While implementing the new Consumer Duty might be the main focus for insurance firms during Q1 2023, there are several publications from both the FCA and PRA to be aware of.

FCA wholesale brokers portfolio letter

The FCA issued a Dear CEO Letter to wholesale brokers to set out its supervisory focus areas for the next two years. This is not specific to insurance brokers but there are some key points to take away.

- **Financial resilience** – Firms should review their liquidity to satisfy themselves that it is commensurate with the risks they face. They will need to look beyond recent historical precedent when modelling stresses and seek to model stress events in more extreme or reverse stress scenarios.
- **Remuneration structures** – There remain issues around weak incentive and reward structures. Low salaries with large cash bonuses can lead to a focus on short-term financial targets at the expense of clients. Firms need to make sure that their remuneration structures match the risks associated with their business model.
- **Governance and culture** – Decision making and oversight play a key role in preventing and addressing issues. The Senior Managers and Certification Regime (SMCR) is important to promote good decision making and accountability, especially when it comes to new hires and regulatory references. Boards with varied skills and experience are likely to make better decisions and manage risks to succeed.
- **Control functions** – The FCA stressed the importance of adequately resourcing risk management and control functions that have influence at board-level. Financial crime was specifically called out as an area with weak systems and controls, particularly in client onboarding processes.

What management should focus on

The FCA provides a reminder that the CEO is responsible for staff understanding the rules and principles, and for their compliance. The FCA expects senior management (and the Board) to discuss the contents of the letter, consider how the risks apply and take action to manage them effectively. This should all be evidenced in the minutes from your next Board meeting, and before the end of February.

FCA guidance for supporting insurance customers in financial difficulty (CP23/1)

The FCA is planning to change its guidance to provide clearer expectations for insurance firms to support customers in financial difficulty. The consultation is open until 11 March 2023.

The FCA previously introduced Covid-19-related guidance for insurance and premium finance to support customers in financial difficulty due to the pandemic. This consultation proposes to expand the scope of the insurance aspects of the guidance to apply to all customers in financial difficulty. The consultation sets out trigger points where firms should take practical action, as well as expectations on how to support customers in these situations.

The guidance aims to reduce the impact of financial difficulty, help customers maintain an appropriate level of insurance they can afford, and reduce the risk of customers losing appropriate insurance cover.

What management should focus on

We would encourage firms to factor this guidance into their Consumer Duty implementation. The proposals will help firms to understand how they should put customers' needs first and act to deliver good outcomes for customers, as required by the Duty.

PRA 2023 priorities

The PRA provided an update on priorities for its supervision of life and general insurers in 2023 in a Dear CEO Letter. The main focus for the PRA will be on:

- **Financial resilience** – Life insurers may be experiencing a greater exposure to credit and concentration risk. Life insurers should therefore stress test their capital planning against prolonged adverse credit scenarios. For general insurers, there will likely be continued pressure on claims inflation. The PRA expects general insurers to factor general and social inflation risk drivers into their underlying pricing, reserving, business planning, and capital modelling.
- **Risk management** – Firms need to assess the adequacy of their risk management and control frameworks, which may need to respond to different market and risk conditions than those experienced previously. Specifically, firms are expected to assess their credit and counterparty credit risk management capabilities and reassure themselves of the continued validity of their models. Insurers will need to test the resilience of liquidity sources to market dysfunction and to re-evaluate potential liquidity demands created by the use of derivatives for risk management.
- **Implementing financial reforms** – An update on the Solvency II reforms is provided below. The PRA has started work to reform reporting requirements and simplify the internal model review process. The PRA will engage with firms during 2023 about the reforms and any changes required. It is also working to assess and authorise branches of international insurers within the Temporary Permissions Regime.
- **Reinsurance risk** – Firms are expected to consider their compliance with the Prudent Person Principle (PPP) for the risks associated with their reinsurance activities. The PRA calls out offshored counterparty concentration risk. Insurers need to consider their reinsurer's resilience over the duration of the exposures, as well as the potential impact of a mass recapture event.
- **Operational resilience** – The PRA expects insurers to have identified and mapped their important business services and set impact tolerances. Insurers will need to demonstrate their ability to operate within those impact tolerances under a range of severe but plausible scenarios, including cyber-attacks. Insurers must make sure their important business services remain within impact tolerances even when relying upon third party providers.
- **Ease of exit for insurers** – The PRA will consult on requirements for insurers to prepare exit plans. In the meantime, firms should consider how they might exit the market (if the need arose), what the obstacles might be, and how they might be overcome. When transferring

run-off business to another firm, the risks should be fully considered and understood by both parties.

Other areas of focus include:

- Non-natural catastrophe risk
- Financial risks arising from climate change
- Diversity, Equity, and Inclusion

What management should focus on

Senior management (and the Board) should discuss the contents of the letter, consider how the risks apply and any action that might be required. This should all be evidenced in the minutes of your next Board meeting. Management should also make sure they are prepared for any communications or requests from the PRA based on the content of this letter.

Review of Solvency II: Reporting Phase 2

The PRA published a consultation paper on Reporting phase 2 of the Solvency II review. The proposals aim to significantly streamline several SII reporting and disclosure requirements. Whilst the proposals are aimed at reducing the ongoing reporting costs for firms, the net benefit of these for firms will vary.

