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United Kingdom: Insurance Core Principles Detailed Assessment of Observance

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

UNITED KINGDOM

INSURANCE CORE PRINCIPLES

DETAILED ASSESSMENT OF OBSERVANCE

JULY 2011

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

AADB	Accountancy and Actuarial Discipline Board
ABI	Association of British Insurers
AML	Anti-Money Laundering
APB	Auditing Practices Board
APER	Approved Persons
ARROW	Advanced, Risk Responsive Operating frameWork
ASB	Auditing Standards Board
BAS	Board for Actuarial Standards
CASS	Client Assets Sourcebook
CDD	Customer Due Diligence
CFEB	Consumer Financial Education Body
CFT	Combating the Financing of Terrorism
COBS	Conduct of Business Sourcebook
CPPI	Core Prudential Program for Insurers
DART	Data Analysis and Review Tool
EEA	European Economic Area
FATF	Financial Action Task Force
FCD	Financial Conglomerates Directive
FIT	Fit and Proper Test
FIU	Financial Intelligence Unit
FOS	Financial Ombudsman Service
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
FSOC	Friendly Societies
GCD	General Counsel Division
GENPRU	General Prudential Sourcebook
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
ICA	Individual Capital Adequacy
ICOBS	Insurance Conduct of Business Sourcebook
IGD	European Insurance Groups Directive
IMD	Insurance Mediation Directive
INS	Insurance
INSPRU	Insurance Prudential Sourcebook
IPRU	Interim Prudential Sourcebook
IRM	Interim Risk Manager
IST	Insurance Sector Team
JMLSG	Joint Money Laundering Steering Group
MER	Mandatory Electronic Reporting

MI	Management Information
MIPRU	Mortgage, Home Finance and Insurance Intermediaries Prudential Sourcebook
MLA	Mutual Legal Assistance
MLR	Money Laundering Regulations
MLRO	Money Laundering Reporting Officer
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum of Understanding
NED	Nonexecutive Director
NEST	National Employment Savings Trust
OFT	Office of Fair Trading
POCA	Proceeds of Crime Act
RAO	Regulated Activities Order
RDC	Regulatory Decisions Committee
RDR	Retail Distribution Review
RMP	Risk Mitigation Program
ROSC	Report on the Observance of Standards and Codes
SDA	Supervisory Data Analysis
SEP	Supervisory Enhancement Program
SIF	Significant Influence Functions
SIS	Shared Intelligence System
SPV	Special Purpose Vehicle
SUP	Supervision Manual
SYSC	Senior Management Arrangements, Systems and Controls Sourcebook
T&C	Training and Competence Scheme

I. EXECUTIVE SUMMARY, KEY FINDINGS AND RECOMMENDATIONS

A. Introduction

1. **This assessment takes into account the significant legislative changes and regulatory developments in the insurance sector of the United Kingdom since 2002.**[1] The United Kingdom undertook an initial Financial Sector Assessment Program (FSAP) in 2002, which included a formal assessment of the Insurance Core Principles (ICPs). The recommendations arising from the 2004 assessment have been largely addressed, although one area, market disclosure, remains in need of improvement.

2. **The initial FSAP was benchmarked against the ICPs issued in 2000, while the current assessment is benchmarked against the ICPs issued in 2003.** The change in methodology, as well as the long period that has elapsed since the last FSAP essentially makes this assessment basically a full new assessment rather than an update. The impact of the Tiner report, the Northern Rock internal report, the Equitable enquiry, and the 2008 crisis has resulted in the strengthening of insurance sector supervision, which the assessors have noted by way of comments, where appropriate. The current assessment also took account of the relevant IAIS standards and guidance that complement the ICPs.

