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From the FSA to the PRA

Current Issues in General Insurance

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Agenda

- The changing structure of UK regulation
- The new regulatory architecture
- The approach to prudential risk
- Interaction with the FCA
 - Challenges: With-Profits
 - Challenges: Enforcement
- Interaction with the Bank of England
 - Challenges: the role of the FPC
- Solvency II
 - IMAP – including validation
 - ICAS+
 - EIOPA interim guidelines



•Then

Reasons for change

- **Politics**
 - **New Labour Government**
- **Conduct Failures**
 - **Financial Scandals**
 - **Blue Arrow**
 - **Guinness**
 - **Miss-Selling**
 - **Personal pensions**
 - **Endowments**
 - **Home income bonds**
- **Prudential Failures**
 - **BCCI/Barings**



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- **Politics**
 - **New Coalition Government**
- **Prudential Failures**
 - **Northern Rock/ Bradford & Bingley**
 - **RBS/ Lloyds TSB & HBOS**
 - **Failure to recognise systemic risk**
- **Conduct Failures**
 - **Payment Protection Insurance**

The changing structure of UK regulation

**Department of Trade and
Industry (Insurance)**

Building Societies Commission

Bank of England

FSA

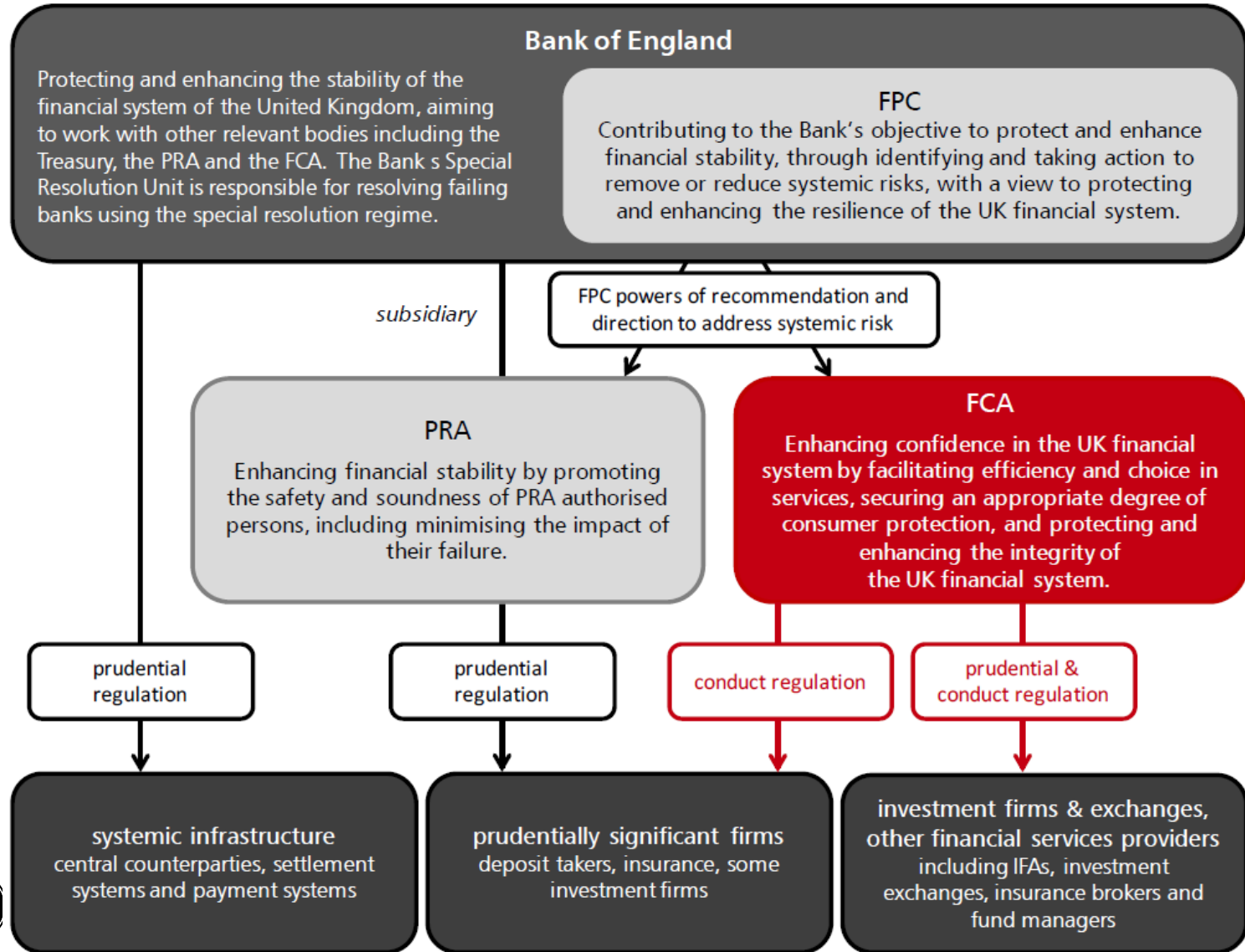
Securities Investment Board

- Personal Investment Authority
- Securities and Investment Authority
- Investment management regulatory organisation



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The new regulatory landscape



The new regulatory landscape

PRA

Two complementary objectives.

1. General objective:
Promote the safety and soundness of the firms it regulates
2. Insurance Objective:
Contribute to the securing of an appropriate degree of protection for policyholders

FCA

Single Strategic Objective:
protecting and enhancing confidence in the UK financial system.

Three operational objectives:

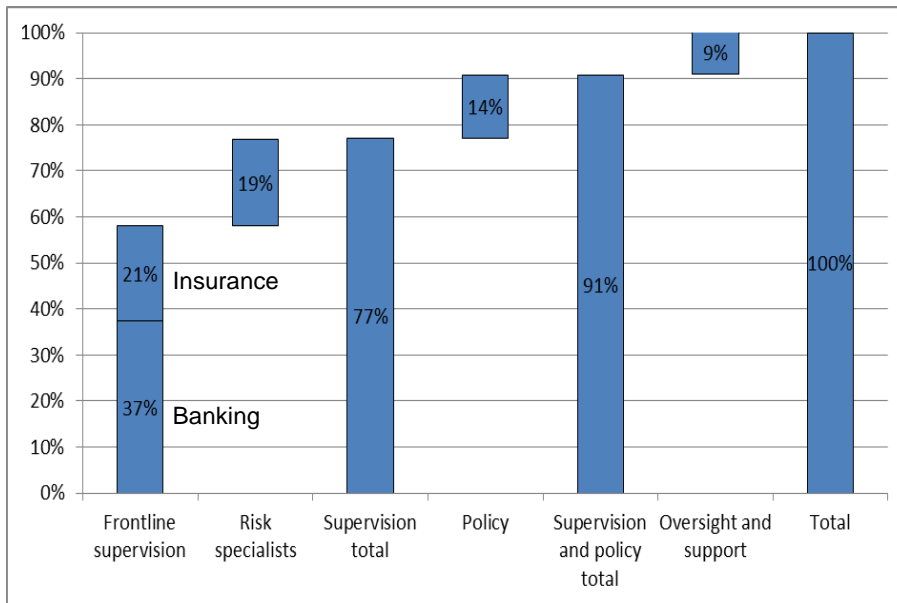
1. Securing an appropriate degree of protection for consumers
2. Promoting efficiency and choice in the market for financial services
3. Protecting and enhancing the integrity of the UK financial system



The new regulatory landscape

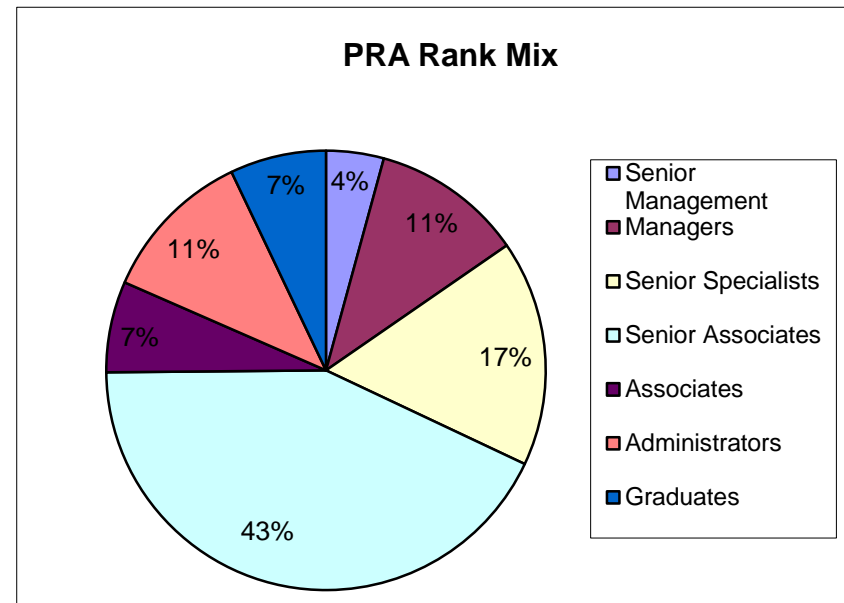
PRA

- The PRA will be a supervisor led body with over 1,000 staff
- Greater proportion of experienced and senior supervisors



