The world continues to wait to see whether the 585 page Brexit withdrawal agreement will be ratified by the UK and European parliament. If it is, we could hear a collective sigh of relief as we will largely see a continuation as if UK were an EU Member without voting rights until the end of the implementation period on 31 December 2020 (extendable by up to two years if all outstanding matters have not been resolved before then). While insurance groups are unlikely to reverse their moves to establish new EEA insurers, the extra time will make it easier to deal with legacy cross-border business. If the agreement is not signed, then 'no deal' preparations are well in hand, with consultations from both regulators about the amendment to their respective rules and further details of how the temporary permissions regime will work for EEA insurers wishing to retain UK market access, with similar temporary arrangements for UK insurers now beginning to be announced by some EEA regulators.

Moving away from Brexit, our three feature articles in this edition of *Illuminate* cover other areas of insurance regulation.

Our first article outlines the last minute actions that insurers should be taking as they move into the final stages of their preparations for the introduction of the Senior Managers and Certification Regime (SMCR) for insurers this month.

Our second item considers some of the practical considerations that Boards should be addressing as they respond to the regulators' increasing focus on operational resilience.

Our third feature discusses the latest pronouncements on climate change by both UK and European regulatory bodies and considers what this means for insurers.

Our final article comprises a round-up of regulatory 'hot topics', drawing from both David Rule's 'D to Z' speech and a variety of other sources. This is intended to complement our usual overview of key future regulatory milestones.

If you would like to talk to anyone about any of the topics covered, please contact the respective author or your usual KPMG contact.

Janine Hawes
Director
+44 (0)20 7311 5261

Are insurers fully ready for Day 1 compliance with the Senior Managers and Certification Regime (SMCR)?

Insurers become subject to the full set of SMCR requirements from 10 December 2018. The SMCR requirements add to the existing Senior Insurance Managers Regime (SIMR) and modified approved person requirements. In particular, SMCR will apply to a much wider population of staff than those requirements and will:

- Introduce the statutory duty of responsibility to senior managers.
- Require Solvency II insurers and large non-Directive insurers to take all reasonable steps to provide a senior manager with all the information and materials they would reasonably expect in order to perform a new senior management function.
- Require insurers to assess and certify (annually from December 2019) the fitness and propriety of staff covered by the Certification Regime (including staff capable of causing significant harm to the firm or its customers).
- Require all Certified staff to meet the Conduct Rules from 10 December 2018, and for all non-ancillary staff to do so from December 2019.
- Require Solvency II insurers and large non-directive firms to submit a conversion notification, statements of individual responsibilities and a management responsibilities map to the FCA to convert existing approved individuals to new senior management roles.

As many insurers have found, there are a number of operational challenges involved in implementing the SMCR, such as resourcing and the cost associated with training tailored to various levels of staff. Several business areas need to be involved in the decision making process, including HR and IT, and firms have had need to consider the impact different entities have on the organisation's structure and governance. Firms also had to determine their internal communications strategy and their processes for obtaining and providing regulatory references. From a technical perspective, firms needed to consider their approach to 'reasonable steps' and ensure a strong level of consistency between their governance maps and individual statements of responsibility.

Despite the challenges, our experience has been that firms identified positive approaches for managing the programme, and they benefitted from holistically reviewing and aligning their governance frameworks. In our report covering Individual Accountability, we highlighted lessons learned from the banking sector and experiences implementing SMCR with insurers. Our discussions with insurers showed a number of key themes emerging:

