court sanctioned process known as a Part VII transfer.[25] The PRA has specific regulatory functions connected with Part VII transfers. This role includes approving the independent expert and the form of the scheme.

- **Administration or liquidation/winding-up:** an insurer may enter a modified administration or liquidation procedure. The administrator or liquidator of an insurer is required to continue to carry on the insurer's business so far as that business consists of carrying out the insurer's contracts of long-term insurance with a view to the business being transferred as a going concern.
- The FSCS provides compensation to eligible policyholders for claims against insurers that are declared to be in default, or seeks to ensure continuation of cover. Such continuity might be achieved by transferring policies elsewhere, or by finding replacement cover.

103. These arrangements vary in the extent to which they have been put into practice. The PRA is doing additional work on more clearly stipulating its expectations for insurers around solvent exit planning.

25 For more information on insurance business transfers, see: PS1/22 | CP16/21 – Insurance business transfers. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/insurance-business-transfers**.

4: Supervisory activity

This section describes how we supervise insurers in practice, including the tools we use and the legal and enforcement powers available. In-line with our key principles, this engagement will be proportionate to the size and potential impact to financial stability of any given firm. Our supervision is focused on the key risks that a firm has the potential to pose to financial stability. For UK insurers, our assessment covers all entities within the consolidated group.

104. As set out in Section 2, our supervisory approach follows three key principles: (i) judgement-based; (ii) forward-looking; and (iii) focused on key risks. These principles require us to utilise a broad range of tools in gathering quantitative and qualitative data to inform our supervisory judgements. Box 3 outlines our approach to authorising new applicant insurers, while the remainder of Section 4 refers to our engagement with insurers following Authorisation.

Box 3: Authorising new insurers

Firms wishing to effect or carry out contracts of insurance must apply to us for authorisation. The application process is a joint assessment between us and the FCA, and we have established a New Insurer Start-Up Unit to help prospective insurers, including a guide. We assess applicant firms from a prudential perspective, with the focus of the FCA being on conduct. The applicant firm will only be authorised if both regulators are satisfied that the insurer will meet their respective Threshold Conditions, at the point of authorisation and on an ongoing basis. As provided for in the MoU between the PRA and FCA, we lead and manage a single administrative process, and the PRA, as the lead regulator for dual-regulated firms, will act as decision maker on the application.

We set out the information that we require insurers to supply to complete our assessment. We stand ready to answer questions where necessary, though this does not extend to providing consultancy on completing applications. Along with the FCA, we have committed to engaging with applicants at an early stage in pre-application meetings, which will aim to produce as complete an application as possible.

We take a proportionate approach to the assessment of applications. All applicants are subject to a minimum level of assessment, beyond which the assessment depends on the potential impact of a firm’s failure on the financial system.

We ensure that, at the point of authorisation, and consistent with requirements, new insurers hold capital sufficient to cover the risks that they run.

Our aim through this proportionate approach is for barriers to entry to be kept to the minimum consistent with our objectives, so enabling us to contribute to a competitive insurance market.

Authorising new insurance special purpose vehicles (ISPVs)

Any entity wishing to undertake the regulated activity of insurance risk transformation must also apply to us for authorisation as an ISPV. Authorisation will only be granted where both we and the FCA are satisfied that the planned ISPV meets the relevant requirements. The legal and regulatory requirements governing establishment and operation of ISPVs can be found on our dedicated ISPV webpage which also outlines the different stages of the authorisation process, including expected timelines.

Engagement with firms

105. Central to our approach is engagement with authorised firms at all levels of seniority. At a senior level, boards as a whole and individual directors should expect regular dialogue with us, either in groups or on an individual basis. In-line with the principle of proportionality, this engagement will be focused on material risks that the firm has the potential to pose to financial stability, and will be proportionate to the size, activity type and potential impact that any given firm could have to financial stability. This results in an approach to supervision which is not formulaic and will vary depending on a firm's particular circumstances.

106. Supervisors require insurers to meet the requirements of Solvency II in relation to regulatory reporting and disclosure to submit sufficient data, of appropriate quality, to support their judgements about key risks. Given the importance of this, we periodically validate insurers' data, either through onsite inspection by our supervisory and specialist risk staff, or by third-parties.[26] Recognising the importance that the PRA places on this, from time to time, the PRA makes use of its powers under s166 of FSMA to commission a skilled persons report focused specifically on the accuracy of regulatory data provided by firms where concerns have been identified.

