



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP34/16

Strengthening individual accountability in banking and insurance: amendments and optimisations

September 2016

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Responses are requested by Monday 9 January 2017.

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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out three sets of proposed amendments and optimisations to the Senior Managers and Certification Regime (SM&CR) and Senior Insurance Managers Regime (SIMR).

1.2 This CP is relevant to all PRA-regulated firms, although specific chapters or sections may be relevant to either Relevant Authorised Persons¹ (RAPs) or insurers only.

1.3 The PRA's final rules to implement the SM&CR are set out in the following Parts of the PRA Rulebook: Senior Management Functions, Allocation of Responsibilities, Certification, Fitness and Propriety, Conduct Rules, Notifications, Senior Managers Regime – Applications and Notifications and Senior Managers Regime – Transitional Provisions. Other parts of the Rulebook such as Audit Committee, General Organisational Requirements, Compliance and Internal Audit, Remuneration and Risk Control are also relevant to aspects of the SM&CR.

1.4 The PRA's final rules to implement the SIMR for Solvency II firms (as well as Lloyd's and Lloyd's managing agents, third country (re)insurance branches and UK ISPVs) can be found in the Insurance - Senior Insurance Management Functions, Insurance - Allocation of Responsibilities, Insurance - Fitness and Propriety, Insurance - Conduct Standards, Notifications, Senior Insurance Managers Regime – Applications and Notifications, Senior Insurance Managers Regime – Transitional Provisions, and the Insurance General Application Parts of the PRA Rulebook for Solvency II firms.

1.5 The PRA's final rules to implement the Senior Insurance Managers Regime (SIMR) for non-Solvency II firms² can be found in the Large Non-Solvency II Firms – Allocation of Responsibilities, Large Non-Solvency II Firms – Conduct Standards, Large Non-Solvency II Firms – Fitness and Propriety, Large Non-Solvency II Firms – Key Function Holder – Notifications, Large Non-Solvency II Firms – Senior Insurance Management Functions, Large Non-Solvency II Firms - Senior Insurance Managers Regime – Applications and Notifications, Large Non-Solvency II Firms - Senior Insurance Managers Regime – Transitional Provisions, Non-Solvency II Firms – Conduct Standards, Non-Solvency II Firms – Fitness and Propriety, Non-solvency II Firms – Senior Insurance Management Functions, Non-solvency II Firms – Senior Insurance Managers Regime – Applications and Notifications and Non-solvency II Firms - Senior Insurance Managers Regime – Transitional Provisions Parts of the PRA Rulebook for Non-Solvency II Firms.

1.6 This CP should be read in conjunction with Financial Conduct Authority (FCA) CPs 16/26 and 16/27 which contain the FCA's equivalent proposals for implementing the changes to the SM&CR introduced by the Bank of England and Financial Services Act 2016 (the Act).³

Summary of proposals

1.7 Chapter 2 of this CP sets out the PRA's proposals for implementing the amendments to the SM&CR and SIMR in the Act and includes:

- setting out the PRA's expectations on the duty of responsibility;¹

1 UK banks, building societies, credit unions and PRA-designated investment firms are collectively referred to in the Financial Services and Markets Act 2000 (FSMA) and in this policy statement as 'Relevant Authorised Persons'; see www.legislation.gov.uk/ukpga/2000/8/contents.

2 PRA Rulebook: Non-Solvency II Firms: Senior Insurance Managers Regime Instrument 2015 www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2115.aspx

3 www.legislation.gov.uk/ukpga/2016/14/contents/enacted/data.htm.

- applying certain Conduct Rules² (SMR)/Conduct Standards (SIMR)³ to those non-executive directors (NEDs) who are not approved persons under the SMR and SIMR⁴ ('Notified NEDs'); and
- a minor, technical change to the PRA's Statement of Policy (SoP) on Conditions, time limits and variations of approval.⁵

1.8 Chapter 3 of this CP sets out the PRA's proposed optimisations for the SM&CR, which include:

- creating a new PRA Senior Management Function (SMF), the Chief Operations function (SMF23), which will bring the individual with overall responsibility for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm;
- creating a new PRA Prescribed Responsibility for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm;
- inserting additional criteria to the definition of the Head of Key Business Area function (SMF6) to supplement the existing quantitative thresholds in rule 3.6 of the Senior Management Functions Part of the PRA Rulebook;⁶ and
- clarifying the PRA's expectations of Statements of Responsibilities (SoRs) and Management Responsibilities Maps (MRMs).

1.9 The proposals set out in Chapter 2 and Chapter 3 of this CP will only apply to RAPs including, where applicable, UK branches of any banks and PRA-designated investment firms based in third countries ('incoming third-country branches'), other than the application of Conduct Rules (SMR) and Conduct Standards (SIMR) to Notified NEDs, which will apply to all PRA-regulated firms.

1.10 Chapter 4 of this CP sets out the PRA's proposed optimisations for the SIMR, which include:

- a streamlined regime for firms in run-off; and

1 See section 66B(5) of FSMA, www.legislation.gov.uk/ukpga/2013/33/section/32.

2 See www.prarulebook.co.uk/rulebook/Content/Part/302677/13-09-2016. The Conduct Rules section of the FCA Handbook ('COCON') can be found at www.handbook.fca.org.uk/handbook/COCON/2/?date=2017-03-07&timeline=True?view=chapter.

3 See www.prarulebook.co.uk/rulebook/Content/Part/318600/13-09-2016 for Large Non-Solvency II Firms and www.prarulebook.co.uk/rulebook/Content/Part/302744/13-09-2016 for Non-Solvency II Firms.

