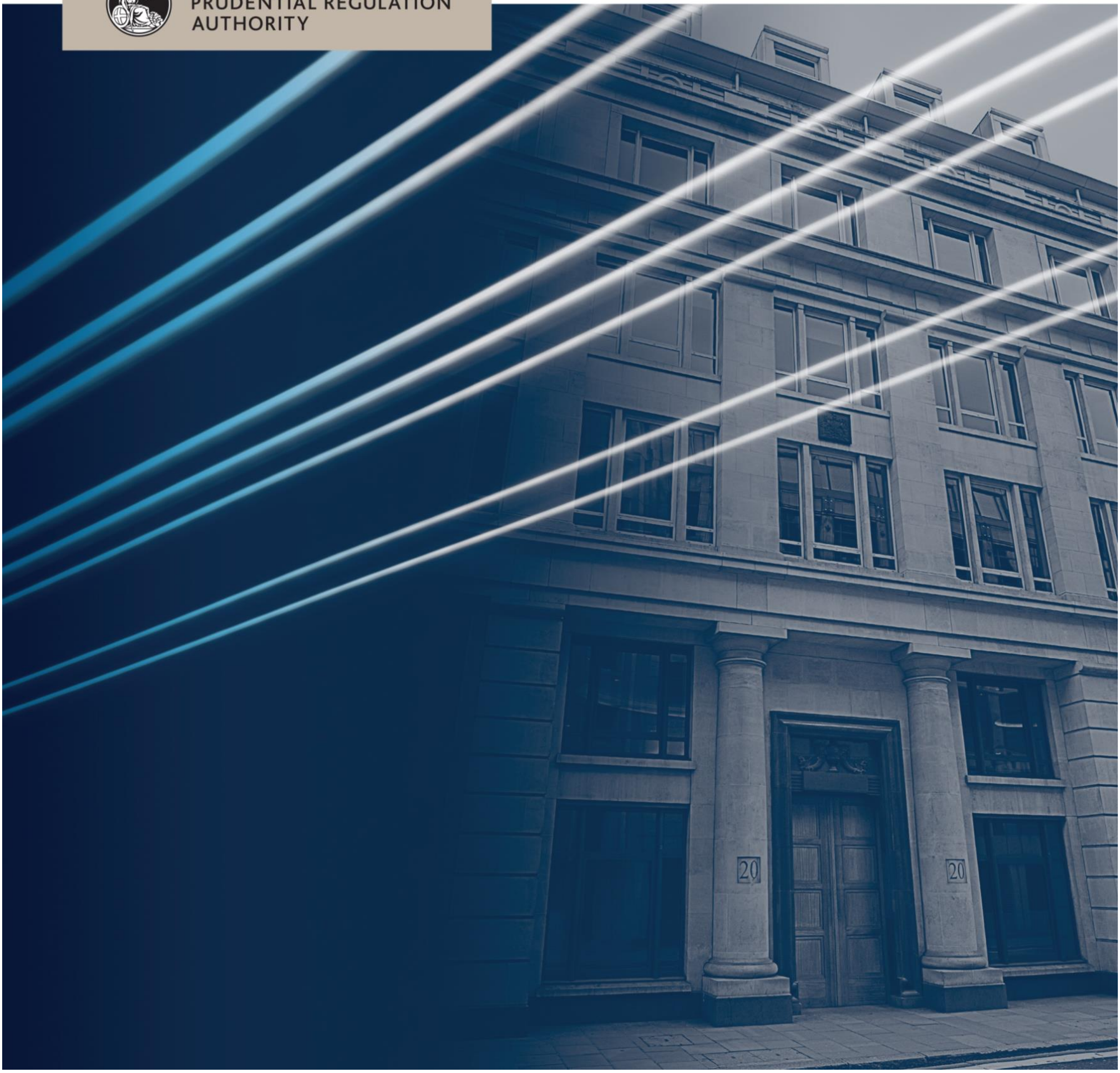
Supervisory Statement | SS2/18

International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision

March 2018

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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1 Introduction

1.1 This supervisory statement adds to 'The Prudential Regulation Authority's (PRA's) approach to insurance supervision'[1] ('the approach document') and supplements Supervisory Statement (SS) 44/15 'Solvency II: third-country insurance and pure reinsurance branches'.[2] It clarifies how the PRA will authorise and supervise third-country insurance branches. Third-country insurance branches are branches of insurers operating, but not headquartered, in the United Kingdom that are not able to benefit from passporting rights. In particular, this statement sets out the PRA's expectations on when a subsidiary would be more appropriate than a branch for a third-country insurer wishing to carry out insurance business in the United Kingdom.