107. We also gather and analyse information on a regular basis, for example through regulatory returns, insurers' annual reports and disclosures, and requiring insurers to participate in meetings with supervisors at a senior and working level. Some discussions are strategic in nature, while other interactions focus on information gathering and analytical work.

26 Bank of England and FCA Dear CEO Letter on transforming data collection, July 2022. Available at: www.bankofengland.co.uk/prudential-regulation/letter/2022/july/transforming-data-collection.

108. For Category 1 and 2 insurers, we may also conduct detailed onsite testing or reviews of particular areas where we have specific concerns. These can be used to look further into areas including asset quality, underwriting, reserving, reinsurance, capital management, liquidity management, financial and operational risk management, and governance. Such reviews involve discussions with staff, reviews of internal documents and testing, and may be done on either an individual or cross-firm basis. In addition, we may review an insurer's approach to stress testing, or undertake bespoke stress testing of our own. We involve our risk specialist, actuarial, and other technical staff in onsite work, stress testing, and other assessments as appropriate. Where we feel we can rely on their effectiveness, we may use insurers' risk, compliance, internal audit, and actuarial functions to identify and measure risks.

Box 4. Section 166 skilled persons reports

Skilled persons reports (under s166 of FSMA) are a supervisory tool that we routinely draw on in our supervision of firms across all potential impact categories and PIF stages. Skilled persons reports are a common feature of how the PRA supervises, and firms should be ready for the PRA to utilise these in a wide range of situations. We routinely utilise this tool more than we have done in the past as part of the regular supervisory programme, especially for our most significant firms.

A skilled person (typically a professional services company, with examples listed on the skilled person panel) could be appointed to produce a report for the PRA for a series of reasons including:

i. diagnostic purposes: to identify, assess and measure risks;
ii. for monitoring purposes: to track the development of identified risks, wherever these arise;
iii. for preventative action: to limit or reduce identified risks and so prevent them from crystallising or increasing; or
iv. for remedial action: to allow the PRA to respond to risks when they have crystallised.

The use of the tool could be prompted by:

i. a specific requirement by the PRA for information;
ii. an analysis of information undertaken by the PRA;
iii. an assessment of a situation by the PRA;
iv. expert advice or recommendations received by the PRA; or
v. a decision by the PRA to seek assurance in relation to a regulatory return.

The PRA might choose to obtain a report in circumstances where an enforcement investigation is being contemplated or is underway. However, the tool is used to support

supervisory assessments first and foremost – the use of a skilled persons report does not imply any presumption of wrongdoing or rules breaches on a firm's part in and of itself.

Proactive Intervention Framework (PIF)

109. The PRA uses a Proactive Intervention Framework (PIF) to support early identification of risks to an insurer's viability. Insurers are assigned a PIF score that is reflective of our judgement of their proximity to failure. Supervisors consider an insurer's proximity to failure when drawing up its supervisory plan. Our judgement about proximity to failure is captured in an insurer's position within the PIF and is regularly updated, informed by the supervisory activities outlined above.

110. Judgements about an insurer's proximity to failure are derived from those elements of the supervisory assessment framework that reflect the risks faced by an insurer and its ability to manage them, namely, external context, business risk, management and governance, risk management and controls, capital, liquidity, and operational resilience. The PIF is not sensitive to an insurer's potential impact or resolvability.

111. The PIF is designed to ensure that we put into effect our aim to identify and respond to emerging risks at an early stage. There are five PIF stages, each denoting a different proximity to failure, and every firm sits in a particular stage at each point in time (Box 5). When an insurer moves to a higher PIF stage (ie as we determine the insurer's viability has deteriorated), supervisors will consider and deploy an appropriate set of supervisory actions. Senior management of insurers will be expected to ensure that they take appropriate remedial action to reduce the likelihood of failure and harm to policyholders, and preparedness for resolution as necessary.

112. We consider it important for markets and counterparties to make their own judgements on the viability of an insurer. We will not therefore routinely disclose to the market or to insurers themselves our own judgement on an insurer's proximity to failure, not least given the possible risk that such disclosures could act to destabilise in times of stress.