4 Under the proposals in this CP, the Conduct Rules / Conduct Standards would apply to any non-executive directors (NED) which are members of the board of directors, or if there is no such board, the equivalent body responsible for the management of the authorised person concerned. Note that this is a different definition to that used in for Notified NEDs in general (<http://www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/66847/02-08-2016>), which captures any individuals performing non-executive functions which occupy the position of a director (by whatever name called), or in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of the relevant firm are accustomed to act. These varying definitions in turn reflect the definitions in sections 64A and 317(1) of FSMA respectively. Where the term 'Notified NEDs' is used in this CP, this refers to Notified NEDs that would be subject to the Conduct Rules / Conduct Standards, unless the context requires otherwise. In the highly unlikely scenario that a Notified NED does not also fall within the population of individuals to whom the Conduct Rules / Conduct Standards apply directly, the PRA expects to be notified of this under Fundamental Rule 7, at which point the PRA would expect to discuss with firms whether it would be appropriate to formally appoint the relevant individual to the firm's board. In addition, note that in such circumstances, the relevant firm would nonetheless be required to require the relevant NED (unless he is a Notified NEDs of a Small NDF) to observe the Conduct Rules / Conduct Standards referred to in Table 1, in accordance with Fitness and Propriety 3.1, Insurance – Conduct Standards 2.2 and Large Non-Solvency II Firms – Conduct Standards 2.2.

5 www.bankofengland.co.uk/pr/Pages/publications/sop/2015/conditions.aspx.

6 www.prarulebook.co.uk/rulebook/Content/Part/212475/01-08-2016.

- tailored requirements for small, less complex insurers that elect to outsource their internal audit function (mirroring with certain differences the requirements for RAPs in rule 4.2(3) of the Allocation of Responsibilities Part of the PRA Rulebook).

Responses and next steps

1.11 This consultation closes on Monday 9 January 2017. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP34_16@bankofengland.co.uk.

1.12 The Act also provides for the extension of the SM&CR to all authorised financial services firms. The PRA and FCA plan to consult in 2017 on their proposals for the extension, which is expected to become effective in 2018.

2 Amendments to the SM&CR and SIMR in the Act

2.1 In October 2015, HM Treasury introduced a range of measures into the Bank of England and Financial Services Bill ('the Bill') to extend and reform the SM&CR: They included:

- a new duty of responsibility "to be applied consistently to all senior managers across the financial services industry".¹ The duty of responsibility replaced the presumption of responsibility in the original SMR, which did not enter into force;
- amending section 64A of FSMA to enable the PRA and FCA to apply rules of conduct (which include the Conduct Rules and Conduct Standards) to persons who are directors² of PRA-regulated firms, which includes directors that are Notified NEDs;³
- deleting the requirement in section 64B(5) of FSMA to notify the PRA and FCA of actual and suspected breaches of rules of conduct by individuals in scope of such rules. The PRA has already implemented the changes to its rules and forms required by this amendment;⁴ and
- introducing the following technical changes to the SM&CR:
 - amending section 63ZB to allow the PRA to vary or remove a time limit previously imposed on a Senior Manager's approval;
 - inserting a new section 59AB of FSMA giving the PRA and FCA enhanced power to grandfather individuals performing Controlled Functions (CF) into SMFs without the need for a statutory instrument; and
 - expanding the definition of 'insolvency' in section 37 of the Financial Services (Banking Reform) Act 2013,⁵ to include building society insolvencies; building society special administrations and investment bank insolvencies.⁶

2.2 The Bill received Royal Assent on 4 May 2016 and was passed as The Bank of England and Financial Services Act 2016 ('the Act'). The new duty of responsibility entered into force on 10 May 2016;⁷ the remaining amendments to the SM&CR introduced by the Act did so on 6 July 2016.⁸

2.3 The ability to apply the Conduct Rules and/or Conduct Standards to all directors applies to all PRA-regulated firms. All the other amendments to the SM&CR described above and provided for in the Act are in respect of provisions in FSMA that currently apply to RAPs only,

1 HM Treasury, 'Senior Managers and Certification Regime: extension to all FSMA authorised persons', October 2015; www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons.

2 Section 64A(7) of FSMA defines a 'director' as "a member of the board of directors, or if there is no such board, the equivalent body responsible for the management of the authorised person concerned".

3 A notified non-executive director is defined as "a non-executive director of a firm who is not an approved person in relation to that firm", see www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/77797/11-07-2016.

4 PRA Policy Statement PS9/16 'Strengthening individual accountability in banking: responses to CP1/16, and the Certification Part of CP29/15', February 2016; www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps916.aspx.

5 www.legislation.gov.uk/ukpga/2013/33/contents.

6 As defined in section 119 of the Building Societies Act 1986 and section 233 of the Banking Act 2009 respectively.

7 The Bank of England and Financial Services Act 2016 (Commencement No. 1) Regulations 2016 www.legislation.gov.uk/uksi/2016/569/contents/made.

8 The Bank of England and Financial Services Act 2016 (Commencement No. 3) Regulations 2016 www.legislation.gov.uk/uksi/2016/627/regulation/2/made.

until the extension of the SM&CR to all FSMA authorised persons takes effect in 2018,¹ when most of them² will apply to all PRA and FCA-regulated firms.

2.4 In the meantime, to ensure that the PRA's requirements and expectations on the SM&CR and SIMR reflect the current statutory framework, the PRA proposes the changes set out below to its rules and to Supervisory Statement (SS) 28/15, 'Strengthening individual accountability in banking' and SS35/15 'Strengthening individual accountability in insurance' – see Appendices 1 and 2, 3, and 4 respectively.

Expectations on the duty of responsibility

2.5 The new duty of responsibility adds a fourth element to one of the three grounds for a finding of misconduct set out in section 66B of FSMA ('Condition C') which allows the PRA to take action for misconduct against an individual performing an SMF ('Senior Manager') if the firm contravenes a regulatory requirement and, at the relevant time, the Senior Manager was responsible for the management of any of the firm's activities in relation to which the contravention occurred, and "*the senior manager did not take such steps as a person in the senior manager's position could reasonably be expected to take to avoid the contravention occurring (or continuing)*". It will be for the PRA to demonstrate that the Senior Manager did not take reasonable steps to prevent or stop the contravention. The PRA previously consulted on sections of SS28/15 which set out its expectations on the presumption of responsibility, including non-exhaustive examples of what may constitute 'reasonable steps' and how firms and Senior Managers could document them.³

2.6 After HM Treasury announced its proposal to replace the presumption of responsibility with the duty of responsibility, the PRA withdrew the relevant paragraphs of SS28/15 and republished it alongside CP1/16, 'Strengthening individual accountability in banking: amendments to notification rules and forms',⁴ with a view to consulting on a revised set of expectations when the statutory framework became clearer.