Information and methodology used for assessment

3. **The sophistication and importance of the United Kingdom insurance sector has been taken into consideration in determining the level of observance for each ICP; however, as is common practice, the assessment reflects the essential criteria only.** Advanced criteria are not taken into consideration in assessing observance of the ICPs, but the supervisory demands for a complex and highly developed insurance sector are reflected in a stringent assessment of the ICPs. Each ICP is rated in terms of the level of observance as follows:

- "Observed"—where all the essential criteria are observed or where all the essential criteria are observed except for those that are considered not applicable.
- "Largely observed"—where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
- "Partly observed"—where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
- "Not observed"—where no substantive progress toward observance has been achieved.

[1] The assessment was conducted from January 17–31, 2011 by Mr. Tom Karp, Insurance Supervision Advisor contracted by the IMF, and Dr. Rodolfo Wehrhahn, Technical Assistance Advisor from the IMF.

4. **The assessment is based solely on the laws, regulations, and other supervisory requirements and practices that are in place at the time of the assessment.** This is particularly relevant in the context of the transition that the supervisory regime is currently undergoing with the dissolution of the Financial Services Authority (FSA) and the creation of two new entities. Thus, the assessment is based on the FSA as of the date of the assessment. Ongoing regulatory initiatives are noted by way of additional comments.

5. **The major source of information used for the assessment is a comprehensive self-assessment carried out by the FSA.** The assessors also made use of information available on the FSA web site, including numerous consultation papers, presentation material provided by the FSA officers, statistical information provided by the Association of British Insurers (ABI) and rating agencies, and background information available from various professional firms and international industry intelligence services. In addition, extensive interviews were conducted with numerous officers in the FSA and the various trade associations, major insurers, including Lloyds of London, and governmental and regulatory bodies concerned with standard setting, education, and consumer protection. The assessors wish to thank all concerned for their time and cooperation, which added significantly to the effectiveness of the assessment.

6. **The assessors are also grateful to the authorities for their full cooperation and thoughtful logistical arrangements and co-coordination of various meetings with industry participants.**

B. Institutional and Market Structure—Overview

7. **The insurance industry in the United Kingdom is the third largest in the world after the United States and Japan.** At the end of 2009, the total premium income had recovered from the crisis and reached 2005 levels, which amounted to £184 billion (£140 billion life business and £44 billion nonlife business) or approximately 8 percent of the world market share. Premium income for life insurance has grown more slowly than for nonlife.

Table 1. The United Kingdom: Gross Premium

(In billions of pounds sterling)

Year	Life	Nonlife
2000	120	29
2009	140	44

Source: Authorities data.

8. **in 2008, U.K. insurers managed investments of about £1.6 trillion or 24 percent of U.K. total net worth.**[2] This represented 13.4 percent of investments in the London stock market, four times more than the banking sector. Insurers are also significant holders of fixed-interest securities issued by both the public sector and the private sector, including the banks. The U.K. insurance industry is an important employer with 275,000 people and the ABI members contributed £8.2 billion in taxes in 2008/2009.

Table 2. The United Kingdom: Insurance Sector Asset Allocation, End 2009

	Cash & Other Investments	U.K. Public Sector Securities	U.K. Ordinary Stocks and Shares	Overseas Ordinary Stocks and Shares	Unit Trusts	Overseas Public Sector Securities	Other U.S. Company Securities	Other Overseas Company Securities	Property	Total
Total Invested Funds (In billions of British pounds)	127.52	191.28	239.1	239.1	207.2	95.64	175.34	223.16	95.64	1594
In percent	8	12	15	15	13	6	11	14	6	100

Source: Association of British Insurance Data.

Table 3. The United Kingdom: Holdings of U.K. Securities, 2009

(In percent of outstanding value)

	Life Insurers	Nonlife Insurers
U.K. Gilts	14.8	20.8
U.K. company shares	32.9	28.8

Source: U.K. Office of National Statistics.

9. **The insurance sector is a major risk carrier for global insurance.** Reflecting the long history of insurance in the United Kingdom, internationally active groups, as well as the markets in Lloyds and the London Market, account together for approximately £41 billion of annual global cross-border, long-term insurance premiums and £13 billion of nonlife business. Benefits from diversification both in lines of business and geographic location, together with highly sophisticated risk management and underwriting structures, are the main characteristics of the entities, although in recent years there has been a reduction in composite insurers.