Box 5. Stages in the Proactive Intervention Framework

Stage	Possible supervisory actions
Stage 1 – Low risk to viability of insurer	– Insurer subject to the normal supervisory risk assessment process and required to plan for stressed conditions and identify appropriate recovery actions or exit strategies. – We assess insurer resolvability.

<table>
<tr><td>Stage 2 – Moderate risk to viability of insurer
Supervisors have identified vulnerabilities in an insurer's financial position of deficiencies in its risk management and/or governance practices.</td><td>Recovery
– The intensity of supervision will increase and the insurer will be required to reassess the appropriateness of recovery actions and exit strategies.
– We may set additional reporting requirements, and make use of information gathering and investigatory powers.
– We will review the insurer's risk profile and the regulatory capital requirements and consider realigning the latter, as well as setting restrictions on the insurer's activities until remedial actions have been completed.
Resolution
– We will identify and instigate any initial contingency planning needed, potentially including information gathering and liaison with the FSCS.</td></tr>
<tr><td>Stage 3 – Risk to viability absent action by the insurer
Significant threats to an insurer's safety and soundness have been identified</td><td>Recovery
– The insurer may be required to submit a recovery plan designed to address specific policyholder protection issues that have been identified, current problems, and to initiate recovery actions in a timely manner to address the vulnerabilities identified. Actions may include: capital raising; asset disposal; and business transfer or sale of the insurer.
– Other actions we may require include: changes to management and/or the composition of the board; limits on asset disposal/acquisition or capital distribution; restrictions on existing or planned activities; a limit on balance sheet growth; and an assessment of the effectiveness of risk transfer arrangements such as reinsurance.
– At the insurer's or our initiative, an insurer's authorisation to carry out new business may be removed.
Resolution
– We may intensify contingency planning for resolution.
– We will co-ordinate with the FSCS to ensure it has obtained the information necessary to evaluate continuity of cover or payout options (this will include an assessment of the potential exposure of the FSCS).</td></tr>
<tr><td>Stage 4 – Imminent risk to viability of insurer
The position of an insurer has deteriorated such that we assesses that there is a real risk that the insurer will fail to meet the Threshold Conditions, but some possibility of corrective action remains</td><td>Recovery
– We may remove the insurer's authorisation to write new business.
– Insurer to accelerate and complete recovery actions, demonstrating to us that these have mitigated the imminent risk to the viability of the insurer.
Resolution
– Working with the FSCS, we will complete all necessary actions for resolution of the insurer including planning for commencement of orderly liquidation or administration and with the assistance of the insolvency practitioner in waiting.</td></tr>
<tr><td>Stage 5 – Insurer in resolution or being actively wound up</td><td>Resolution
– As necessary, we will trigger the appropriate insolvency process and the insolvency practitioner will work with the FSCS to effect continuity of cover and/or compensation to eligible claimants.
– As appropriate, we will monitor insurers exiting the system.</td></tr>
</table>

Setting supervisory strategies

113. There are regular internal stocktake meetings, known as Periodic Summary Meetings (PSMs) for all insurers that we supervise to discuss the major risks they face based on the output of the tools outlined above. This is used to inform the supervisory strategy, and proposed remedial actions, including guidance about the adequacy of an insurer's capital (as described in Section 3). There is senior level involvement in these assessments, such that major judgements are made by our most senior and experienced individuals. These formal assessments are also subject to rigorous review by those not directly involved in day-to-day supervision, including risk specialists and independent advisers. Depending on the Potential Impact category of the insurer, the assessment may also be reviewed by the PRC. The role of the PRC is explained further in Box 6.

114. There is a clear and direct link between the risks that we identify and the actions we expect from firms in consequence. For example, if we have identified deficiencies in an insurer's forecasts of earnings, or inappropriate remuneration structures, leading to risks to its financial health, we will expect the insurer to take steps to tackle this. Or the assessment may have revealed that senior management has an inadequate view of the insurer's aggregate exposures, compromising the effectiveness of the insurer's governance and, in consequence, the firm's soundness. We may then expect the insurer to enhance internal systems for monitoring aggregate exposures or to review the design and effectiveness of its governance and reporting lines.

115. Following the PSM, we send a letter. For most firms we send an individually tailored letter clearly outlining the risks that are of greatest concern, and against which we require action. For those firms with the lowest potential impact we send a standard letter outlining issues relevant to all firms in a peer group, unless specific issues have been identified with a particular firm.