- **The importance of a multi-disciplinary approach to implementing SMCR.** Most insurers saw the benefit of Compliance being engaged with HR, Legal and IT teams to ensure a smooth handover between the initial programme and BAU owners of key elements of SMCR.
- **The role of technology.** In implementing SMCR stakeholders found that it is vital to work with Technology colleagues to understand current systems and capabilities and to invest in new solutions where there are gaps, particularly in firms with large populations of Certified individuals and Conduct Rules staff, to ensure these can be monitored on an ongoing basis.
- **The benefits of SMCR to the overall governance and operation of the firm.** Despite the many challenges presented by the implementation of SMCR, many firms identified benefits of using the regime as an opportunity to 'spring clean' current arrangements, assess where processes may not be fully effective and drive change within the business.
- **Scope of the Certification Regime.** Insurers have generally found the Certification Regime to be the most challenging aspect of SMCR, and had challenges in finalising the Certified population.
- **Practical ways to ensure Senior Manager Functions (SMFs) can evidence reasonable steps.** There are a number of practical ways that firms can ensure Senior Management buy-in and prepare their SMFs for becoming subject to the duty of responsibility from 10 December, for example by conducting scenario analysis and stress-testing a firm's reasonable steps framework, and working through scenarios with a number of SMFs to understand where accountabilities lay in certain situations.

With the implementation deadline now upon us, insurers need to have made material progress with the design of their full SMCR framework, with at most only small gaps in their implementation plans.

Key links

Our report, Individual accountability – Global regulatory developments in financial services looks at experiences of implementing SMCR in the UK and policies and regulations being adopted globally.

Watch our video as David Miller, Partner in Risk Consulting, explores what the key challenges are for both insurers and brokers, what the main differences are between Senior Insurance Managers Regime (SIMR) and Senior Managers and Certification Regime (SMCR) and explains why he believes SMCR is a positive step for the industry.

Key contacts

David Miller
Partner
KPMG in the UK

Max Lewis
Senior Manager
KPMG in the UK

UK's financial sector operational resilience – Impact on key business services

Across the financial sector we have seen a number of high profile operational changes being implemented by firms without a full appreciation of the potential risk, a lack of ability to reverse the change and no credible recovery plan. The failed implementation of these changes, combined with some notable supply chain failures and cyber threats, have rapidly made Operational Resilience one of the hottest topics across financial services today.

Regulatory interest has also significantly appreciated with the PRA, FCA and Bank of England's joint discussion paper stressing the need for action by firms to protect the UK financial system. This provides a clear signal that they see operational resilience being as important as financial resilience.

Why does operational resilience matter?

When considering the resilience of the broader financial system, regulators want to understand how firms will absorb and respond to stress events. Seen through this lens, operational resilience becomes more strategic in nature than traditional operational risk considerations. Additionally, scale is not a great differentiator in this context – All firms are in scope for challenge regarding their resilience.

The theme of operational resilience cuts across common aspects of many firms' business models.

For example:

— Customer experience has become increasingly technology focussed;

— Processes within the business are more inter-connected with a desire to simplify legacy systems;

— Some firms are heavily reliant on third party providers to on-board, service and fulfil policyholder obligations;

— Existence and recognition of 4th party risks, and

— New agile business models are leveraging common tools across multiple geographic regions.

Practically, what should be the focus of Executives and Boards?

Key areas of change will need to be driven by the Board to demonstrate their greater awareness of the commercial drivers for the design and implementation of robust Operational Resilience. Prior to practical action there is a need to shift the internal discussion from 'avoidance' to 'management', accepting that disruption is inevitable given the degree of change, hostile cyber environment and introduction of additional technology across the whole financial services sector. Firms need to think about when, not if, large scale operational failures could happen. Adopting a mind-set that failure at some stage is inevitable will help drive proper and 'real' scenario planning including customer communication strategies.

One means of demonstrating this step-change in outlook is Board engagement and management being held accountable for robust risk assessments. Whilst business continuity, disaster recovery and operational risk assessments are commonplace, many firms lack a coordinated approach that focuses on their vulnerabilities and resilience to a multi-faceted event. Operational resilience built on a bottom-up and realistic approach will require virtual teams to come together and firms' existing risk assessment processes to become more integrated. Starting to build this picture and plan of action should events crystallise is something that firms could, and should, be doing today.