Templates proposed for deletion	Templates with a change in the reporting frequency	Templates with proposed changes to reporting threshold
• S.05.01 Premiums, claims and expenses by line of business; • S.07.01 Structured products; • S.08.02 Derivatives transactions; • S.21.01 Loss distribution risk profile; • S.21.03 Non-life distribution of underwriting risks – by sum insured; • S.30.01 Facultative covers for non-life and life business basic data; • S.30.02 Facultative covers for non-life and life business shares data; • S.31.02 Special Purpose Vehicles; • S.36.03 IGT – Internal Reinsurance;	• S.06.02 List of assets • S.06.03 Collective investment undertakings - look-through approach • S.12.01.02 Life and Health SLT Technical Provisions • S.17.01.02 Non-Life Technical Provisions	• S.03.01 Off-balance sheet items – general • S.05.04 (placeholder template code) By-country reporting • S.05.02 Premiums, claims, and expenses by country • S.11.01 Assets held as collateral • S.19.01 Non-life insurance claims • S.20.01 Development of the distribution of the claims incurred • S.30.07 Life reinsurance proportional cover • S.35.01 Contribution to group Technical Provisions

• NS.05 Revenue account life; • NS.06 Business model analysis (life); and • NS.12 The Society of Lloyd's Solvency Capital Requirement		• NS.14 (placeholder template code) Excess Capital Generation

Changes to the scope of Solvency II and NST reporting

The PRA has also proposed changes to the design of the reporting disclosure templates with the addition of new templates to capture outward reinsurance reporting for both life and non-life reinsurance contracts. Whilst NS.12 has been proposed for deletion the PRA has proposed to combine NS.12 into a new template for NS.13 which will capture gaps identified by the PRA.

Further proposals have been made to the presentation of the SCR by solo undertakings, which can be used to show the split of SCR by sub-risk modules that correspond with the standard formula requirements.

The PRA has also consulted on changes to the following areas:

- Own funds
- Reporting by insurance groups
- Internal model outputs
- Life obligations analysis
- Reporting on activity by country
- Reporting on premiums, claims, and expenses by line of business and country

Reporting on new topics

The following new reporting has been proposed:

Excess capital generation – new annual template NS.14 on excess capital generation (ECG) that would apply to life firms writing non-unit linked premiums exceeding £1 billion on an annual basis.

Cyber underwriting risk – new annual template, S.14.03 to report the types of cyber risk coverages provided, potential accumulation of risks and the risk mitigation techniques.

Non-life obligations analysis – new annual template s.14.02 which would be equivalent in nature to template s.14.01 on life obligations analysis.

What management should focus on:

It is intended the proposals in this CP will be implemented at the same time as other aspects of the proposed SII reform, which are still subject to further consultation. Firms should familiarise themselves with the changes proposed and where applicable prepare for reporting the new information that may be collected by the PRA.

Firms should respond to the consultation by 8 May 2023.

HM Treasury – Review of Solvency II: Consultation – Response

The Government issued its response to the Solvency II consultation in November 2022. Some of the key points are summarised below.

Risk margin

- The Government will legislate as necessary to reduce the risk margin by 65% for life insurance business and 30% for general insurance business
- The Government agreed a modified cost of capital method should be used to calculate the risk margin
- There is no intention to restrict commercial decisions on capital allocation although firms will be encouraged to provide a greater range of affordable products for consumers

Matching adjustment

- Following the consultation, the Government has decided to leave the design and calibration of the fundamental spread as it stands today
- There will be an increase in the risk sensitivity of the current fundamental spread approach with the allowance of different 'notched' ratings
- The Government will support the PRA in enforcing additional measures:
    - requiring insurers to participate in regular stress testing exercises as prescribed by the PRA, with the PRA able to publish individual firm results.
    - to require nominated senior managers with formal regulatory responsibilities and sanctions under the Senior Managers Regime to attest formally to the PRA on the sufficiency of the level of fundamental spread.
    - allowing an add-on where the standard allowance is insufficient.
    - to update its matching adjustments rules as appropriate to reflect the widening of the eligibility requirements to include assets with highly predictable cashflows.

Increased investment flexibility

- There will be changes to broaden the matching adjustment eligibility, with increased flexibility to include assets with prepayment risk or construction phases.
- The requirement that all eligible assets have *fixed* cashflows will be replaced by *highly predictable* cashflows.
- The removal of the 'BBB cliff' which placed a disproportionately severe treatment of assets in matching adjustment portfolios with ratings below BBB.

Reducing reporting and administrative burdens

- Branch capital requirements are being removed which will benefit branches of foreign insurers based in the UK, whilst reducing the barriers for foreign insurers wishing to establish a UK branch in the future.
- There will be an introduction of a new mobilisation scheme for insurers.
- The Government has increased the threshold for the size of insurers before Solvency II applies to £15 million in annual gross written premiums and £50 million in gross technical provisions.

What management should focus on

Firms will need to carefully review the Government's response to assess the impact of the proposed changes. In particular firms should assess the new investment allowances and identify any changes that need to be made to investment strategies and risk appetite. Whilst there is expected to be a decrease in the risk margin, the extent to the capital release for each firm will need to be assessed individually and will vary from the Government's forecast.

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