2.7 In this CP, the PRA is consulting on its expectations on the new duty of responsibility, including what may constitute reasonable steps and how firms can document them.

2.8 These proposed expectations, which are set out in the draft revised SS28/15 (Appendix 3) have not changed materially as a result of the shift from the presumption of responsibility to the duty of responsibility, but reflect necessary amendments in keeping with the change in status from a presumption to a duty. The PRA welcomes feedback on them in light of firms' practical experience of developing a framework for demonstrating reasonable steps as part of their implementation of the SM&CR.

2.9 The PRA's proposals on the duty of responsibility should be read alongside FCA CP16/26, which contains the equivalent FCA guidance. The PRA's expectations and FCA guidance have been developed in close co-ordination and are aligned in substance.

1 The extension of the SM&CR to all FSMA authorised persons is intended to come into operation during 2018: www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorized-persons.

2 The provision expanding the definition of 'insolvency' in section 37 the Financial Services (Banking Reform) Act 2013 only applies to RAPs.

3 See paras 2.56-2.75 in the July 2015 version of SS28/15; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss2815.aspx.

4 January 2016, www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp116.aspx.

QUESTION 1: *Do you agree with the proposed PRA expectations on the new duty of responsibility as set out in the revisions to Supervisory Statement 28/15 in Appendix 3 to this CP? If so, do you have any comments or suggestions on the draft text?*

Application of the Conduct Rules/Conduct Standards to Notified NEDs in RAPs and insurers

2.10 As originally drafted, section 64A of FSMA allowed the regulators to apply rules of conduct (including the Conduct Rules and Conduct Standards) to:

- individuals who are subject to pre-approval by the PRA and/or FCA under section 59 of FSMA (such as Senior Managers and individuals performing a Senior Insurance Management Function (SIMF) ('Senior Insurance Managers')); or
- individuals who are employees, as defined in section 64A(6) of FSMA, of RAPs.

2.11 As Notified NEDs are not subject to pre-approval by the regulators and do not meet the relevant definition of 'employee' in FSMA, the PRA and FCA could not apply the Conduct Rules or Conduct Standards to them. However:

- under the previous Approved Persons Regime (APR), all NEDs in PRA-regulated firms were subject to the predecessor to the Conduct Rules and Conduct Standards (the Statements of Principle and Code of Practice for Approved Persons (APER)). Applying the Conduct Rules and Conduct Standards to Notified NEDs will therefore reinstate them to the position they were in under the APR;
- although enforcement action for misconduct against NEDs has historically been uncommon, there could be situations where the PRA may deem it appropriate to take such action; for example, if a Notified NED fails to act with integrity, which would breach PRA Individual Conduct Rule 1 for RAPs or the equivalent (Individual) Conduct Standard 1 for insurers;¹ and
- under the FCA's rules, the Individual Conduct Rules will, from March 2017 apply to a large number of individuals within RAPs, including relatively junior employees.² It would therefore be unusual for these rules not to apply to some members of a firm's board.

2.12 In light of this statutory change, the PRA and FCA propose to apply:

- Individual Conduct Rules 1-3 in Conduct Rules 2 and Senior Manager Conduct Rule 4 in Conduct Rules 3.4 for Notified NEDs in RAPs;³ and
- in insurers:
 - Individual Conduct Standards 1-3, and Senior Insurance Manager Conduct Standards 4 and 5 in Conduct Standards 3 for Notified NEDs in Solvency II firms⁴ and large non-Directive firms ('NDFs');¹ and

1 Individual Conduct Standard 1 for Solvency II insurers and large non-Directive firms ('NDFs') and Conduct Standard 1 for small NDFs.

2 See COCON 1.1 Application in the FCA handbook as at 7 March 2017 www.handbook.fca.org.uk/handbook/COCON/1/1.html?date=07-03-2017&timeline=True.

3 www.prarulebook.co.uk/rulebook/Content/Part/302382/11-08-2016.

4 www.prarulebook.co.uk/rulebook/Content/Part/302677/11-08-2016.

- Conduct Standards 1-3, 7 and 8 in Conduct Standards 2² for Notified NEDs in small NDFs.

2.13 This will mean that for insurers these Conduct Standards will apply to all NEDs, as defined in section 64A of FSMA, of Solvency II firms (as well as Lloyd's and Lloyd's managing agents, third country (re)insurance branches and UK ISPVs) and at both large and small NDFs.

2.14 Table 1 describes how the PRA proposes to apply the Conduct Rules and/or Conduct Standards to Notified NEDs.

Table 1

Conduct Rules for Notified NEDs in RAPs	Conduct Standards for Notified NEDs in insurers	
	Solvency II firms and large NDFs	Small NDFs
Individual Conduct Rule 1: You must act with integrity.	Individual Conduct Standard 1: You must act with integrity.	Conduct Standard 1: You must act with integrity.
Individual Conduct Rule 2: You must act with due skill, care and diligence.	Individual Conduct Standard 2: You must act with due skill, care and diligence.	Conduct Standard 2: You must act with due skill, care and diligence.
Individual Conduct Rule 3: You must be open and co-operative with the FCA, the PRA and other regulators.	Individual Conduct Standard 3: You must be open and co-operative with the FCA, the PRA and other regulators.	Conduct Standard 3: You must be open and co-operative with the FCA, the PRA and other regulators.
Senior Manager Conduct Rule 4: You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.	Senior Insurance Manager Conduct Standard 4: You must disclose appropriately any information of which the FCA or the PRA would reasonably expect to have notice.	Conduct Standard 7: You must disclose appropriately any information of which the FCA or the PRA would reasonably expect to have notice.
	Senior Insurance Manager Conduct Standard 5: When exercising your responsibilities, you must pay due regard to the interests of current and potential future policyholders in ensuring the provision by the firm of an appropriate degree of protection for their insured benefits.	Conduct Standard 8: When exercising your responsibilities, you must pay due regard to the interests of current and potential future policyholders in ensuring the provision by the firm of an appropriate degree of protection for their insured benefits.