10. **At the end of 2009, 934 companies were authorized by the FSA to carry out insurance business in the United Kingdom.** This represents a 7 percent reduction in the last two years. More recently, consolidation has accelerated, with insurance groups reducing their number of legal entities for cost reasons and in preparation for Solvency II.

[2] According to the ONS, Economic and Labor Market Review, August 2010 as reported by ABI.

Table 4. The United Kingdom: Number of Insurers

	End-2007	End-2008	End-2009
Life	215	209	190
Nonlife	788	762	744

Source: Authorities data.

11. **The top six groups account for around 50 percent of the market, with a strong market leader with 23.7 percent premium market share.** The concentration in the life industry is higher with a dominant market leader with 32.3 percent of premium income and the top five life insurers accounting for more than 60 percent. The nonlife business is less concentrated with the top five insurers accounting for only 30 percent of the market.

Table 5. The United Kingdom: Market Share of the Top Six Insurance Groups, 2009

(In millions of pounds sterling)

Name	Assets End-2009	Percentage	Premiums End-2009	Percentage
LandG	254,989	16.4	45,295	23.7
Prudential	138,249	8.9	8,418	4.4
Aviva	108,276	7.0	10,025	5.3
Lloyds	114,830	7.4	12,036	6.3
Standard Life	97,263	6.3	9,855	5.2
Royal and SA Ins	20,069	1.3	3,632	1.9
Total	**733,676.6**	**47.2**	**89,20.5**	**46.8**

Source: Authorities data.

Table 6. The United Kingdom: Market Share of the Top Five Life Insurers, 2009

(In millions of pounds sterling, unless otherwise indicated)

Life Insurance Companies	Total Assets at End-2009	Total Assets at End-2009 (In percent of total)	Premiums at End-2009	Market Share (In percent of total)
LandG	254,989	20	45,295	32.3
Prudential	138,249	11	8,418	6.0
Aviva	108,276	8	10,025	7.2
Lloyds	114,830	9	12,036	8.6
Standard Life	97,263	8	9,855	7.0
Other	564,924	44	54,509	38.9
Total	**1,278,532**	**100**	**140,138**	**100**

Source: Authorities data.

Table 7. The United Kingdom: Market Share of the Top Five Nonlife Insurers, 2009

Top Five Largest Nonlife Insurance Companies	Premiums in 2009 (In thousands of £)	Market Share (In percent of total)
Royal and SA Insurance	3,631,539	8.3
AXA Insurance Group	3,020,795	6.9
Aviva Insurance U.K.	2,449,689	5.6
Chartis Insurance U.K.	2,234,418	5.1
BUPA Insurance	2,255,563	5.2
Others	30,087,996	68.9
Total	**43,680,000**	**100**

Source: Authorities data.

12. **Life and nonlife insurers offer a diversified range of protection and investment-related products as analyzed in Tables 8 and 9.**

Table 8. The United Kingdom: Analysis of Gross Premiums–Life

(In millions of pounds sterling)		
	2009	In Percent of Total
Regular premiums		
Protection	4,109	2.9
Annuities	186	0.1
Savings	5,167	3.7
Individual pensions	6,997	5.0
Group pensions	9,684	6.9
Single premiums		
Protection	426	0.3
Annuities	14,054	10.0
Savings	14,003	10.0
Individual pensions	17,039	12.2
Group pensions	68,473	48.9
Total	**140,139**	**100**

Source: Authorities data.

13. **Pension reforms, including the introduction of automatic-enrolment and NEST, will pose challenges and opportunities for life insurers.** It is important to note that, with a large part of the life insurance business being pension-related, the life insurers will be significantly affected by upcoming government reforms. On the one hand, take-up rates in their existing schemes might increase dramatically (with a lower cost of acquisition), and on the other hand they will have to compete with NEST (the government's new low-cost pension scheme), which might increase downward pressure on prices.