Following an initial base-lining of current operational resilience maturity and related risk exposure, we expect that firms will start to develop, monitor and test the resilience of their key processes and services. At a time of unprecedented change within the financial services sector, this broader perspective poses both capability and capacity challenges.

Looking ahead

As inter-connected business models become the norm, the commercial and strategic benefits of a truly resilient organisation are clear. This could become a positive differentiator whilst also protecting both brand and reputation in the event of disruption. With the UK regulator playing a leading role in global thinking on this issue, firms need to actively engage to address their operational resilience.

David Miller
Partner, FRM

Eamon McGinnity
Director, FRM

Climate change

The days of climate change being reserved for scientists, environmental lobbyists and politicians are long past. There is now much greater understanding of the impacts on us all and policymakers recognise that they need the support from financial market participants if they are to achieve the Paris Agreement targets to limit global warming to below 2 degrees Celsius. In our sector, boards of insurance companies are increasingly needing to understand the impact of climate change risks to their business models arising from their underwriting and investment activities, both inside and outside of the organisation.

Climate change risks

There is now a general consensus that the main categories of climate change risks to insurers' balance sheets are:

— *Physical risks:* While non-life insurers are able to adjust underwriting exposures to extreme weather events through annual contract re-pricing, the occurrence of uncorrelated events could result in an unexpectedly high claims burden. Life insurers also need to manage their mortality and morbidity exposures as extreme weather events could compound pre-existing health conditions.

— *Transition risks:* Moving to a low-carbon economy could affect the value of investments and the costs of doing business. For example, several European reinsurers have made recent public commitments to stop investing in companies that generate more than 30% of their revenues from coal-related business.

— *Liability risks:* The risk of litigation for not fully considering or responding to the impacts of current and future environmental risks, both by insurance company boards themselves or exposures arising from the companies to whom they provide D&O, PI or third party environmental cover.

Focus for regulators

Climate change is becoming increasingly relevant to financial regulation and supervision. Most recently, the PRA released a consultation paper[1] outlining expectations on insurers (and banks) to manage the financial risks arising from climate change. Insurers will need to embed climate change within the existing governance framework and assign board-level accountability for oversight. CROs will need to consider long-term scenario testing to inform the firm's strategic response to climate change and build climate change risk into risk management processes (such as the ORSA).

While insurers are already required to disclose information on material risks in their regulatory reporting, and UK firms must disclose information on principal risks and uncertainties, it is not clear whether the regulators will seek greater consistency of disclosures. Firms will also need to consider whether their existing disclosures are sufficient and whether to engage in wider initiatives such as the *'Recommendations of the Taskforce on Climate-related Financial Disclosures'* published by the FSB in June 2017.

The PRA also incorporated climate change scenarios within its General Insurance Stress Test in 2017 to improve its understanding of the impact on insurers' solvency positions and key exposures to reinsurer counterparties and jurisdictions. It has also interrogated reported asset data to assess UK insurers' exposure to the risk of an abrupt transition to a low-carbon economy.

More broadly, the European Commission has been developing proposals for an EU taxonomy for environmental, social and governance risks and is considering additional disclosure requirements.

EIOPA has been tasked to deliver recommendations to the Commission, by 30 April 2019, on how existing regulatory frameworks might incorporate sustainability risks and factors and an opinion on the impact of Solvency II on insurers' sustainable investment and underwriting activities by 30 September 2019. For example, the assessment of sustainability risks within asset-liability management and investment policies under Solvency II as well as the inclusion of sustainability factors when designing and distributing insurance products and managing conflicts of interest under the Insurance Distribution Directive.

What boards should be considering

Boards should have an overall strategy in relation to climate change risks taking into account the expectations of both investors and policyholders. This strategy should consider the investment approach over a range of time horizons to ensure that those are consistent with the firm's overall strategy and planning. For example, it might be more challenging to justify long-term sustainability goals to stakeholders that are not prepared to compromise on short-term profitability.