116. In response we expect insurers to formally allocate an SMF to take responsibility for addressing each key risk and action highlighted by the PRA in the PSM letter. These responsibilities should be reflected in the relevant SMFs' Statement of Responsibilities (SoR).[27] We focus on the most material issues we have identified, and supervisory interventions are clearly and directly linked to reducing risks to our objectives. We will communicate to a firm's board when and how we intend to verify whether any remedial actions taken to address the key risks have been completed to our satisfaction. We actively engage with the firm's board and its subcommittees, where applicable, and its non-executive directors on progress made in addressing the most significant risks identified. Lastly, we may also engage with the relevant individuals at a firm to understand how success or failure in addressing the key risks and associated actions will affect the remuneration awards of the responsible SMFs.

27 Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss**.

117. Insurers may sometimes disagree with our judgements: this is inherent given the tensions between the public and private interest. We, in general, discuss issues with insurers in reaching our decisions, and carefully consider representations made, not least to ensure that our decisions are made on the basis of all the relevant evidence. However, insurers should not approach their relationship with us as a negotiation.

Box 6: The Prudential Regulation Committee (PRC)

The Prudential Regulation Committee (PRC) has responsibility within the Bank for exercising the Bank's functions as the PRA, as set out in the Bank of England Act 1998 and the Financial Services and Markets Act 2000.

The PRC makes our most important decisions. It sets the PRA levy, by way of rules, and adopts the budget of the PRA, with the approval of Court. It makes key supervisory decisions in relation to the largest firms we supervise. It has a number of non-delegable responsibilities, including the PRA's high-level strategy and policy-making functions. The PRC is accountable to Parliament, in the same way as the Monetary Policy Committee (MPC) and Financial Policy Committee (FPC), the Bank's other statutory decision-making bodies.

The PRC is chaired by the Governor of the Bank of England. Other members of the PRC are: the Deputy Governors for Financial Stability, Markets, Banking and Resolution, and Prudential Regulation; the Chief Executive of the FCA; a member appointed by the Governor with the approval of the Chancellor; and at least six members appointed by the Chancellor.

Engagement with external auditors and actuaries

118. Insurers' external auditors can and should play a role in supporting prudential supervision, given their ability to identify and flag to us current and potential risks in an insurer. As required by the 2023 Act, we maintain arrangements to provide an insurer's external auditors with relevant data and information, as well as exchanging opinions with those auditors on the implications of such information. As part of this, we will meet with the external auditors of Category 1 and 2 insurers annually. We expect to work with insurers' external auditors in an open, co-operative, and constructive manner and will maintain rules setting out the duties external auditors have to co-operate with us in connection with our supervision of PRA-authorised firms. We expect auditors to disclose to us emerging concerns within insurers where this would assist us in carrying out our functions. We have published a

Code of Practice[28] detailing the arrangements we maintain with firms' external auditors to promote a mutually beneficial and constructive relationship.[29]

119. Given their role in assessing the risks to which an insurer is exposed, actuaries can play an important part in supporting prudential supervision. Full, regular and timely dialogue between actuaries and supervisors should form a key part of supervision, so we seek also to maintain a constructive relationship with actuaries, as a profession and individually, enabling us to understand and critically challenge actuarial judgements within insurers. Engagement with the Financial Reporting Council (FRC) Board and its advisory Actuarial Council, and the Institute and Faculty of Actuaries is an important part of this dialogue.

Engagement with the FCA

120. We also make use of the FCA's findings on firms' key conduct risks, including money laundering, and any material prudential risks in relation to FCA-authorised subsidiaries of dual-regulated groups where they are materially relevant to our objectives. These are shared under the MoU between the PRA and FCA.

121. We are not a 'fraud' regulator; this role is filled by other authorities. Our onsite inspections are not therefore designed to uncover all instances of malpractice. Rather, we aim to assess the adequacy of a firm's control framework in preventing operational risk (including serious fraud) that could threaten its safety and soundness, drawing to the attention of the relevant authorities any suspicion or information that may be of material interest to them.