Table 9. The United Kingdom: Analysis of Gross Written Premiums—Nonlife
(In millions of pounds sterling)

	2005	2009
Accident and Health	5,158	6,312
Motor	8,596	7,681
Household and Domestic	6,205	6,226
Financial Loss	4,106	3,377
Motor	2,989	2,379
Property	6,529	6,516
Liability	7,472	
Financial Loss	990	615
Aviation	869	978
Marine	1,076	1,747
Goods in Transit	374	567
Miscellaneous	20	12
Total	**44,383**	**43,680**

Source: Authorities data.

14. **A general deterioration of the motor vehicle bodily injury claims experience has affected the insurers in recent years.** The main causes are linked to fraud and more generous court awards. Notwithstanding the worsening of claims, the commercial business remains in a soft cycle and lowering of profits is expected.

15. **Overall solvency of the insurance sector remains stable both, under Solvency I and individual capital adequacy (ICA) requirements.** The ICA results have not required an increase of capital in most companies, but, apparently, the recently carried out QIS5 test is causing several companies to query the proposed calibrations inherent in Solvency II requirements. Over 100 companies are expected to file for internal model approvals as Solvency II becomes mandatory. The large number of companies for which the standard model does not seem to be adequate is another indication of the complexity of the insurance industry in the United Kingdom.

16. **The current FSA preparation and advance status for the implementation of Solvency II is second to none.** Paving the way for the implementation of Solvency II, the FSA has been working over the last 18 months with a team of 250 people and a budget of £100 million to £150 million, and is in a very advanced stage for the implementation, including the internal model approvals. The industry cost for implementing Solvency II will be multiples of the FSA's costs, but the insurers' resulting improved risk management and understanding of their business will also be considerable. The excellent focus and quality of resources dedicated to the Solvency II work needs to continue. The approval of internal models is a crucial step for the insurance industry in this highly specialized and sophisticated

market. The models will be complex and only sufficient resources and expertise will allow understanding of the sufficiency of the resulting capital levels to warrant a solvent industry.

C. Main Findings

17. **The conditions for effective supervision are adequately met, reflecting the highly developed legal system, institutional framework, financial markets, and long-standing insurance market.** The United Kingdom has been heavily involved in developing Solvency II requirements and has positioned itself well for effective implementation. The United Kingdom is also contributing significantly to international developments in financial regulation, which have been moving more rapidly since the financial crisis. However, reliance on EU and international developments as the prime drivers for change risks missing changes that are needed due to local market weaknesses or developments.

18. **Insurance regulation in the United Kingdom is thorough and effective.** Insurance regulation and supervision were strengthened following financial market turbulence around 2003–04. This helped the insurance sector to come through the more recent financial crisis in reasonable shape where no government financial aid being required.

19. **The powers given to the FSA under the Financial Services and Market Act have allowed it to develop comprehensive and detailed regulatory requirements and supervision guidance.** The substantial FSA Handbook containing regulation and detailed guidance is kept up to date with current market developments and supervisory needs. Changes and additions to regulation and supervision undergo a transparent consultative process before implementation.

20. **As a consolidated supervisor, the FSA has been able to use economies of scale.** A well developed and consistent set of centralized functions for common supervisory activities across the financial sectors are in place and access to experts in different financial sector areas is internally available. It is recommended that due regard be given to maintaining the high standards of the currently centralized activities, such as licensing, fit-and-proper assessments, changes in control, and fraud detection, when restructuring the supervisory authority.

21. **The change in the last three years in intensity, intrusiveness, and supervisory quality cannot escape our analysis.** Issues that were tolerated or ignored in the past have been discovered and dealt with in an effective and forceful way. Supervision has become intrusive and intensive in certain areas and for the high-risk firms. Initiatives like the Core Prudential Program for Insurers (CPPI) and Solvency II preparatory work are to be commended. However, CPPI has not been fully completed and thus further work is required so that the supervisory analysis and thinking it entails can be embedded into the processes and expertise of the FSA. CPPI should be extended to a wider range of insurers, but this will need careful adjustment to ensure it is applied proportionately to firms of various impacts,

especially in respect of the key financial risks and associated 'deep dives' when applied to general insurers. It will clearly involve extra resources.