Note: The Conduct Rules and/or Conduct Standards set out in Table 1 will apply to any non-executive directors which are members of the board of directors, or if there is no such board, the equivalent body responsible for the management of the authorised person concerned. Note that this is a different definition to that used in the Notification Part of the PRA Rulebook, which captures any individuals performing non-executive functions which occupy the position of a director (by whatever name called), or in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of the relevant firm are accustomed to act. These varying definitions in turn reflect the definitions in sections 64A and 317(1) of FSMS. In the highly unlikely scenario that a NED covered by the definition in the Notification Part does not also fall within the population of individuals to which the Conduct Rules and/or Conduct Standards apply directly, the PRA expects to be notified of this under

1 www.prarulebook.co.uk/rulebook/Content/Part/318600/14-09-2016.

2 www.prarulebook.co.uk/rulebook/Content/Part/302744/14-09-2016.

Fundamental Rule 7, at which point the PRA would expect to discuss with firms whether it was appropriate to formally appoint the relevant individual to the firm's board. In addition, note that in such circumstances, the relevant firm would nonetheless be required to require the relevant notified non-executive director (unless they are a Notified NEDs of a small NDF) to observe the Conduct Rules and/or Conduct Standards referred to in Table 1, in accordance with Fitness and Propriety 3.1, Insurance – Conduct Standards 2.2 and Large Non-Solvency II Firms – Conduct Standards 2.2.

2.14 For most firms, this proposal will not be a significant change to current requirements regarding the observation of the Conduct Rules and/or Conduct Standards by Notified NEDs. This is because firms (other than small NDFs) are already required to require Notified NEDs to observe the Conduct Rules and/or Conduct Standards, and for RAPs this should already be applied as a contractual requirement by these firms.¹

Notification of disciplinary action due to breaches of the Conduct Rules

2.15 The extension of the Conduct Rules to Notified NEDs in RAPs means that firms would be required to notify the PRA and FCA of internal disciplinary action against a Notified NED if it relates to a breach of the Conduct Rules in accordance with section 64C of FSMA. FSMA defines 'internal disciplinary action' as the:

- issuing of a formal written warning;
- suspension or dismissal of the person; and/or
- reduction or recovery of any of the person's remuneration.²

2.16 Under section 64C of FSMA a RAP has a duty to inform the regulator if it takes disciplinary action against an individual to whom the conduct rules apply in relation to a breach of a conduct rule. The effect of Rules 11.2-11.4 of the Conduct Rules: Notifications Chapter of the PRA Rulebook is to require a RAP to notify the PRA of any disciplinary action taken against an SMF or an employee performing a Certification function (as defined in PRA rules) due to a breach of a conduct rule within seven business days of taking the relevant disciplinary action.³

2.17 The PRA proposes to apply the same, seven business day notification deadline to cases involving Notified NEDs. The rationale for this proposed approach is that:

- if a member of a firm's board is found to have committed misconduct, it is important for PRA supervisors to be notified of it as soon as reasonably practicable so as to assess the risks to the safety and soundness of the firm and the stability of the UK financial system;
- misconduct by a Notified NED may be symptomatic of wider governance issues in a firm. Section 64C notifications can serve as a mechanism by which the PRA can be made alert to this; and

1 Currently RAPs, SII firms and large NDFs must require, and in the case of RAPs, contractually require, Notified NEDs to observe the Conduct Rules and/or Conduct Standards referred to above. See Rule 3.1 in the Fitness and Propriety Part of the PRA Rulebook, Insurance – Conduct Standards 2.2 and Large Non Solvency II Firms – Conduct Standards respectively.

2 In practice, this form of internal disciplinary action is unlikely to apply to Notified NEDs as Remuneration 15.3 prevents firms from awarding variable remuneration to NEDs in relation to their role.

3 Under Certification 2.2-2.4, Certification functions are broadly aligned to individuals classed as Material Risk Takers (MRTs) under the Material Risk Takers Regulation. MRTs are defined in the Glossary to the PRA Rulebook www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52619/11-08-2016.

- although Notified NEDs might not be Certified employees (if they do not fall within the definition of ‘employees’ for these purposes), they are classed as MRTs under Article 3(2) of the Material Risk Takers regulation, and the PRA considers it reasonable to treat all MRTs consistently for the purposes of section 64C notifications.

2.18 The PRA proposes that section 64C notifications involving Notified NEDs are submitted using Form L.¹

QUESTION 2: *Do you agree with the PRA’s proposals for applying the Conduct Rules and/or Conduct Standards to Notified NEDs in RAPs and insurers? In particular, do you agree with:*

- *the specific Conduct Rules and Conduct Standards that the PRA proposes to apply to Notified NEDs; and*
- *the proposed deadline for notifying the PRA of internal disciplinary action for breaches of the Conduct Rules against Notified NEDs in RAPs under section 64C of FSMA?*

Amendment to the PRA Statement of Policy - Conditions, time limits and variations of approval

2.19 As originally drafted, section 63ZB of FSMA did not allow the PRA to modify or remove a time limit on a Senior Manager’s approval until such a time limit had run its course. This drafting prevented the PRA from taking into account legitimate reasons to modify or remove the time limit before it expired thereby limiting the usefulness of this statutory power.

2.20 For instance, where a time limit was imposed alongside a condition on a Senior Manager’s approval, the original drafting of section 63ZB would have prevented the PRA from removing the time limit even if the accompanying condition had been met.