FCA

- Roughly 3,000 staff
- Greater focus on cross sectoral and thematic work

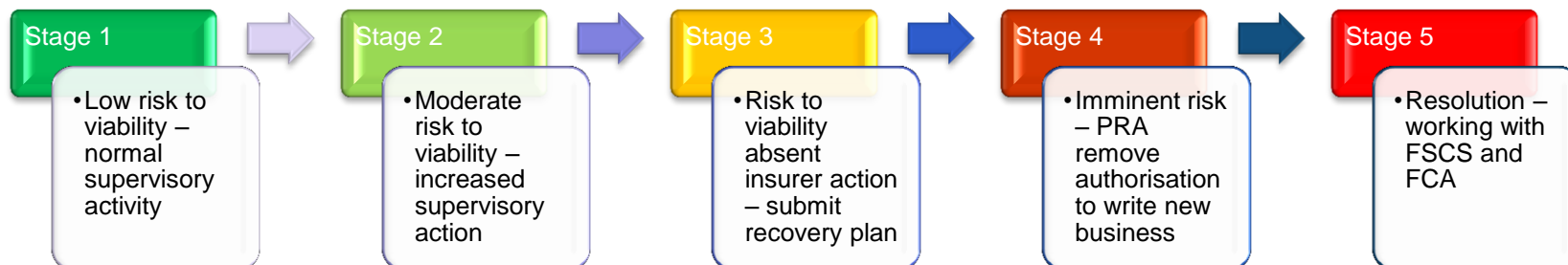


Approach to prudential risk

- Risk assessment framework

Gross risk			Safety and soundness				
1. Potential impact	2. Risk context		3. Operational mitigation	4. Financial mitigation		5. Structural mitigation	
Potential impact	External context	Business risks	Risk management and controls	Management and governance	Liquidity	Capital	Resolvability

- Assessment backed by proactive intervention framework which provides a 'ladder of intervention'(PIF)



Approach to prudential risk

- Focus on ensuring firms meet the thresholds conditions. Firm must:
 - Conduct business in a prudent manner
 - Be a fit and proper person
 - Be supervisable
- The PRA will adopt a forward looking, judgement based approach – focusing on the key risks that firms pose.
- Like the FSA, the PRA will not operate a zero-failure regime.
- This means that we have to ensure firms are resolvable
 - No ‘Disorderly failure’
 - Revising the resolution framework.



Interaction with a more robust FCA

- FCA has committed to intervene early
 - Traded Life Products
 - Product reviews e.g low value GI products
- These activities will have prudential implications
 - Sustainability of business models
 - Financial penalties
- Coordination of activities will be essential



Interaction with the Bank of England

- The PRA is part of the Bank
- This gives the PRA connection to its other functions e.g.
 - Market intelligence
 - Non public material from money market
 - Oversight of financial market infrastructure
 - Including exchanges
 - Prudential policy
 - With a focus on financial stability
 - Financial sector resilience and resolution
- Greater flow of information allowing more effective supervision



Interaction with the Bank of England: The FPC

- So far the FPC has focussed on issues affecting the banking sector:
 - Eurozone exposures
 - Opacity of risks introduced by synthetic ETF
 - Impact of banking capital buffers on growth
- In the future we can expect more engagement with insurance
 - Cross Sectoral Leakages e.g. Commercial Real Estate Lending; Non-Traditional Non-Insurance; focus on shadow banking like activities



Implementation of Solvency II

- Finalising Solvency II has been a challenge under the FSA
- Implementation under PRA
 - Solvency II is consistent with the proposed supervisory approach.
- Interim arrangements
 - PRA will not implement Solvency II early.
 - PRA will build on existing requirements, allowing firms to use models and systems developed for Solvency II



Implementation of Solvency II

- EIOPA preparatory guidelines consultation
 - We will continue to supervise against Solvency I
 - Give feedback
 - Final guidelines published in September/October after which PRA will decide to comply/intend to comply/explain
- ICAS+
 - Focus on setting ICG using a Solvency I balance sheet and Solvency II internal model
 - Focus on key Solvency II internal model issues to give feedback to the firm
 - Review of the in-development ORSA



Implementation of Solvency II

- IMAP
 - Proportionate
 - Review areas that are ready for review



Internal Model Validation – What good enough looks like?