22. **The FSA applies a sophisticated and well developed risk-based approach to supervision based on the Advanced, Risk Responsive Operating frameWork (ARROW) framework.** This approach, which provides for an affective resources allocation to the issues that present high risk to the FSA objectives, is complemented by thematic supervision that applies to the whole spectrum of the supervised entities. Supplementing its risk-based and thematic approach, the FSA sometimes conducts 'transaction examinations.' This brings to the surface unknown (to both the FSA and the insurer) problems, so it is an effective complement to top-down-driven examinations. When insurers are aware that the FSA occasionally undertakes such examinations, it also becomes a force for keeping insurers on their toes, rather than having them concentrate on areas where they think on-site work will occur. The FSA should ensure that the further development of its approach to supervision maintains an emphasis on random 'transaction examinations' (in relevant areas such as underwriting, reinsurance, claims, and even investments) covering both the largest insurers and even some smaller insurers.

23. **A modern and risk-sensitive regulation on firms' capital should require details of the capital held by individual firms to be made public to provide a clearer view for their financial position than that allowed for by Solvency I.** The granularity, scope, and appropriate frequency of data availability in carrying out the suitable level of supervision are currently only achieved in a reactive fashion. While the published standard return information has been improved and updated, no comprehensive revision has been undertaken for a number of years. This is predominantly because EU developments on Solvency II have been ongoing for a few years and it was clear that, when introduced, they would significantly change and increase the data that insurers would be required to disclose. The FSA, as a response to its urgent need to acquire a more realistic view of the firms' financial position in the complex insurance market it operates, introduced ICAs along with the reporting of realistic balance sheets for large with-profits funds in 2004. At present, this additional valuable knowledge of the financial position of the company does not have to be made public, but this will change with implementation of Solvency II. However, it would have been beneficial to the system to implement suitable data requirements consistent with the complexity of the market had been implemented at an earlier stage.

D. Summary of Observance of the Insurance Core Principles—ROSCs

Table 10 A. Summary of Observance of the Insurance Core Principles—ROSCs

Insurance Core Principle	Grading
ICP1 - Conditions for effective insurance supervision	Observed
ICP2 - Supervisory objectives	Largely Observed
ICP3 - Supervisory authority	Largely Observed
ICP4 - Supervisory process	Observed
ICP5 - Supervisory cooperation and information sharing	Largely Observed
ICP6 - Licensing	Observed
ICP7 - Suitability of persons	Observed
ICP8 - Changes in control and portfolio transfers	Observed
ICP9 - Corporate governance	Observed
ICP10 - Internal controls	Observed
ICP11 - Market analysis	Observed
ICP12 - Reporting to supervisors and off-site monitoring	Observed
ICP13 - On-site inspection	Partially Observed
ICP14 - Preventive and corrective measures	Observed
ICP15 - Enforcement or sanctions	Largely Observed
ICP16 - Winding-up or exit from the market	Observed
ICP17 - Group-wide supervision	Largely Observed
ICP18 - Risk assessment and management	Observed
ICP19 - Insurance activity	Observed
ICP20 - Liabilities	Observed
ICP21 - Investments	Observed
ICP22 - Derivatives and similar commitments	Observed
ICP23 - Capital adequacy and solvency	Largely Observed
ICP24 - Intermediaries	Observed
ICP25 - Consumer protection	Observed
ICP26 - Information, disclosure and transparency toward markets	Partially Observed
ICP27 - Fraud	Observed
ICP28 - Anti-money-laundering, combating the financing of terrorism	Largely Observed

Table 10 B. Summary of Observance of the Insurance Core Principles—Detailed Assessments