2.21 The Act rectifies this issue. In response, the PRA proposes to replace the wording in paragraph 21 of Statement of Policy ‘Conditions, time limits and variations of approval’, published in July 2015,² with the following text:

~~21. Once a time limit is imposed, FSMA does not allow the PRA to remove or reduce it before it lapses. Consequently, where a time limit is imposed in conjunction with a condition, fulfilment of the condition does not automatically cause the time limit to lapse. In this situation, when the time limit lapses, the PRA may vary or remove a time limit on a Senior Manager’s approval before the time limit lapses will re-examine depending on its assessment of the individual circumstances of the case, including but not limited to fulfilment of any conditions.~~

2.22 The other two technical amendments to the SM&CR introduced by the Act, listed in paragraph 1.6 of this CP, do not require the PRA to modify its rules or expectations. Therefore they are outside of the scope of this CP.

QUESTION 3: *Do you agree with the proposed modification to the PRA’s Statement of Policy on conditions, time limits and variations of approval?*

1 Available at www.bankofengland.co.uk/prapages/authorisations/smr/default.aspx.

2 Available at www.bankofengland.co.uk/prapages/publications/sop/2015/conditions.aspx.

3 Proposed optimisations to the SM&CR

Proposed Chief Operations Senior Management Function (SMF)

3.1 The PRA proposes to introduce a new SMF known as the Chief Operations function (SMF23) in RAPs.

3.2 The proposed Chief Operations function seeks to bring into scope of the PRA's SMR the most senior individual responsible for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm. For firms to which the rules set out in General Organisational Requirements ('GOR') 2.4, 2.5 and 2.6 and/or the rules set out in the Operational Continuity Part of the PRA Rulebook, the PRA expects that this function would commonly include responsibility for compliance with those rules. For incoming third-country branches, the PRA expects that this function would commonly include responsibility for the matters set out in paragraphs 2.5, 2.6 and 2.7 of SS4/16.¹

3.3 The rationale behind the proposed Chief Operations SMF is the recognition of the importance of operations, systems and technology on the safety and soundness of firms and financial stability, and the corresponding need to ensure appropriate accountability for these areas at the most senior levels in firms.

3.4 A number of recent Bank of England initiatives and publications illustrate the current and growing importance of the areas likely to fall under the responsibility of the proposed Chief Operations SMF. They include:

- the Dear Chairman II exercise, which the PRA and FCA undertook in 2014/15 to review the critical infrastructure and technology resilience of the seven largest UK deposit-takers. Among other conclusions, the exercise found "a relative lack of maturity in firms' IT risk management capabilities, including inadequate delineation between first and second line responsibilities";²
- The Financial Policy Committee's (FPC) July 2015 Financial Stability Report, which identified cyber risk as a key risk to the financial system;³ and
- SS9/16 'Ensuring operational continuity in resolution',⁴ published in July 2016, which sets out the PRA's expectations on firms to ensure operational continuity of critical services to facilitate recovery actions, orderly resolution and post-resolution restructuring.

3.5 Like all SMFs except the three mandatory functions specified in Rule 2.2 of the Senior Management Functions Part of the PRA Rulebook (Chief Executive function (SMF1), Chief Finance Function (SMF2) and Chairman function (SMF9)), firms will only be required to have an individual approved as the proposed Chief Operations SMF if they have an individual performing that function. This will enable this proposed requirement to apply to RAPs in a proportionate manner. Where relevant, the proposed Chief Operations SMF will also apply to incoming third-country branches.

1 'Internal governance of third country branches', February 2016; www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss416.aspx.

2 <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/Letter-from-Tracey-McDermott-FCA-to-Treasury-Chair-19-10-15.pdf>.

3 www.bankofengland.co.uk/publications/Documents/fsr/2015/fsrfull1507.pdf.

4 www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss916.aspx.

3.6 Individuals likely to be in scope of the proposed Chief Operations SMF commonly hold the job title of Chief Operating Officer ('COO') but may also hold job titles such as Chief Administrative Officer ('CAO') or Head of Operations and Technology (O&T). However, not every individual with these job titles will necessarily come into scope of the proposed new PRA SMF; this will be determined by their specific responsibilities. Where firms have significant levels of operational infrastructure and oversight based outside the United Kingdom, it may be appropriate for the Chief Operations SMF to also sit outside of the United Kingdom, such as at group or parent-entity level.

3.7 The majority of individuals likely to be covered by the proposed Chief Operations SMF in large RAPs are currently already in scope of the SMR. In most cases, they fall under the FCA's Other Overall Responsibility function (SMF18) or, if based in an incoming third-country branch, Other Local Responsibility function (SMF22). This should significantly expedite and facilitate firms' implementation of this proposal as there will be no need for a grandfathering exercise. In such cases, firms would simply have to submit a Form E requesting that the relevant individual is transferred from his current SMF to the proposed new function.¹

QUESTION 4: *Do you agree with the proposal to create a Chief Operations PRA SMF and the proposed definition and scope of the function?*

New Prescribed Responsibility for operational resilience and operational continuity

3.8 To complement the proposed Chief Operations SMF, the PRA is proposing to create a new Prescribed Responsibility, listed in Allocation of Responsibilities 4.1 and 6.2, for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm.

3.9 Like the remaining Prescribed Responsibilities in Allocation of Responsibilities 4.1, all firms except credit unions and small CRR firms (those with gross total assets of £250 million or less), will need to allocate this Prescribed Responsibility to a Senior Manager. Where a firm has an individual approved as the proposed Chief Operations SMF, the PRA would expect firms to allocate this responsibility to them. In other cases, the PRA will expect firms to allocate the Prescribed Responsibility to a suitable executive SMF.

3.10 Incoming third-country branches will also be subject to the new Prescribed Responsibility. However, the Prescribed Responsibility will only apply to the activities of the UK branch (rather than the firm as a whole), in line with the general approach taken with regard to the application of Prescribed Responsibilities to incoming third-country branches.

QUESTION 5: *Do you agree with the proposed new Prescribed Responsibility for 'managing the areas processes and systems aimed at preserving the operational resilience (including technology security), and the operational continuity of a firm's functions?'*

Additional criteria to the definition of the Head of Key Business Area (SMF6)

3.11 At present, under Senior Management Functions 3.6, individuals managing a business area in a Relevant Authorised Person are subject to pre-approval by the PRA as a Head of Key Business Area (SMF6) only if the area of the firm that they manage meets both of the following quantitative criteria:

1 www.bankofengland.co.uk/pr/Pages/authorisations/smr/default.aspx.
 2 See Allocation of Responsibilities 4.1 and 6.2 in the PRA Rulebook www.prarulebook.co.uk/rulebook/Content/Part/212514/14-09-2016.

