

PRA Publishes Consultation Paper CP21/23 on Its Approach to the Authorisation and Supervision of Insurance Branches

16 October 2023

On 4 October 2023 the PRA took the next step in the reform of the rules that govern its authorisation and supervision of overseas (re)insurers that write business in the United Kingdom through a third-country branch (“TC branch”). The PRA aims to consolidate and formalise existing policy and offer more clarity to TC branches and prospective applicants for authorisation. In formulating these reforms, the PRA has drawn on its extensive experience authorising TC branches under the Temporary Permissions Regime (the “TPR”) which came into effect on 31 December 2020 (the end of the transition period after the United Kingdom’s exit from the European Union) and which is scheduled to end on 31 December 2023.

The proposals are relevant to all TC branches and to any (re)insurance firm headquartered outside the United Kingdom or Gibraltar that is seeking authorisation to operate as a branch in the United Kingdom. Historically, the PRA has preferred the establishment of a UK subsidiary instead of a branch where there are £500 million or more of insurance liabilities covered by the FSCS, and this threshold and other relevant factors are specifically raised in the PRA’s updated assessment of TC branch suitability.

The proposals are only part of the wider overhaul of the existing Solvency II framework, to be replaced by a bespoke “Solvency UK” regime for (re)insurers. Of particular relevance to overseas (re)insurers is CP12/23, published by the PRA on 29 June 2023, which sets out other proposals for TC branches, including the removal of branch capital requirements.

Approach to authorisation and supervision. The PRA’s substantive rules are not changing, but more detail is provided. This includes a seven-step flow chart of questions including an assessment as to whether the home jurisdiction’s regulatory regime is “broadly equivalent”, the TC branch’s size versus the overseas undertaking as a whole, and whether the PRA will be able to conduct effective supervision in the face of any reinsurance arrangements. The PRA also gives further information on the factors it will consider when assessing the risks of a TC branch, which will include:

- the impact of a TC branch’s failure on the wider insurance market;

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- whether the overseas undertaking can meet the Threshold Conditions, in particular, what actions the PRA may take when an overseas undertaking notifies the PRA that it is in, or projected to be in, difficulty;
 - whether there is sufficient supervisory cooperation with the home supervisor;
 - whether United Kingdom policyholders of the TC branch will be given the appropriate priority in an insolvency (namely that, in the event of a winding-up, there will be no discrimination against policyholders whose business is written in the United Kingdom); and
 - the application of the Senior Managers and Certification Regime to the individuals responsible for the TC branch.

The PRA clarifies its approach to the significance of the UK operations of an overseas undertaking in comparison with its business in other jurisdictions. Where a TC branch writes the majority of an overseas undertaking's business, the PRA may consider that a subsidiary would be more appropriate.

Assessing the reinsurance arrangements of an overseas undertaking. The PRA considers that overreliance on reinsurance can distort incentives for prudent risk management. The focus is on intra-group reinsurance, aggregate reinsurance cessions and concentration of reinsurance arrangements—three areas the PRA considers pose risks to an overseas undertaking's independence and supervisibility.

The PRA gives the following examples of reinsurance arrangements that might be of concern:

- high levels of intra-group reinsurance being ceded by the overseas undertaking (which could reduce the capital protecting the TC branch's policyholders and leave them reliant on the financial resources of the reinsurer, with whom the PRA may have no supervisory relationship), and
- an overseas undertaking ceding more risk than is retained (which may reduce the overseas undertaking's independence).

Of the 180 or more TC branch applications processed under the TPR, the PRA highlights those applications with issues relating to complex reinsurance arrangements as having taken the longest time to process (sometimes double the amount of time), particularly as such applications often involved several rounds of actuarial analysis. (Re)insurers should therefore consider their existing and proposed reinsurance

arrangements as part of the broader assessment of any TC branch in the United Kingdom and take account of this in planning the timelines for such approval.

Expectations of TC branches. The PRA has also sought to clarify its expectations of TC branches in relation to specific areas. The notifications expected will be expanded to new circumstances, including;

- when financial resources are no longer considered adequate;
- when the overseas undertaking projects that the FSCS-protected liabilities of the TC branch may grow above the £500 million threshold;
- when reinsurance arrangements change materially; and
- when the liabilities and/or premiums of the TC branch increase materially as compared to those of the overseas undertaking.

TC branches will be allowed to submit the overseas undertaking's Own Solvency and Risk Assessment ("ORSA") without being required to submit their own, branch-specific separate ORSA, so long as the overseas undertaking's ORSA identifies and sufficiently covers material risks for the TC branch's operations and the risks of the firm's wider operations that may have an effect on the TC branch's operations. It remains to be seen what "sufficiently" means in this context, and the PRA's existing guidelines for TC branch ORSAs will likely remain instructive.

The PRA has also indicated, in an effort to increase transparency, that it will clarify the exact PRA Rulebook provisions applicable to TC branches. Specific rules flagged by the PRA include those on governance and organisational structures, particularly the factors that TC branches should consider when assessing their need for Senior Management Function ("SMF") role-holders in order to meet the PRA's expectations. The PRA also clarifies that TC branches are subject to the rules on outsourcing and operational risk, and the rules on reinsurance counterparty credit risk.

Key outcomes. The PRA has been pushing for changes to the TC branch regime for several years, and recent developments in the space this year, as part of the broader review of the financial services regulatory regime in the United Kingdom, seem poised to achieve some of the stated aims. Reducing the reporting burden and capital requirements were two key changes proposed earlier this year. While many of the changes in CP21/23 seek to clarify rather than significantly alter the regime, it is clear that the PRA is seeking to ease the process of authorisation and simplify the obligations of TC branches in the United Kingdom, which will be a welcome development for many internationally operating (re)insurers.

Next steps. Consultation on CP21/23 closes on 12 January 2024 and the PRA plans to publish its final policy by Q2 2024, with the changes coming into force at the same time.

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Please do not hesitate to contact us with any questions.



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