1.2 This supervisory statement is relevant to all third-country insurance branches, as well as to any insurer not headquartered in the United Kingdom looking to operate in the United Kingdom in the future. This statement does not apply to Swiss General Insurers, as defined in the PRA Rulebook, to which different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC).

1.3 Setting out the PRA's proposed approach to branch supervision in a supervisory statement helps all firms to understand the PRA's expectations, and so uses the resources of the PRA efficiently. In addition, the benefits set out at consultation[3] advance the PRA's objectives of promoting safety and soundness, and policyholder protection of PRA authorised firms, in order to protect and enhance the stability of the financial system of the United Kingdom.

Background

1.4 The approach to the supervision of insurers that operate in the United Kingdom was set out in the approach document and further clarified in SS44/15. In the approach document, the PRA explains how its supervisory approach is anchored in its objectives to promote the safety and soundness of firms, and contribute to securing an appropriate degree of protection for policyholders.

Insurers in the United Kingdom

1.5 If authorised to do so, insurers headquartered outside of the United Kingdom can operate in the United Kingdom either through a branch or by forming a subsidiary. This can either be through direct PRA authorisation or, in some circumstances, through passporting rights. A subsidiary is a separate legal entity from its parent and, as such, must meet regulatory capital requirements with its own funds and have its own governance and risk management. A branch forms part of a legal entity headquartered abroad.

1.6 Third-country insurers operating through a branch in the United Kingdom are subject to the PRA's rules on third-country branches as set out in the PRA Rulebook with additional background in the approach document and SS44/15. For example, such branches need to have sufficient assets attributed to their branch business to meet branch liabilities and to have a local branch manager. The PRA also requires that the legal entity as a whole has sufficient financial resources. Supervisory powers reflect the differences in how a firm is structured. Insurance subsidiaries are subject to the PRA's solo insurance regime. In contrast,

1 March 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-approach-documents-2016.
2 November 2015: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-third-country-insurance-and-pure-reinsurance-branches-ss.
3 Consultation Paper 30/17 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision', December 2017, available on page 2 at: www.bankofengland.co.uk/prudential-regulation/publication/2017/international-insurers-pras-approach-to-branch-authorisation-and-supervision.

responsibilities for the prudential supervision of branches are split between the supervisor where the insurer is headquartered (the home supervisor) and the PRA (the host supervisor).

1.7 In promoting its statutory objectives of safety and soundness and policyholder protection, the PRA focuses principally on the harm that firms can cause to the stability of the UK financial system. Aspects of both life and non-life insurance can be deemed critical to ensuring a stable financial system. The PRA's view is that, subject to certain safeguards, the ability of financial services firms to branch into other countries is an important component of an open world economy which in turn benefits the UK economy.

1.8 The Financial Conduct Authority (FCA) is the conduct regulator for all insurers operating in the United Kingdom. All branches are subject to the FCA's rules: these are not affected by this supervisory statement.

2 Assessing risks of a third-country branch in the United Kingdom

2.1 When considering applications from a firm for authorisation as a third-country branch, the PRA's approach is anchored in its statutory objectives and includes an assessment of regulatory equivalence and the PRA's ability to supervise an insurer that seeks to operate in the United Kingdom through a branch. The PRA considers, and needs to be satisfied that:

- the home jurisdiction's prudential supervision regime is 'broadly equivalent' in an assessment of equivalence by the PRA including assessment of the home jurisdiction's (this is not an exhaustive list):
  - regulatory framework;
  - powers;
  - supervision of individual firms and the consolidated group;
  - information sharing;
  - confidentiality; and
  - competence and independence of supervision.

  (Such an assessment is likely to be linked to, but not necessarily the same as, formal determinations of equivalence in respect of Solvency II.)
- the firm is capable of being supervised effectively by the home supervisor;
- the whole firm is able to meet the Threshold Conditions;
- there is sufficient supervisory cooperation with the home supervisor;
- UK policyholders of the firm will be given the appropriate priority in an insolvency and that there is no discrimination against policyholders whose business is written in the United Kingdom in the event of a winding up;

- the firm is able to meet relevant PRA rules, including the Senior Insurance Managers Regime and, on its implementation, the full Senior Managers and Certification Regime[1] applicable to the relevant individuals responsible for the branch;
- given the scale of UK branch activity covered by the Financial Services Compensation Scheme (FSCS), the protected amount covered by the FSCS can be absorbed by insurers liable to contribute to the FSCS; and
- the impact of the failure of a firm with a UK branch on the wider UK insurance market and financial system would not lead to broader instability.