After defining a strategy and identifying relevant metrics to measure and manage climate change risks, the Board must define its risk appetite and tolerances recognising that these might change over time. Boards should also review their governance and risk management policies and consider whether and how these incorporate environment risks. It is important to assign clear responsibilities for assessing and monitoring these risks to individuals that have the appropriate skills and expertise to properly assess and manage them and who are able to produce effective management information to report to the board.

Where such risks are material, this should be fully explained within the firm's own risk and solvency assessment report and the risks should be subjected to appropriate stress and scenario testing.

Firms should be cognisant of the development of a European taxonomy for categorising potential risks across a broader spectrum of ESG (environmental, social and governance) risks. Until this framework has been defined which is targeted for Q2 2019, firms will need to determine their own objective criteria to help their risk teams reach consistent judgements.

As supervisors obtain increasingly more granular data points about an insurer's risk universe, Boards might wish to consider where they require independent assurance over their processes and controls as well as assurance over the information supplied as part of industry-wide reviews.

Many Boards will have already considered the extent and scope of climate-related financial disclosures and have been voluntarily including these within their financial statements. Such disclosures are likely to receive increasing attention from analysts and supervisors, especially around the appropriateness and results of scenario analyses.

Michael Crawford
Partner
KPMG in the UK

Matthew Francis
Director
KPMG in the UK

Insurance supervision update

David Rule's speech on the 'D to Z' of current issues concerning insurance supervision was a timely reminder that there are far more things for insurance Boards to consider beyond (valuation and credit ratings of illiquid) Assets, Brexit and Climate Change. Taken together with other regulatory communications, we highlight below our current top four considerations for insurers. We anticipate increased supervisory attention in particular on insurer's business models and governance structures.

Actuarial reserving and modelling

The PRA continues to express concerns about the adequacy of specialist general insurers' pricing and underwriting standards and the associated risk of under-reserving in light of soft market conditions. In particular, the PRA continues to have concerns regarding the sustainability of some firms' business plans, including actions taken to mitigate risks to its sustainability. Boards of affected firms were asked to respond to Anna Sweeney's Dear CEO letter earlier in the year which raised connected concerns around insufficient use of technical pricing models, delayed reactions to emerging loss development and optimistic loss ratios and future reserving assumptions in business plans given current market conditions.

Sid Malek's letter to Chief Actuaries of life insurance companies focused on internal models (including the longevity assumptions following slower population mortality improvements, modelling of credit risk and dependency modelling), matching adjustment and transitional measures. We would draw out Sid's comments on stress and reverse stress testing and disclosure of the sensitivity of the SCR coverage ratio, especially given recent market volatility.

Capital management

There have been many papers that indicate the PRA's general concerns about firms' capital management policies and risk appetite for solvency breaches. It is clear that the PRA is not comfortable with a risk appetite that could result in either foreseeable and/or frequent SCR breaches, and that this could lead them to question the effectiveness of the firms' system of governance.

Although the letters issued to firms following their Periodic Summary Meeting (PSM) are confidential, from our position as auditor, we can see a number of themes emerging across a spectrum of firms. Solvency concerns arise fairly frequently, including both volatility in regulatory capital levels and/or SCR coverage, management actions and optimising firms' capital position.

Another theme relates to firms' ability to adapt to market volatility and the link between execution of strategy and transitions risks. Linking with the earlier section, the PRA expects firms should not adopt a policy to improve their strategic growth at the expense of good underwriting policy.

Board effectiveness

Across the financial services sector, both regulators seek to understand the rationale for any frequent changes in management structure. Not only do they want to understand whether there are any underlying concerns, but also the impact this could have on the overall Board effectiveness.

There are a number of instances where the complexity of a group's legal entity structure has been called into question, with actions required to simplify this. Although recovery and resolution requirements do not yet apply in earnest beyond the three UK G-SII (global systemically important insurers) groups, the introduction of these requirements – On a proportionate basis – From 2020, means insurers can expect to see increased challenge in this area.