International supervisory colleges

122. We continue to work closely with all international regulatory bodies to oversee PRA regulated insurers, participating in global supervisory colleges either as a home supervisor, or host supervisor where relevant. To be fully effective, colleges must operate in a manner that enables supervisors to be open and transparent with each other, and to address difficult issues. We seek to adopt this approach when we run colleges and expect other authorities to participate on the same basis. As the lead authority and college chair for UK insurance groups, we are prepared to tackle instances where we believe that other authorities are not acting in a manner consistent with our objectives. We encourage other authorities to challenge us if they have concerns.

[28] Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice.

[29] SS7/13 – The relationship between the external auditor and the supervisor: a code of practice. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice-ss.

Using powers in the course of supervision

123. To assist with our risk assessment, we may choose to use our statutory powers, in particular, our information gathering power and our powers to commission reports by Skilled Persons on specific areas of interest (under s165, 165A, 166 and 166A of the 2023 Act). Such reviews can be undertaken where we seek additional information, an assessment, further analysis, independent expert advice and recommendations, or assurance on aspects of a regulated firm's activities. We may enter into a contract with a Skilled Person directly, following a transparent and consistent approach to selecting and appointing them, or we may allow the regulated firm to contract with the Skilled Person. We are always regarded as the end user of a Skilled Person report regardless of the appointment approach taken. Further detail on our approach to using s166 Skilled Person powers can be found in Box 4.

124. In addition to the powers to request information from insurers outlined above, we have a variety of other formal powers available to us under the Act, which we can use in the course of our supervision, if deemed necessary to reduce risks. These include powers by which we can intervene directly in an insurer's business. For example, we may vary an insurer's permission or impose a requirement under Part 4A of the Act to prevent or curtail an insurer undertaking certain regulated activities, which may require a change to a firm's business model or future strategy.

125. We may also use our statutory powers to approve or allow certain changes requested by insurers, for example its permissions to perform regulated activities. Where those changes could adversely affect the safety and soundness of the insurer, we may use our powers to refuse such requests. In certain circumstances, we are also able to grant a waiver or modification to a rule, using powers under FSMA.[30] In exceptional circumstances, we may approve or require a capital add-on where we conclude that a firm's risk profile deviates significantly from the assumptions underlying its SCR or where its system of governance deviates significantly from the requirements set out in the Conditions Governing Business Part of the PRA Rulebook.

126. While we look to insurers to co-operate with us in resolving supervisory issues, we will not hesitate to use formal powers where we consider them to be an appropriate means of achieving our desired supervisory outcomes. There is substantial flexibility for us to tailor requirements specific to the circumstances of an insurer and the nature of our concerns, including serious cultural failings. This means that, in certain cases, we will choose to deploy formal powers at an early stage and not merely as a last resort. This can include addressing serious failings in the culture of insurers.

127. When we impose a requirement on a firm at our own initiative, we must publish such information about the matter as the PRA considers appropriate. However, we do not have to publicise the imposition of requirements if publication would be unfair to the person

30 Waivers and modifications of rules; available at www.bankofengland.co.uk/prudential-regulation/authorisations/waivers-and-modifications-of-rules.

concerned, prejudicial to the safety and soundness of a firm, or prejudicial to securing the appropriate degree of protection for policyholders.[31]

128. We consider when and how to use our formal powers, and assess the particular facts and circumstances, on a case-by-case basis. In all cases, we are likely to consider a number of factors in connection with the possible deployment of such powers, including:

- the confidence supervisors have that insurers will respond appropriately to our requests without the use of powers;
- our view of the insurer's proximity to failure, as reflected in its position within the Proactive Intervention Framework; and
- the likely impact, including systemic implications, of the insurer's failure.

Enforcement

129. Where a firm or individual fails to comply with requirements or rules imposed by the PRA, we can take enforcement action. We have a wide range of enforcement powers and, for example, can issue a financial penalty or public censure against a firm or individual who is found to be in breach of our rules. We can also prohibit an individual from working in the regulated financial services sector. This way we clearly set out, for the benefit of the whole regulated community, the actions we consider unacceptable.

130. In practice, not every breach of a rule or requirement will result in enforcement action. This is because, in any given situation, there may be a range of possible regulatory responses by the PRA. The appropriateness of using its enforcement tools will, therefore, need to be measured against:

- the anticipated benefits in advancing the PRA's statutory objectives;
- the alternative courses of action available to the PRA; and
- the proportionality of opening an investigation, given the level of resources it may require and the level of intrusion and cost to the subject.

