UK CLIENT MEMORANDUM | ENGLISH LAW UPDATES

New Governance Regime Impacting Senior Managers and Non-Executive Directors in the UK Insurance Sector

2 March 2015

AUTHORS

Joseph D. Ferraro | Nicholas Bugler | Jennifer Tait

On 23 February 2015 the UK's Prudential Regulation Authority (PRA) announced further details on how it plans to hold senior insurance executives accountable under a new, stricter governance and compliance regime. The Senior Insurance Managers Regime (SIMR) seeks to ensure that senior persons who are effectively running insurers, or who have responsibility for other key functions at those firms, meet standards of fitness and propriety for acting with integrity, honesty and skill and that senior management be responsible for compliance with UK regulatory requirements. The new regime represents an important change regarding the development of personal responsibility for managers and key executives.

The new regime applies to all firms within the scope of Solvency II, including insurance and reinsurance firms, UK branches of foreign firms, insurance special purpose vehicles, the Society of Lloyd's and managing agents. The proposals will also apply at the level of holding companies above the regulated firms themselves.

The PRA and the Financial Conduct Authority (FCA) jointly published two consultation papers (CP 14/26 and CP 14/25) outlining an accountability regime for the insurance sector parallel to the regime for senior banking managers, and amending the FCA's current approved persons regime to reflect the Solvency II framework, respectively. The PRA proposed the introduction of a narrower range of senior persons within insurers known as "key function holders", who will need to be pre-approved by the PRA to perform a "controlled function", as well as a new set of conduct rules applying to the above individuals and to a wider scope of insurance employees to the extent they perform a key function. The FCA's proposals focus largely on changes it proposes to make to the current approved persons regime for Solvency II firms. The new conduct rules will replace the existing Statements of Principle and Code of Practice for Approved Persons for senior insurance managers within the scope of the new regime and for employees within the scope of the regime for approved persons, allowing the regulators to impose fines or take other disciplinary action in relation to those persons for breach of the conduct rules. There will be three new generic standards applicable to senior individuals: acting with integrity; acting with due skill, care and diligence; and dealing with the PRA, the FCA and other regulators in an open and cooperative way.

The SIMR is aligned with the Senior Managers Regime for banks, but it is not identical. The business models of insurers, the risks they present to the PRA's objectives and the legislative framework under which they operate are different from those for banks. Accordingly, the potential criminal sanctions, and the "presumption of responsibility" for the purposes of establishment of misconduct by senior banking managers, will <u>not</u> apply to senior insurance managers.

The SIMR also takes account of the need to introduce measures relating to governance and the fitness and propriety of individuals performing key functions as part of Solvency II. As the fit and proper requirements under Solvency II apply to insurance groups and holding entities, the PRA proposes that those parent company (or other group) senior executives who have a significant influence on the management or conduct of the affairs of the insurer, in relation to its regulated activities, will also be subject to pre-approval.

In relation to non-executive directors, the PRA has now confirmed that the chairman, the senior independent director, the chair of the risk committee, the chair of the audit committee and the chair of the remuneration committee will all be held individually accountable under the new regime, stating that they have been chosen because they have specific responsibilities for areas "directly relevant to a firm's safety and soundness". In addition to any collective responsibility they may have as members of the Board, non-executives within the scope of the SIMR will be held individually accountable for their areas of responsibility. The PRA is also proposing to require firms to ensure that all Board members are held to high standards of conduct. The individuals performing these roles will be subject to all aspects of the new regime, including regulatory pre-approval and the FCA's and the PRA's new conduct rules.

The PRA notes that the allocation of specific accountability to individuals subject to the SIMR is not intended to undermine the fiduciary, legal, and regulatory responsibilities of the Board, which will retain ultimate decision-making power and authority over all aspects of the firm's affairs. It remains to be seen how in practice individuals with Board fiduciary duties, and having a specific responsibility allocated to them under the SIMR, are to deal with a collective Board decision with which they disagree, but for which they would ultimately be individually accountable. The FCA and the PRA have jointly released a consultation paper on their approaches to non-executive directors, which consultation ends on 27 April 2015.

Consistent with this theme of individual responsibility and accountability, firms will need to have a "governance map" allocating certain core responsibilities to PRA-approved individuals. The allocation of these and any other significant management responsibilities must be recorded in a governance map, along with details of reporting lines, key functions identified by the firm (highlighting those that amount to effectively running the firm), and the names of the individuals effectively running the firm or responsible for other key functions. This requirement will also apply to UK branches of non-EU insurers. It is not proposed at this stage that the governance map be required to be made publicly available. However, we note that insurance holding company groups that are publicly listed will need to consider, within the PRA-regulated company, the ways in which the governance map should fit within the framework of the governance and compliance requirements of the relevant stock exchange.

The SIMR demonstrates that the PRA and the FCA are serious about ensuring that individuals have the right expertise to carry out their functions properly but we also believe they will not hesitate to ascribe individual blame should there be regulatory failings in the future. While many firms may have well-developed existing governance frameworks, the task of recasting reporting lines, apportioning responsibilities and informing and training senior managers and non-executive directors to prepare for the new regime will be extensive. Insurers will need to add compliance with the new SIMR to their busy regulatory change agenda in the lead-up to Solvency II and will need to make preparations to put a governance map in place as a key regulatory tool. Although the detailed timing is still to be established, an initial tranche of rules will be made in March 2015 and these are expected to take effect from January 2016 in line with the timetable for Solvency II.

If you have any questions regarding this memorandum, please contact Joseph D. Ferraro (+44 20 3580 4707, jferraro@willkie.com), Nicholas Bugler (+44 20 3580 4704, nbugler@willkie.com), Jennifer Tait (+44 20 3580 4729, jtait@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.

2 March 2015