- it has over £10 billion in gross total assets; and
- it accounts for 20% or more of the firm's, or its group's, gross revenues.

3.12 The policy intent behind SMF6 is to bring into scope of the SMR those individuals in RAPs responsible for business lines that are sufficiently large and complex to have a potential impact upon the safety and soundness of RAPs. While the current criteria achieve this policy intent quite effectively, there are some business lines that do not meet both of the quantitative criteria but are still considered capable of having a potential impact on the safety and soundness of RAPs on account of their commercial or strategic importance that would warrant their inclusion within the scope of the SMR.

3.13 Consequently, to ensure that the heads of all key business lines with the relevant potential systemic impact are covered by the SMF6, the PRA proposes to add further criteria to the definition of the SMF6 to supplement the existing quantitative thresholds. The PRA also proposes to amend the rules to clarify the application of the current quantitative criteria to business lines which extend across multiple entities in the same group.

3.14 Under the proposed criteria, which would complement but not replace the existing thresholds, an individual will also be in scope of the SMF6 if the business area they are responsible for:

- meets both of the existing quantitative criteria in Senior Management Functions 3.6; or
- meets one of the existing criteria in SMF3.6; and satisfies either of the following criteria:
 - it performs a 'critical function' as defined in sections 3(1) and(2) of the Banking Act 2009 (as amended);¹ or
 - it is a 'material business unit' as defined in Article 3(6) of the Regulatory Technical Standards for the definition of material risk takers for remuneration purposes ('MRT regulation'), which also defines the scope of the PRA's Certification Regime.²

3.15 As with the proposed Chief Operations SMF, individuals likely to be covered by the revised definition of SMF6 are likely to be currently in scope of the SMR as SMF18, which should make implementation straightforward for firms.

3.16 The PRA proposes that the scope of the SMF6 definition will continue to be limited to RAPs, excluding incoming third-country branches.

QUESTION 5: *Do you agree with the proposed revised definition of the Head of Key Business Area function (SMF6)?*

PRA Expectations on Statements of Responsibilities and Management Responsibilities Maps

3.17 As part of implementation of the SM&CR, the PRA reviewed a large number of Statements of Responsibilities (SoRs) and Management Responsibilities Maps (MRMs). These reviews enabled supervisors to develop their expectations on the clarity, consistency, level of

1 http://www.legislation.gov.uk/ukxi/2014/3348/pdfs/ukxi_20143348_en.pdf.

2 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0604&from=EN>.

detail, formatting and structure which these documents should have to effectively set out the responsibilities of Senior Managers and the governance arrangements of RAPs.

3.18 The PRA's expectations on SoRs and MRMs are set out in the revised draft of SS28/15 included in Appendix 3. Amongst other comments:

- SoRs and MRMs should:
 - be drafted in a clear and complete way with a consistent structure and an appropriate and proportionate level of detail;
 - comprise more than a tick-box allocation of Prescribed Responsibilities; and
 - reflect how the business model, complexity, risk profile and size of a firm affect each Senior Manager's responsibilities.
- SoRs that read like generic job descriptions and do not reflect firm-specific circumstances, priorities or projects are not consistent with the spirit of the SMR. The additional and overall responsibilities sections of SoRs are important sections that should be used for signposting the unique responsibilities of given Senior Managers.

QUESTION 6: *Do you have any comments, questions or suggestions relating to the PRA's expectations on SoRs and MRMs in the draft revised SS28/15 in Appendix 3?*

4 Proposed optimisations to the SIMR

4.1 Following implementation of the SIMR, the PRA is proposing the following technical modifications. These proposals seek to ensure and enhance the proportionate, risk-based application of the regime.

4.2 Relevant amendments to the Forms, ie Long form A, Short Form A, and Form E for Solvency II firms, and the SoR form for both Solvency II firms and large NDFs, are available at Appendix 5. These amendments to the forms would facilitate the application of the technical modifications in this chapter of the CP, and also correct some minor errors that have been identified in these forms. A declaration to be signed by both the individual and the firm has also been added to the two SoR forms for when these are to be submitted offline.

Outsourcing of the internal audit function by smaller insurers

4.3 A number of small, less complex, Solvency II insurance firms outsource their internal audit function to a third party. Consequently, some of these firms do not have an individual in-house with sufficient authority or expertise to take on the Head of Internal Audit function (SIMF5).

4.4 This issue also arose in some small banks and building societies during the development of the SM&CR for RAPs. Consequently, and in the interest of consistency between the banking and insurance regimes, the PRA proposes a similar solution namely to exempt any Solvency II insurers, and Lloyd's managing agents, classed as 'not significant', along with large NDFs, (collectively 'smaller insurers') which elect to outsource their internal audit function to a third party from the requirement to have an individual approved to perform the Head of Internal Audit function (SIMF5).

4.5 Instead of the requirement to have an individual approved to perform the Head of Internal Audit function (SIMF5), the PRA proposes that smaller insurers which elect to outsource their internal audit function to a third party will be required to allocate a new Prescribed Responsibility to one of their non-executive Directors who performs a SIMF or an FCA controlled function,¹ such as the Chair of the Audit Committee (SIMF11) for:

- providing for an effective internal audit function; and
- overseeing the performance of the internal audit function.

4.6 Smaller insurers which have an internal audit function, either at the firm or group level, which is not outsourced would continue being required to have the head of that function approved as a SIMF5.

Firms in run-off that no longer have regulatory permissions to write new business

4.7 Where a UK Solvency II firm has its permission to write new business withdrawn under section 55J(7B) of FSMA ('firm without permission to effect contracts of insurance'), after breaching the requirement to maintain the minimum capital requirement (MCR), it may be unduly burdensome to require it to continue meeting the full requirements in SIMR.