131. Before taking enforcement action against a firm or an individual, we usually investigate whether (and if so, which) regulatory requirements have been breached and any concerns about an individual's fitness and propriety. The PRA has published a set of referral criteria which sets out the considerations we take into account when deciding whether or not it is appropriate for us to conduct an enforcement investigation, and to determine which of the PRA's investigation tools and powers to use.[32]

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[31] The use of PRA powers to address serious failings in the culture of firms – June 2014. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2014/the-use-of-pra-powers-to-address-serious-failings-in-the-culture-of-firms**.

[32] Available at: **www.bankofengland.co.uk/prudential-regulation/pra-statutory-powers**.

5: Proportionate application of the supervisory approach

We are responsible for supervising a diverse range of insurance companies. These include life, general, wholesale, reinsurance and international companies. Even within these broad categories there is substantial diversity in firm structures and sizes as well as products, which shapes the business models and risks to which these insurers are exposed. We tailor our application of the supervisory assessment framework to take account of this diversity and ensure a proportionate approach.

The Society of Lloyd's and the Lloyd's market

132. We are the prudential supervisor of the Society of Lloyd's and the managing agents that operate within the Lloyd's market.

- We supervise the Lloyd's market to the same standards as regulated firms in the insurance market outside Lloyd's. But the unique legal framework of Lloyd's means that we need to tailor our approach.
- Supervision is carried out at two levels: (i) the Society of Lloyd's itself (which provides central functions, including the maintenance of the New Central Fund);[33] and (ii) each of the managing agents (which carry out the underwriting and risk management functions for Lloyd's members).

133. We have powers to intervene directly with individual members of Lloyd's (or with all of them together) or to direct the Council or the Society (acting through the Council) if we determine that such action is necessary for the purpose of advancing our objectives.

134. The MoU between us and the FCA sets out how we co-ordinate in respect of the supervision of the Lloyd's market. In general, we and the FCA will consult the other before using a power of direction over members and, in particular, will obtain consent from the other when exercising powers to require members of Lloyd's to become authorised. We have a co-operation agreement with the Society of Lloyd's which sets out how we and the Society envisage working together to ensure the effective supervision of managing agents.

33 As provided for in the Lloyd's New Central Fund Byelaw (Number 23 of 1996).

With-profits insurers

135. A separate MoU sets out how we work with the FCA to protect the interests of with-profits policyholders appropriately.[34] Special arrangements are needed because the returns on with-profits policies are not well defined, and are at the discretion of the insurer.

136. We seek to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness. The FCA has responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications to policyholders, the FCA's conduct rules, and the insurer's overriding obligation to treat customers fairly.

137. There may be circumstances where the proposed discretionary benefit allocations call into question the safety and soundness of the firm as a whole and so its ability to meet its obligations to policyholders generally. In such circumstances, we will work with the insurer and the FCA to explore alternative ways those allocations could be made without materially impairing the insurer's safety and soundness. If no reasonable alternative exists, given the risk to the insurer's overall safety and soundness and its ability to meet obligations to policyholders, the statute gives us the power to take action to prevent such allocations being made. Where we are satisfied that the insurer's decisions, or the FCA's requirements, do not materially affect the overall safety and soundness of the firm, we will not take action.

Insurers posing a very low risk to our objectives

138. There are a large number of category 4 insurers, most of which are small overseas insurers (branches or subsidiaries), small regional or niche insurers, as well as small mutual insurers. Insurance special purpose vehicles, which support specific risk transfer transactions commonly known as insurance-linked securities, are also Category 4 insurers.

139. Although at an individual level, these insurers have almost no capacity to cause significant harm to the stability of the system, our statutory objective to contribute to securing an appropriate degree of protection for all policyholders requires a baseline level of supervisory monitoring for all insurers. Further, there is a risk that several insurers may fail together through a common exposure, with possible wider impact on financial stability.

140. Given that these insurers are likely to pose low risks to our objectives, we supervise them on a portfolio basis. Insurers' regulatory returns are analysed on a peer basis. Any outliers and unusual trends are examined separately and may result in individual analysis of a firm's regulatory returns.