Insurance Core Principle	Grading	Comments
ICP1 - Conditions for effective insurance supervision	O	Best international practice in several essential criteria.
ICP2 - Supervisory objectives	LO	The tension between the current objectives and some of the principles of good regulation risk compromising or slowing down prudential action. Although we have seen no direct evidence of this, it can impact the organization's culture. In particular, the requirement for the FSA to have regard to the "desirability to maintain the competitive advantage of the United Kingdom" as well as "the need to minimize the effects on competition" appear to be competing with the market confidence objective and there is no indication of how these two issues are supposed to be balanced. The more recent inclusion of the objective of financial stability is helpful in achieving a re-balance (FSMA does show the primacy of the financial stability objective, as it is a regulatory objective while the principles of good regulation are factors which the FSA 'must have regard to' in discharging its duties (FSMA 2 (3)). However, it would be more helpful if it was made clearer that market confidence and financial stability were the prime prudential objectives with financial innovation and competition secondary. It should also be clarified that market confidence is essentially about financial soundness and prudential regulation. The consumer protection objective is also an important objective, but can often be interpreted as being mostly about fostering an environment in which potential customers can obtain good deals through strong competition. Consumer protection in a prudential regulation context is actually more about maintaining the financial soundness of firms so that they can deliver to customers the promises embodied in their products.

		Clarity on this helps significantly in judging the performance of the prudential regulator.

ICP3 - Supervisory authority	LO	Essential criterion e is not observed as there are no requirements to make public the circumstances in which the Chairman or other Board members could be removed from office. However, in practice arbitrary removal of the Chairman would give rise to strong questioning by parliament as the independence of the FSA is legally established. There is considerable uncertainty around the precise form of the new financial regulatory arrangements and what the remit, culture and supervisory approach of the new financial regulatory bodies is likely to become a destabilizing factor. Some senior insurance staff are leaving and there is a considerable risk that the vacuum thus created will only exacerbate the uncertainty, resulting in more staff losses. Consideration should be given to further strengthening retention of expertise.
ICP4 - Supervisory process	O	Transparency and accountability in the supervisory process are at international levels.
ICP5— Supervisory cooperation and information sharing	LO	Essential criteria g and i are [largely] observed. There are formal requirements for the FSA to consult with other EEA supervisors before taking action in certain scenarios In addition, this policy is embedded in the FSA's ARROW, which supervisors use in relation to all firms (chapter 5, ARROW Toolkit, tool 7 implements how to contact a non-U.K. regulator/supervisory authority for the purposes of ARROW firms work in relation to assessment, mitigation and remedial action). Going forward, the FSA is also engaged in international developments such as: ➢ Solvency II Directive, which will introduce legal obligations for EEA

		supervisors to work together in the supervision of insurance groups to ensure timely cooperation, exchange of information and consultation among them (i.e., the adoption of remedial actions etc). This Directive is expected to be implemented by January 12, 2012; and the IAIS, where we have applied to be a party to the IAIS Multilateral Memorandum of Understanding (MMOU), which will facilitate the exchange of information and cooperation with foreign supervisors (essentially non-EEA regulators).
ICP6— Licensing	O	The licensing requirements are numerous, detailed and transparent. The licensing process is carried out by a central authorizations area within the FSA with input from the firm's assigned FSA supervisors. Assessments of applications are thorough without causing undue delay. There is a risk that the licensing process in the new structure might not be as thorough and consistent.
ICP7— Suitability of persons	O	The U.K. regime for suitability of persons is very strong, with both high requirements and a rigorous approval process. This process has been made more robust after the financial crisis through numerous FSA interviews of candidates for senior roles in insurers. There is a risk that the rigor in this process and the robustness of the suitability of persons' regime may be difficult to preserve in the new structure.
ICP8— Changes in control and portfolio transfers	O	As with authorizations, the United Kingdom has a robust regime for changes of control, which are applied thoroughly and with disregard to external pressure. The current structure allows the FSA to draw on expert staff in dealing with this type of regulatory transaction or other specialist advice (risk, actuaries, and legal) when needed. Processes and requirements are well documented and applied.

