

Insurance & Reinsurance Industry Group: Corporate Insurance & Regulatory Bulletin - London

Solvency II – FSA publishes second IMAP Update

On 15 February 2010, the FSA published the “Solvency II – IMAP Update towards pre-application” which provides information on key developments as firms start to enter the “pre-application” phase of the Internal Model Approval Process (“**IMAP**”). The key points are as follows:

- we are now almost exactly half way through the process with the implementation date still being 31 October 2012. The next 18 months will be critical for those firms intending to follow their internal model route for calculation of their solvency requirements;
- the FSA will have written to all firms intending to apply to use an internal model by the end of February. The FSA will provide a standard template, which the firm must complete one month before they intend to start pre-application. The timing of a firm’s entry into pre-application will be subject to them meeting the qualifying criteria;
- the FSA has carried out a pilot programme with a number of different types of firms which has indicated that the pre-application will be an exacting activity for the firms and for the FSA. It is also evident that “groups” issues, not just for the IMAP but also for many other elements of Solvency II, will be more complex than originally expected; and
- in December 2009, the FSA asked all insurance firms that indicated they intend to use an internal model to fill in a questionnaire. From those responses, risk management was the topic where firms rated themselves as closest to the standards required. Firms scored themselves weakly when it came to being able to explain the limitations of the internal model and defining their own validation policies.

Lloyd’s of London publishes its 2010-2012 Strategy

On 8 February 2010, Lloyd’s published its 2010-2012 strategy which summarises Lloyd’s strategic vision and the major priorities for the market and the Corporation in the next three years, as well as the major activities required to deliver the strategy. The strategy has been drafted after a detailed review of the market’s position and following consultation with over 50 managing agents, brokers and market associations.

Commenting on Lloyd’s 2010-2012 strategy, Lloyd’s CEO, Richard Ward, stated:

“This is about evolution, not revolution. We have stood up well in the face of the worst recession since the great depression, and we don’t see a huge necessity to change direction. The Lloyd’s subscription model backed by a layer of mutual security is serving us and our customers well, as is our location in the heart of the London insurance market.

While we are in good shape, we cannot afford to be complacent. In 2010 we will be absolutely focused on underwriting and risk management and in preparing for the introduction of Solvency II”.

It should be noted that the strategy paper does not include any major changes to Lloyd’s previous approach as the consultation concluded that the Lloyd’s market and its participants are currently performing well and are well positioned to meet future opportunities. The strategy paper seeks to build on that success.

To view a fully copy of Lloyd’s 2010-2012 strategy, please click [here](#).

New FSA approved person regime deadline

On 6 February 2010, the transitional period ended for firms to bring themselves into compliance with the FSA's new approved person regime for "significant influence" functions. "The approved persons regime - significant influence review" ("PS09/14") has importantly widened the scope of the concept of "significant influence" function at FSA-regulated firms. The necessary changes to the FSA's Handbook of Rules and Guidance took effect on 6 August 2009 but with a transitional period which ended, as noted, on 6 February 2010.

The changes include:

- an extension to the scope and application of Controlled Function ("CF") 1 (director function) and CF2 (non-executive director) to include those persons employed by a parent undertaking or holding company, whose decisions or actions are regularly taken into account by the governing body of a regulated firm (EEA regulated parent and holding companies are excluded);
- amending the application of the approved persons regime to UK branches of overseas firms outside the EEA so that CFs may apply; and
- an extension of the rule obliging firms to provide references on request for applicants of the CF30 (customer function) to all CFs.

Any one individual who falls within this wider definition was required to be approved by 6 February 2010. Plainly, firms operating as part of a group must remain alive to this issue on an ongoing basis for senior staff changes and any change in reporting structures. A failure to consider the issue could expose firms and senior managers within them to significant risk of regulatory penalties.

The FSA has stated that the new rules will catch the following categories of people:

- the chairman of the audit committee at the parent company level;
- any director of a parent company who exercises significant influence by way of his involvement in taking decisions for that FSA regulated firm;

- any individual responsible for setting the objectives for, and remuneration of, the executive directors of the FSA regulated firm; and
- any other individual who is a director or senior manager of a parent undertaking who is accustomed to influencing the operations of that FSA regulated firm.

The FSA has indicated that in order to be caught by the new rules, there will need to be an "arrangement" between the individual concerned and the FSA authorised firm. FSA guidance suggests that this requirement should be interpreted to mean any contract or arrangement that permits the performance of the role by the individual for and on behalf of the FSA authorised firm in question.

Caution should be exercised in considering whether or not an arrangement is in place - given the FSA's well established rules on apportionment of responsibilities, it may well expect an arrangement to be in place where an individual exerts significant influence over the management of an FSA authorised firm.

The FSA has always insisted upon clear reporting lines and transparency in the manner in which a business is run. A distinction can be drawn, however, between individuals responsible for setting group level strategy and those responsible for implementing that strategy at the level of the FSA authorised firm. The fact that there is a reporting line to a parent/holding company does not necessarily imply that the recipient of the report must be registered as an approved person of the UK firm.

FSA client money and assets report

During 2009, the FSA conducted thematic visits to a range of intermediary firms to review compliance with client money and custody requirements. This project was driven by the FSA's specialist CASS Risk Team created in March 2009, following identification in the 2009 Financial Risk Outlook that more difficult market conditions meant an increased risk of intermediary firms entering into insolvency. This January, the FSA published the results of its work in the form of a "Dear CEO" letter and an accompanying report document.

The FSA has concluded that there is still a significant amount of work for firms to do in order to ensure client money and assets are adequately protected. Nearly all of the FSA's visits resulted in actions for firms to improve their compliance with the FSA's CASS rules. Its tolerance for CASS compliance failures is low. For insurance brokers visited by the FSA, the following failings were found:

- senior management did not ensure a clear allocation of duties leading to confusion between staff and lack of effective accountability;
- inconsistencies between Terms of Business Arrangements and client money calculations;
- inadequate evidence of review and sign off processes surrounding client money calculations and reconciliations;
- failure by some firms to perform adequate due diligence on acquisitions to assess client money risks;
- unallocated cash and legacy balances not being reduced promptly enough;
- firms overreliant on CASS audit reports rather than performing their own compliance checks; and
- non-statutory trust bank accounts being used for non permitted purposes.

Action taken by the FSA on its findings have included referrals to enforcement, private warnings, imposition of skilled person reports, and even freezing of assets and restrictions from taking on new business.

Though the front line regulatory responsibility for its compliance with CASS rests with the insurance broker, insurers should be alive to the fact that the behaviour of their brokers in this respect also presents an important risk management matter for insurers and raises wider customer treatment issues.

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or the contact referred to below.

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