4.8 The PRA therefore proposes that such firms should be required to comply with a streamlined SIMR, which would be very similar to that for transitional run-off firms and small

¹ A definition of an FCA 'controlled function' is available in the Glossary of the FCA Handbook at www.handbook.fca.org.uk/handbook/glossary/?starts-with=C.

NDFs, but with the additional ongoing requirement to have an individual approved to perform the Chief Finance Function (SIMF2).

4.9 The key differences between the streamlined SIMR for firms without permission to effect contracts of insurance and the full SIMR for Solvency II insurance firms would be as follows:

- firms without permission to effect contracts of insurance would only be required to have individuals approved to perform the Head of Firm without permission to effect contracts of insurance function (SIMF19A); Chief Finance function (SIMF2) and, where applicable, With-Profits Actuary function (SIMF21), rather than the full suite of SIMFs which Solvency II insurance firms are required to have; and
- there would be a smaller set of four PRA Prescribed Responsibilities (similar to those for small NDFs and transitional run-off firms), which these firms would need to allocate among their SIMFs, or to an FCA controlled function who is in a 'relevant senior management function'.¹

4.10 However, these firms will still need to appoint key function holders (KFHs) for the four mandatory key functions (ie actuarial, risk management, internal audit, and compliance), ensure that they are fit and proper on an ongoing basis, and notify these individual KFHs to the PRA on appointment with all the information needed for a fit and proper assessment.

¹ As defined under section 59ZA of FSMA.

5 Implementation

5.1 The consultation period for this CP will run until Monday 9 January 2017. The consultation period is aligned to the consultation period for FCA CPs 16/26 and 16/27, which contain the FCA's equivalent proposals for the areas covered in Chapter 2 of this CP. The PRA and FCA intend to publish final rules on these areas in Q2/Q3 2017.

5.2 The PRA and, where relevant, the FCA, propose for the following proposals to become effective within two months of publishing their respective final rules:

- the proposals stemming from the amendments to the SM&CR in Chapter 2 of this CP and the FCA's CPs 16/26 and 16/27;
- expectations on SoRs and MRMs set out in Chapter 3; and
- the amendments to SIMR in Chapter 4.

5.3 The proposals relating to the creation of a new Chief Operations SMF; a new Prescribed Responsibility and additional criteria for the Head of Key Business Area function (SMF6) will require changes to the PRA's and FCA's forms and IT systems and are therefore likely to become effective at a date later than the remaining proposals in this CP. The PRA will confirm the precise date when these proposals will become effective when it finalises its rules.

QUESTION 7: *Do you agree with the proposed implementation dates for the proposals in this CP?*

6 The PRA's statutory obligations

6.1 Before making any rules, FSMA¹ requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons;²
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective³, insurance objective⁴ (if applicable), and secondary competition objective⁵; and
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles⁶.

6.2 The PRA is also required by the Equalities Act 2010⁷ to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

Cost benefit analysis

The PRA's proposals for implementing the amendments to the SM&CR and SIMR in the Bank of England and Financial Services Act 2016

PRA expectations on the Duty of Responsibility

6.3 The PRA's proposal to include a section in SS28/15 setting out its expectations on the new statutory Duty of Responsibility in section 66B(5) of FSMA may result in firms adopting new or revised measures and processes to ensure that their Senior Managers take reasonable steps in the performance of their duties and document such steps. While there will be some costs associated with adopting these new measures and processes, there will be benefits associated with these measures as they help mitigate the risk of Senior Managers failing to take reasonable steps in the performance of their duties thereby causing the failure of their firms and/or breaching any regulatory requirements.

6.4 In addition, this proposal could help encourage individual accountability by facilitating the PRA's ability to hold individuals to account where a failure occurs, which, in turn, will help bring the benefits of an increased deterrent against negligent or reckless management and decision making.

Application of the Conduct Rules/Conduct Standards to Notified NEDs in RAPs and insurers

6.5 The PRA's proposal to apply certain Conduct Rules and Conduct Standards to Notified NEDs in RAPs and insurers reflects the PRA's view that Notified NEDs, although outside of scope of the SMR and SIMR should, as a minimum, be subject to the same basic conduct

1 Section 138J of FSMA.

2 Section 138K of FSMA.

3 Section 2B of FSMA.

4 Section 2C of FSMA.

5 Section 2H(1) of FSMA.

6 Sections 2H(2) and 3B of FSMA.

7 Section 149.

requirements as employees performing a Certification function of otherwise subject to the Conduct Rules and/or Conduct Standards.

6.6 The PRA expects the cost to firms of complying with this proposal to be minimal as it does not reflect a change in the PRA's expectations of Notified NEDs. CRR Firms - Fitness and Propriety 3.1 and Insurance - Conduct Standards 2.2(3) (and equivalent rules for large NDFs) already require firms to require Notified NEDs to observe the Conduct Rules and/or Conduct Standards which this CP proposes to apply to them directly.

6.7 However, the proposed extension of the Conduct Rules and Conduct Standards to Notified NEDs will give the PRA greater flexibility in taking enforcement action for misconduct against a Notified NED. In addition, this proposal could help encourage individual accountability by enhancing the PRA's ability to hold Notified NEDs to account.

Proposed optimisations to the SM&CR

Proposed Chief Operations PRA SMF and corresponding new Prescribed Responsibility for operational resilience and operational continuity

6.8 The PRA proposes to:

- create a new PRA SMF covering the most senior individual responsible for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm ('Chief Operations SMF' - SMF23); and
- create a new Prescribed Responsibility relating to responsibility for managing, and ensuring the operational continuity and resilience of, the internal operations, systems and technology of a firm.

6.9 The PRA anticipates that the cost for firms of complying with the proposed Chief Operations SMF will be limited because:

- as is the case with all other SMFs except for the three mandatory functions ie Chief Executive (SMF1), Chief Finance (SMF2) and Chairman (SMF9), firms will only be required to have an individual approved as an SMF23 where they already have someone performing that function, thereby helping to ensure that the proposed new SMF applies proportionately; and
- the majority of individuals likely to be covered by the proposed new SMF are likely to be already in scope of the SMR, generally under the FCA's Other Overall Responsibility function (SMF18).