		There is a risk that in the new structure access to such specialist staff and robust processes might be challenging.
ICP9— Corporate governance	O	The FSA is very robust in its assessment and treatment of oversight and governance of insurance firms.
ICP10—Internal controls	O	The FSA requirements for insurers to have adequate internal controls are comprehensive and detailed under ARROW. They also make clear that ultimate responsibility lies with the Board of Directors. From viewing a few ARROW packs, it is clear that the FSA robustly assesses internal control mechanisms and requires rectification where these are inadequate.
ICP11—Market analysis	O	Through the establishment and substantial growth of the FSA's Insurance Sector Team, an impressive capability exists to conduct quality market analysis and link it to supervisory objectives and outcomes. There is effective communication to industry and senior people in insurance firms of the industry key risks, issues and trends indentified through these processes. The IST financial analysis reports are primarily based on statutory accounts data, so there is limited reliance on the FSA returns. These reports provide a different perspective to supervisors to complement their review of annual returns. This approach allows the FSA to update the analysis during the year, e.g., on half yearly and quarterly bases. Financial analysis is supplemented by other timely updates on emerging issues, some of which will involve gathering financial data (e.g., a recent motor market survey, and the analysis of and a commentary on reinsurance renewals that is currently underway). Additionally, the IST tracks and monitors external market commentary and analyses and forwards these to relevant areas in supervision and other insurance areas of the FSA on a

		timely basis. Shortening the time to “market” of the IST reports should be considered to make them even more effective.
ICP12—Reporting to supervisors and off-site monitoring	O	There is substantial return information required to be produced, certified, audited, and lodged with the FSA. This has been supplemented with additional required information as needed given the type and size of insurer and as its financial and organizational position changes. While there have been improvements and updates, there has not been a compre-hensive revision of the standard return information required of insurers for a number of years. This is predominantly because EU developments on Solvency II have been ongoing for a few years and it was clear that when introduced they would significantly change and increase the data insurers would be required to lodge with insurance supervisors. It is recommended that the FSA continue to contribute to the finalization of Solvency II data requirements and work now to position itself and its insurers for timely implementation of these data requirements.
ICP13 - On-site inspection	PO	ARROW provides a well-structured approach to risk-based supervision through its use of firm impact ratings, which drive the minimum amount of supervisory work and the firm’s probability rating, which drives the amount of additional supervisory work to deal with identified specific risks and issues in the firm. ARROW therefore is the driver of the amount and type of on-site work that is conducted on an individual insurer. The FSA process for planning on-site reviews and finalizing ARROW assessments is thorough and requires a substantial amount of thinking and challenge from outside the direct supervisory team, including from risk and sector specialists and senior supervisory executives.

		The introduction of the CPPI was a good step toward getting a deeper under-standing of the major life insurers. The CPPI needs to be continued to embed the supervisory analysis and thinking it entails into the processes and expertise of the FSA. It should be extended to a wider range of insurers, but this will need careful adjustment to ensure it is applied proportionately to firms of various impacts, especially in respect of the key financial risks and associated 'deep dives' when applied to general insurers. It will clearly involve extra resources. Some of the on-site reviews related to risks and controls and thematic reviews have examined representative samples of individual transactions (e.g., looking at the underwriting files of some commercial risks in an insurer). Such 'transaction examination' is highly effective in establishing if the control mechanisms around a particular risk are actually working to ensure that the risk is properly managed in accordance with the policy and controls laid down by the insurer. Deep dives or Financial Risk Reviews (FRR) carried out as part of CPPI are not triggered by particular concerns or specific risk drivers, but are carried out periodically. There are seven FRR work streams, one of which looks at intra group exposures and risk transfers and typically reviews key reinsurance treaties in detail. The FRR, which looks at intra group exposures and risk transfers, typically reviews key reinsurance treaties in detail. On the nonlife side, the FSA undertakes file reviews as part of ARROW assessments or on an ad hoc basis. The FSA's use of such 'transaction examination' is sometimes driven from a top-down assessment of inherent risks and any concerns arising from other sources of information (e.g., complaints, risks, and audit reports). The FSA also