2.2 The PRA's approach to broad equivalence of a home supervisor, policyholder discrimination and relevant PRA regulation has been published in SS44/15 and the PRA's approach document. The final two factors above, which will be considered in parallel to the others when reviewing an application for third-country branch authorisation or when considering the appropriate future structure for an existing third-country branch operation, are explained further below.

2.3 The PRA assesses these considerations in their totality, but emphasises the overall 'supervisability' of an insurer that operates in the United Kingdom through a branch. In particular, the PRA will place considerable weight on assessing the extent and quality of cooperation with the home supervisor. In performing the assessment, the PRA will balance the overall supervisability against the nature and scale of the insurance activities that the firm proposes to carry out, including those through its UK branch.

The scale of United Kingdom branch activity covered by the FSCS

2.4 Eligible policyholders of insurers operating in the United Kingdom which are authorised by the PRA are covered by the FSCS. Therefore, regardless of whether third-country insurers operating in the United Kingdom do so through branches or subsidiaries, the potential cost to the FSCS of an insurer default would be the same.

2.5 The level of FSCS-protected liabilities is a strong indicator of the impact of failure of a branch to both policyholders and FSCS levy payers.

2.6 Levies on insurers writing FSCS-protected business are used to cover the costs of compensation. The size of these levies is limited to prevent insurers becoming unprofitable as a result of their FSCS levy obligations. The FSCS has a borrowing protocol in place with HM Treasury for access to the National Loans Fund for funding requirements in excess of these annual limits. Given this, the PRA expects a greater level of supervisory oversight for these firms and the PRA has a greater ability to mitigate risks in subsidiaries as it has access to a wider range of supervisory tools and legal powers. While not a hard threshold, the PRA expects third-country branches to have under £500 million of insurance liabilities covered by the FSCS when operating as a branch and may consider authorisation as a subsidiary as an alternative where this is not the case.

2.7 In referring to 'FSCS-protected liabilities', the PRA means an estimate of the aggregate gross amount of liabilities calculated by reference to protected contracts of insurance with eligible claimants. This is calculated before the application of any limits on the compensation that would be paid by the FSCS (for example where the limit of cover is 90% of the claim for

1 HM Treasury has announced that the extension of the SM&CR to insurers will commence on 10 December 2018: www.gov.uk/government/news/new-accountability-rules-for-insurers.

certain protected contracts of insurance). The gross amount of such protected liabilities excludes any recovery that the FSCS might make from the estate of the insurer which is in default. It is also independent of the assets of the estate, including any recoveries which the insurer may be able to make under contracts of reinsurance.

2.8 The PRA will take into account the medium-term strategy, business plan and forecasts of the branch business in assessing the FSCS-protected liabilities threshold. For example, the PRA may decide to allow a firm to operate through a branch if FSCS-protected liabilities are likely to fall below the threshold in the near future. Conversely, the PRA may expect a firm to begin preparations to operate through a UK subsidiary where its FSCS-protected liabilities are currently below the threshold but the firm is projecting that they will grow above it in the near future.

2.9 The PRA is aware that the process of converting from a branch to a subsidiary requires planning and preparation, and will consider with firms a reasonable time period to restructure, where appropriate, taking into account the operational steps involved and the risks to the PRA’s objectives.

The impact of a branch failure on the wider insurance market and financial system

2.10 If an insurer’s FSCS liabilities are below the threshold of £500 million of FSCS liabilities, it could still, in some cases, pose a significant risk to the financial stability of the United Kingdom. The PRA will consider other relevant factors when reviewing the potential impact of a third-country branch on financial stability, including the:

- availability of substitute products that would offer a policyholder a similar level of protection;
- branch’s position in the UK market, particularly assessing the size of the market share in a niche market;
- level of connectivity of a branch in the industry it operates within: for example, the extent and complexity of inter-firm transactions; and
- significance of the UK operations of the third-country branch compared to the amount of business within other jurisdictions.