Operational resilience

The joint Discussion Paper issued by the PRA and FCA in July on their approach to operational resilience in the financial services sector shows that this is now a key area of focus for both regulators, and firms need to be able to demonstrate how this is embedded within their organisation.

While the Chief Operations Function has the prescribed responsibility for managing and ensuring operational continuity and resilience of the internal operations, systems and technology of the firm, as an integral part of a firm's overall strategy, operational resilience should be driven from the Board.

This can be seen (in part) as a link to recovery and resolution measures, with an emphasis on maintaining continuity of provision of 'critical economic functions' – To both the firm's customers and the UK economy – Regardless of the cause of disruption.

Cyber resilience forms a key part of this, as well as natural hazards, IT and man-made failures.

Firms need to start from a mindset that failure is inevitable and assess the potential implications of this from a customer service perspective. Scenario planning will help in identifying key services that will need to be protected. In addition to testing of potential responses, Boards should set and monitor clear Operational Resilience tolerance levels for the firm's critical services augmenting existing and complimentary risk appetite measures.

Matthew Francis
Director
KPMG in the UK

Future Regulatory Milestones – Outstanding

Date	Activity/Topic	Impact on industry
Solvency II		This section provides an overview of key Solvency II developments, primarily proposed changes at UK and EU levels.
1 Nov 2018	EIOPA report on challenges and diverging practices in group supervision and in the supervision of cross-border passporting arrangements.	The Commission requested this report by 1 November 2018, but at the time of writing this has not yet been published. EIOPA highlighted the need to ensure a level playing field in the area of cross-border provision of insurance business in its 2018-19 Supervisory Action Plan. These messages were reinforced at the recent EIOPA Annual Conference, with particular reference made to detection of unsustainable cross-border business models, sufficiency of technical provisions in cross-border business and fit and proper analysis. Insurers may see future Opinions being issued by EIOPA to ensure greater harmonisation in the treatment of cross-border business – For example to address concerns raised about treatment of French construction business.
15 Nov 2018	Introduction of UK audit exemption from external audit of the Solvency and Financial Condition Report (SFCR) for small Solvency II firms/groups.	The exemption is based on a 'score' metric (based on gross written premiums and best estimate liabilities). Firms with a 'score' of less than 100 will be exempted. Insurance groups where all Solvency II firms meet this threshold test are also exempted.
7 Dec 2018	Response deadline to the Commission's consultation paper on its review of the standard formula Solvency Capital Requirement (SCR) calculation.	The proposals build from EIOPA's advice (excluding those on interest rate) and would amend the detailed calculations in the Solvency II Delegated Regulation in a number of areas, including: — New simplifications — Unrated debt and unlisted equity investments charges — New principles regarding the determination of the loss absorbing capacity of deferred taxes — Adjustments to various underwriting risk parameters. The proposals on segmentation will apply from 1 January 2020. All other changes will be effective 20 days following publication in the Official Journal.
Q4 2018	EIOPA long term guarantees review.	Part of the annual assessment process started in 2016.