141. We will examine these insurers more closely should a significant be discovered, for example through a review of the insurer's returns, or an approach from the insurer itself, or in

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34 Available at: www.bankofengland.co.uk/about/Pages/mous/default.aspx.

response to authorisation requests from the insurer (for example a request to change its permissions to undertake regulated activities, or to extend the nature or scale of its business).

142. The lowest potential impact insurers contact us through a centralised enquiries function and do not have an individually named supervisor.

143. In most instances we conduct regional visits annually which allow us to engage with a number of smaller firms. Nevertheless, all insurers, regardless of category, are subject to onsite work by us, with a period of notice, at any time.

Mutual insurers

144. Our approach to the supervision of mutual insurers is consistent with the approach adopted for other insurers. It reflects variety in the sector, for example different constitutions, different governance frameworks, and different policyholders. It also recognises that there are issues that are specific to the mutual sector, for example constraints on raising external capital.

Reinsurers

145. Our approach to supervising reinsurers is based on the same principles as our supervision of primary insurers. However, reinsurance may give rise to a greater degree of connectivity with other parts of the financial system than is usually seen with primary insurance business. Undertaking an appropriate degree of supervision of the reinsurance business transacted in the UK is therefore an important element in meeting our objectives.

Insurance special purpose vehicles (ISPVs)

146. Only our general objective, to promote the safety and soundness of the firms we regulate, applies to ISPVs. ISPVs need to comply with the relevant Threshold Conditions and Solvency II requirements, including the requirement to be fully funded, on an ongoing basis. ISPVs deal with insurance companies and sophisticated investors as their counterparties. As such, they are relatively low potential impact firms, and in line with other such firms, a peer group approach is applied to assess the risks posed by ISPVs in aggregate. Given the risk profile, the core assurance supervisory activities for these firms are proportionate and risk based. We expect to identify emerging risks through ongoing supervision and the assessment of qualitative and quantitative reports submitted to the PRA annually.[35]

[35] SS8/17 – Authorisation and supervision of insurance special purpose vehicles. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/authorisation-and-supervision-of-insurance-special-purpose-vehicles-ss.

Non-Solvency II firms

147. We supervise Non-Solvency II firms in peer groups. Should a significant risk crystallise for one of these insurers, we will examine them more closely. They are not subject to the Solvency II tests and standards, either for reasons of scale or other reasons as detailed under the Insurance General Application Part of the PRA Rulebook.[36]

148. Non-Solvency II firms have their own reporting requirements, as prescribed in the PRA Rulebook. In most cases, they submit their regulatory reporting on an annual basis, for which supervisors review the key components of capital coverage and changes in capital requirement, premium, and asset volumes. The same approach is adopted for non-Solvency II friendly societies, but on a triennial basis according to their reporting schedule.

Insurers in solvent run-off

149. Insurers in solvent run-off do not write new insurance policies, but instead settle their remaining liabilities as they fall due. Save in respect of insurers for whom only part of their business is in such run-off, such insurers fall into two distinct categories, passive run-off firms/insurer and acquirers. Passive run-off insurers simply run off their liabilities, and form the majority of the sector by both number of firms and aggregate size of reserves. Acquirers by contrast actively aim to acquire additional legacy liabilities from other insurers (whether live insurers or other run-off firms), which they then proceed to run off.

150. We have rules (and expectations) specific to run-off insurers reflecting run-off specificities.[37] In particular, where a firm has decided to cease to effect new contracts of insurance in respect of the whole of its insurance business, it must within 28 days of that decision, submit a run-off plan to the PRA, maintain a Scheme of Operations containing details of the firm's run-off strategy, and financial projections. Importantly, the Run-Off Operations Rules include a requirement that the firm will notify us, seeking PRA non-objection, at least 28 days before entering into or carrying out any material transaction.[38]

International insurers

151. Many third country insurers, including some reinsurers, operate in the UK and are significant providers of financial services to the UK economy.[39]

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36 PRA Rulebook – Non-SII Firms. Available at: **www.prarulebook.co.uk/rulebook/Content/Sector/211133/04-05-2023**.

37 PRA Rulebook – Insurers in solvent run-off. Available at: **www.prarulebook.co.uk/rulebook/Content/Part/213364/17-05-2023**.

38 Capital extractions by run-off firms within the general insurance sector. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2014/capital-extractions-by-run-off-firms-within-the-general-insurance-sector-ss**.