- **Elements to consider**
 - Board is responsible for putting in place systems which ensure that the internal model operates properly on a continuous basis.
 - Validation framework should address two key questions:
 - Does the model do what we want it to do?
 - Have we got the right model (is it fit for purpose)?
- **Our observations**
 - Most of the validation seen to date focuses solely on the former - poorly or incompletely
 - Most of the validation seen to date mostly ignores the latter

Model validation is not just a mere collection of tests but a framework providing efficient challenge for the Board to ensure model is appropriate on an on-going basis

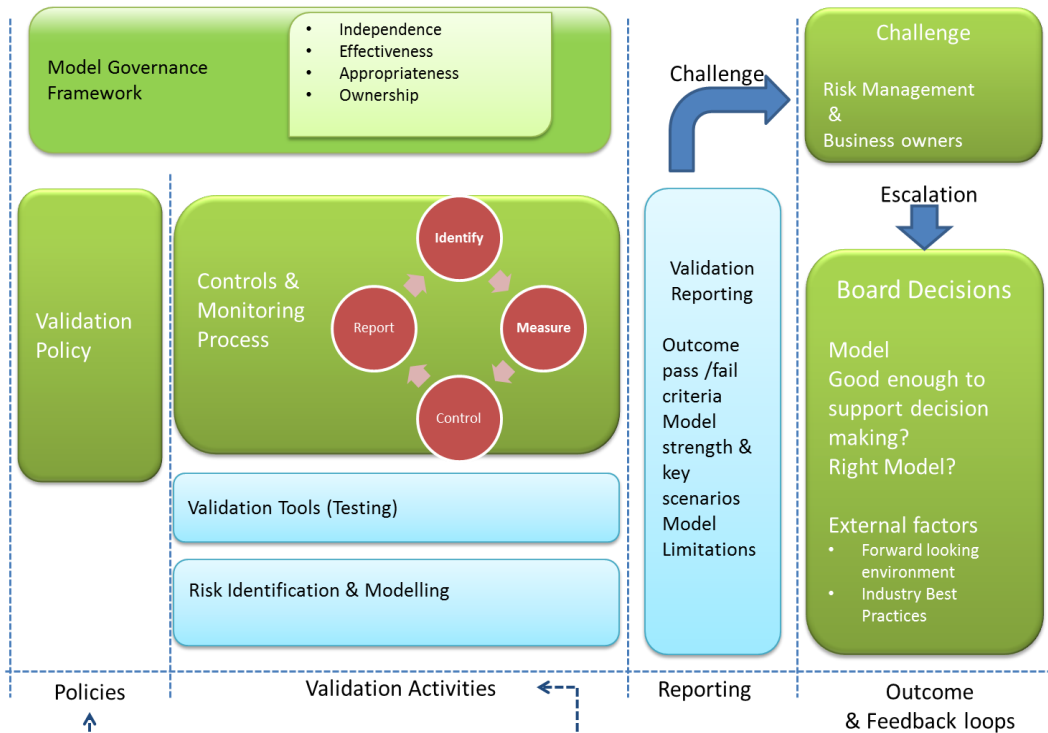


Governance and Validation Framework

- Validation forms part of the broader model governance framework and should interact with the change process to the model. Its effectiveness will depend on:

Internal Model Governance and Validation Framework

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- The validation policy setting the **appropriate scope and frequency, and specifying the processes** to carry out validation activities;
- The quality of the **controls and monitoring of the performance** of the model;
- The robustness of the **validation tools applied and conclusions drawn** from their application;
- Whether **internal or external** to the firm, the **independence of the validation** creating an effective challenge to the model and ensuring that the model is adequate to support the Board's business decisions;
- The **reporting of material validation findings to the Board** to allow it to form a view on the appropriateness of the model;
- A forward looking validation to ensure the on going appropriateness of the model.



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