Date	Activity/Topic	Impact on industry
Jan 2019	EIOPA expects to publish the results of the 2018 insurance stress test.	For the first time, EIOPA aims to publish individual results of the 42 insurance groups that participated.
30 Jan 2019	Response deadline to EIOPA consultation on possible amendments to the delegated acts under Solvency II and IDD concerning the integration of sustainability risks and factors.	Recommendations on how sustainability might be integrated into systems of governance, risk management, prudent person principle and assessment of target market. EIOPA is due to report to the Commission by 20 April 2019.
30 Sep 2019	EIOPA to deliver opinion on sustainability within Solvency II.	The Commission has requested EIOPA to identify possible incentives and disincentives for sustainable investment under Solvency II, the calibration of SCR charges, practices in the design and pricing of insurance products and the extent to which sustainability is considered within cash flow projections in the calculation of the best estimate liability.
16 Dec 2019	Deadline for EIOPA to provide the Commission with information on the impact of Solvency II on long term insurance and reinsurance activities.	This review will consider insurer's behaviour as long term investors, availability of long-term guarantees in insurance products and financial stability. The Commission is due to produce a report to the European Parliament and the Council on these matters by 1 January 2021.
Conduct		This section provides a brief overview of recent developments in key FCA and EIOPA initiatives relevant to the insurance sector.
Q1 2019	FCA to publish interim report on Wholesale Insurance Brokers Market Study.	The review aims to explore how competition is currently working and whether improvements could benefit clients. Focus areas will be market power, conflicts of interest management and broker conduct.
Q1 2019	EIOPA expects to publish key findings from its thematic review on the use of Big Data in the motor and health sectors.	EIOPA announced this review in July, aiming to identify both potential benefits and risks from the use of Big Data across the insurance value chain.
Q1 2019	EIOPA expects to publish key findings from its thematic review on travel insurance.	This review was also announced in July. Given the product is often sold as an ancillary product, EIOPA wants to understand potential sources of consumer detriment and best practices in its distribution.
1 Apr 2019	FCA to assume responsibility for regulating Claims Management Companies (CMCs).	Registration forms must be submitted by 31 March 2019 to obtain temporary permission before full application windows open.
Other key UK regulatory requirements		
10 Dec 2018	Senior Managers and Certification Regime applies to insurance companies.	Firms must have implemented the regime affecting senior managers and certified individuals.

Date	Activity/Topic	Impact on industry
14 Dec 2018	Deadline for insurers to respond to PRA's letter regarding their preparations for transition from LIBOR to risk-free rates	Responses should provide a board-approved summary of key risks relating to LIBOR discontinuation and details of actions planned to mitigate those risks. The response should also identify a Senior Manager within the firm to oversee implementation of those plans.
Packaged Retail and Insurance-based Investment Products (PRIIP)		The PRIIP Regulations introduced standardised pre-contractual disclosure requirements through the Key Information Document (KID) for investment and insurance contracts with an investment element.
6 Dec 2018	Deadline for responses to consultation from the European Supervisory Authorities on targeted amendments to the KID.	The proposals relate to the performance scenarios, with the ESAs aiming to feed this into the Commission's general review covered below.
31 Dec 2018	Deadline by which the Commission must review the PRIIPs Regulation under Article 33.	The review is intended to include a general survey of its operation as well as the practical application of the rules.
International Association of Insurance Supervisors (IAIS)		Consultation on the insurance capital standard that will form part of the supervision of Internationally Active Insurance Groups (IAIGs) closed in October. Open consultations are covered below.
17 Dec 2018	Deadline for responses to consultation on Application Paper on Proactive Supervision of Corporate Governance.	The paper is aimed at supervisors, providing examples of good practices to promote proactive supervision of corporate governance. As such, there is no immediate impact on insurers.
7 Jan 2019	Deadline for responses to consultation on Application Paper on Recovery Planning.	The paper provides guidance in a number of areas, including the nature of a recovery plan and the roles of the supervisor and insurer with respect to the recovery plan.
24 Jan 2019	Deadline for responses to consultation on Holistic Framework for Systemic Risk in the Insurance Sector.	The draft framework would be used to assess and mitigate systemic risk in the insurance sector, either arising directly from the failure of individual insurers or caused by insurers amplifying shocks through collective exposures or actions. Policy measures (pre-emptive, on-going supervision and intervention powers) could therefore apply to a wide population of insurers, but on a proportionate basis.
Nov 2019	IAIS to adopt all revisions to its Insurance Core Principles and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).	Version 2.0 of the Insurance Capital Standard (ICS) will form part of ComFrame. It will be used for confidential reporting to group supervisors from 2020 and will only become a prescribed capital requirement (PCR) and subject to public reporting at the end of a five year monitoring period.

kpmg.com/uk

Produced by Create Graphics I Document number: CRT103383