6.10 Therefore, the PRA does not expect to approve many individuals currently outside of scope of the SMR or carry out a grandfathering exercise in light of the proposed new SMF. For most firms, the initial cost of complying with this proposal is likely to be limited to submitting a Form E to the PRA/FCA requesting the relevant individual be transferred from their existing SMF ie SMF18 to the proposed new SMF23.

6.11 The PRA recognises that creating a corresponding new Prescribed Responsibility for operational resilience and operational continuity may lead to a potential cost to firms as they will need to identify the Senior Manager responsible for the area, agree to allocate this responsibility to them and update their SoRs and MRMs.

6.12 However, the proposed Chief Operations function could help encourage individual accountability by enhancing the PRA's ability to hold to account the most senior individual

responsible for a firm's internal operations, systems and technology should there be a failure within this area.

Additional criteria to the definition of the Head of Key Business Area (SMF6)

6.13 The proposed additional criteria to the definition of the Head of Key Business Area (SMF6) is expected to have a negligible impact on the total number of heads of business lines in scope of the SMR. All of these individuals are already in scope of the SMR as SMF18s. Consequently, as with the proposed Chief Operations SMF, the incremental costs will be of minimal significance.

The PRA expectations on Statements of Responsibilities and Management Responsibilities Maps

6.14 The PRA expectations on SoRs and MRMs set out in in the revised draft of SS28/15 are intended to assist firms in meeting the requirements of the regime and are not anticipated to give rise to significant additional costs.

Proposed optimisations to SIMR

Outsourcing of the internal audit function by smaller insurers

6.15 The proposal that smaller firms which outsource their internal audit functions would not need to appoint a SIMF5 as head of internal audit, should help to overcome the practical difficulty that has been encountered by such smaller firms with the relatively small supply of suitable individuals who are willing to be considered for this post, and thereby enable these firms to compete more effectively with other larger firms.

6.16 The PRA believes that this represents a proportionate response to the issues identified by a number of these smaller firms with outsourced internal audit functions. This proposal is not expected to have a significant cost impact for firms. Any possible additional supervisory costs for the PRA would be outweighed by the potential efficiency savings to be made from aligning the PRA's rules with the rules for banking firms.

Firms in run-off that no longer have regulatory permissions to write new business

6.17 The PRA believes that the proposed streamlined regime would be proportionate for these firms without permission to effect contracts of insurance, while at the same time enabling the PRA to approve a core number of SIMFs. The proposal is not expected to give rise to any significant additional costs.

Compatibility with the PRA's objectives

6.19 The proposals in this CP seek to enhance the effectiveness of the SM&CR and SIMR, which in turn seek to strengthen individual accountability and improve corporate governance in PRA-regulated firms thereby advancing the PRA's safety and soundness and policyholder protection statutory objectives.

6.20 The PRA has assessed whether the proposals in this CP facilitates effective competition. The implementation costs for firms of the proposals in this CP are expected to be minimal. Overall, these proposals will not significantly affect effective competition.

6.21 The proposal that smaller firms which outsource their internal audit functions would not need to appoint a SIMF5 as Head of Internal Audit should help to overcome the practical difficulty that has been encountered by such smaller firms with the relatively small supply of suitable individuals who are willing to be considered for this post, and thereby enable these firms to compete more effectively with other larger firms.

6.22 The proposal that firms in run-off and which no longer have permissions to write new contracts, should have a streamlined version of the SIMR applied to them, should facilitate a more suitable exit strategy for such firms, and hence facilitate more effective competition.

Regulatory principles

6.23 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Two of the principles are of particular relevance.

6.24 The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction. The proposals in this regime seek to enhance the effectiveness of the SM&CR and SIMR without imposing undue implementation costs for firms. In particular, the proposals in Chapter 2 will ensure that the PRA's requirements and expectations align to the existing statutory framework for the SM&CR. The proposals in Chapters 3 and 4 seek to:

- ensure appropriate senior management accountability for several areas relevant to the PRA's safety and soundness statutory objective, such as operational resilience and operational continuity;
- ensure that all individuals in RAPs responsible for business areas which are capable of impacting on our objectives are in scope of the PRA's SMR; and
- improving firms' compliance with the letter and spirit of the PRA's requirements on SoRs and MRMs.

6.25 The principle that a firm's senior management is responsible for the firm's activities and for ensuring that its business complies with regulatory requirements. The proposals in this CP seek to further entrench the notion of individual accountability by, for instance, promoting a clearer and more consistent allocation of responsibilities to senior individuals.

Impact on mutuals

6.26 FSMA requires that the PRA assesses whether, in its opinion, the impact of the proposed rules on mutuals will be significantly different from the impact on other firms, and if so, details of the difference. In the PRA's opinion, the impact of the proposals in this CP on mutuals is expected to be no different from the impact on other firms.

6.27 The PRA is aware that some mutual firms, for example, Protection and Indemnity ('P&I') Clubs, had particular difficulty in finding an appropriate individual to be appointed as SIMF5. The PRA's proposals in respect of externally outsourced internal audit functions help ensure that the impact on mutual societies will not be significantly different from the impact on other firms.

Equality and diversity

6.28 The PRA carried out a full equality impact assessment as part of the development and implementation of the SM&CR and SIMR. The PRA considers that the proposals in this CP do not give rise to additional equality and diversity implications.

Appendices

1	Draft instrument: PRA RULEBOOK: CRR FIRMS, NON CRR FIRMS: SENIOR MANAGERS REGIME AMENDMENT (NO. X) INSTRUMENT [DATE]	25
2	Draft instrument: PRA RULEBOOK: SOLVENCY II FIRMS, NON SOLVENCY II FIRMS: SENIOR INSURANCE MANAGERS REGIME AMENDMENT (NO. 2) INSTRUMENT [DATE]	36
3	Draft revised SS28/15 – Strengthening individual accountability in banking	56
4	Draft revised SS35/15 – Strengthening individual accountability in insurance	99
5	Draft forms	130