39 A firm authorised in Gibraltar can passport into the UK. Available at: **www.bankofengland.co.uk/prudential-regulation/authorisations/passporting**.

152. For UK subsidiaries of third country insurance groups, we have full powers and responsibilities and so our approach is to treat such insurers in the same way as UK-owned insurers. We will apply our full prudential requirements to the UK subsidiary.

153. When the UK subsidiary is part of a third country group, our supervisory approach will depend on whether the overseas group supervision regime is deemed equivalent to the UK prudential regime. If the third country group is subject to an equivalent group supervision regime, we will rely on the global supervision exercised by the third country group supervisor. If the overseas group is not subject to an equivalent group supervision regime, we are unable to rely on the third country group supervisor and will ensure appropriate group supervision either through direct supervision of the group or through use of other methods.

154. In assessing the appropriateness of an insurer operating in the UK through a branch, the PRA emphasises the extent to which we can be satisfied that the firm is capable of being supervised effectively by the home state supervisor, and our authorisation applies to the whole insurer. The whole firm needs to be able to meet the Threshold Conditions and at the point at which a new third country insurer seeks initial authorisation to establish a branch in the UK, and then on an ongoing basis, we will form a judgement on the adequacy of the worldwide financial resources of the third-country undertaking (Legal Entity) and its compliance with its home country prudential regime. We will assess whether the home country prudential supervision regime is broadly equivalent to the regime applied to UK insurance firms, and maximise our engagement with the competent home state supervisor. Following the UK's departure from the EU, we treat UK branches of EU insurers in the same way as any other branch of an international insurer.

Annex

July 2023: This issue of 'The Prudential Regulation Authority's approach to insurance supervision' has been updated to reflect recent developments in policies and approach. The key changes are outlined below.

- New foreword from Sam Woods, PRA CEO and Deputy Governor for Prudential Regulation at the Bank (pages 3-4).
- Removal of text regarding the UK's withdrawal from the EU following transition to a steady state relationship with the EU post-withdrawal.
- Addition of text relating to the 2023 Act and the PRA's additional secondary objective for international competitiveness and the growth of the UK economy in the medium to long-term (page 6).
- Addition of text relating to disruption to continuity of critical economic functions in relation to the PRA's general objective (page 7).
- Addition of text relating to orderly firm failure (page 9).
- Addition of text relating to the 2023 Act requirement for the PRA to 'have regard' to the government's 2050-net zero target and environment targets (page 10).
- Update to 'Box 2 - Working with other authorities' following EU withdrawal (page 14).
- Removal of previous Figure 1 - The PRA's approach to risk assessment.
- Inclusion of amended Figure 1 - The PRA's Risk Element Framework (page 18).
- Updated section summarising the PRA's approach to assessing Potential Impact, following the revision of the categorisation process to include four categories of insurer rather than five (page 19).
- Restructuring of 'Management and Governance' section (pages 21-25).
- Addition of climate change related risk to risk management section (page 26).
- Updates to capital section (page 27-30).
- Addition of a separate section on 'Operational Resilience' to align with changes to the PRA's Risk Element Framework (page 31). This includes reference to: Statement of Policy: Operational Resilience (March 2021) and SS1/21: Operational resilience: Impact tolerances for important business services
- Added reference to HMT consultation on an Insurer Resolution Regime (page 32).
- Restructuring of Section 4 to include additional sub-section titles to aid clarity (pages 34-43).
- Addition of Box 4 outlining the PRA's use of Section 166 Skilled Persons Reports (page 36).
- Updates to Proactive Intervention Framework (pages 37).
- Updates to 'setting supervisory strategies (page 39) following the PRA's updated approach to core assurance.
- 'International supervisory colleges' updated to reflect post-EU withdrawal arrangements (page 41).
- Restructuring of 'Using powers in the course of supervision' (pages 42), including the addition of a specific section on enforcement.
- Section 5 renamed 'Proportionate and tailored application of the supervisory approach' to better represent the contents within the section.
- Additional clarity provided on our approach to ISPVs (page 46).
- Addition of 'insurers in solvent run-off' section (page 47).

- Updates to Section 5 'International Insurers' section to reflect changes in approach since previous iteration of the approach documents and post-EU withdrawal arrangements (page 47).
- References to Non-Directive Firms have been updated throughout to refer to Non-Solvency II firms.