		requires firms to commission investigative work from a skilled person (skilled person (FSMA section 166) reports). This can be risk-specific but can also cover more general insurance activity. The FSA's thematic projects often involve file reviews. Some of the on-site inspections are relatively recent, arising from an increase in the intensity of the FSA's supervisory approach. The FSA should ensure that the further development of its approach maintains an emphasis on random 'transaction examinations' (in relevant areas such as underwriting, reinsurance, claims, and even investments) on both the largest insurers and some smaller insurers. This will often bring to the surface unknown (to both the FSA and the insurer) problems, so it is an effective complement to top-down driven examinations. When insurers are aware that the FSA undertakes such examinations, it also becomes a force for keeping insurers on their toes rather than having them concentrate on areas where they think on-site work will occur.
ICP14 - Preventive and corrective measures	O	The FSA processes flowing from ARROW assessments and ongoing supervisory monitoring appear to be adequate to provide confidence that the supervisory action that was decided on is taken, and firm, required actions are followed up. Consideration should be given to developing a more structured framework for the types of remedial action that should generally be considered and taken for each, or at least for the most common, ARROW assessment outcomes. This would assist supervisory staff in deve-loping supervisory responses and, over time, could reduce the reliance on the expertise of the senior people involved in panels and other review mechanisms.
ICP15 - Enforcement or sanctions	LO	Sanctions and enforcement are actively used when needed by the

		FSA to achieve corrective action and to act as a deterrent to others. A wide range of sanctions are available, including variations of permission, directions, fines, public censure, disqualifications, and removal of authorizations. The FSA does not have the power to arrange for a compulsory transfer of the obligations under the policies from a failing insurer to another willing insurer. However, it can facilitate the transfer where appropriate and where there is a willing transferee.
ICP16 - Winding-up or exit from the market	O	There are clear provisions for the exit and winding up of insurers in the United Kingdom. Policyholders have preference in a windup over other creditors except employees. Where ultimately an insurer's claims cannot be paid, the FSCS would compensate eligible claimants (generally individuals and small businesses) for losses up to 90 percent of the value of their insurance contract (100 percent in the case of compulsory insurances).
ICP17 - Group-wide supervision	LO	The FSA supervises insurance groups and financial conglomerates as a supplement to solo supervision of insurers and reinsurers, in accordance with the European Insurance Groups Directive (IGD) and Financial Conglomerates Directive (FCD). Effective requirements exist for group capital, financial reporting, material intra-group transactions and risk and control systems to assess intra-group risks. The FSA leads or participates in supervisory colleges for insurance groups and financial conglomerates and, in recent years, it has taken on its home supervision role in a more intensive way, conducting inspections of branches outside the United Kingdom; thus gaining a better understanding of the whole group operation. The FSA has no direct jurisdiction to supervise unregulated holding companies and needs to operate

		indirectly through the regulated entities thus adding complexity to their supervision and monitoring activities of groups.
ICP18 - Risk assessment and management	O	The recently introduced CPPI, including the deep dives as well as the allocation of more resources, has brought to light additional internal control weaknesses in a few companies. These have been addressed and corrections enforced.
ICP19 - Insurance activity	O	The with-profits business has been under close supervision for several years with respect to all technical aspects, such as reserving and investment strategies, In the last few years, with the increased resources in the supervisory and actuarial areas as well as the introduction of ARROW 2 and CPPI, the FSA has focused more intensively on pricing and underwriting deficiencies. The results and actions taken in the last few to monitor and enforce compliance by insurers with the insurance risk-management requirements have led to the observance of this principle. The authorities are recommended to maintain the momentum and focus on actuarial and supervisory activity in order to be fully compliant with this principle.
ICP20 - Liabilities	O	The reporting forms required by the FSA have added detail and increased the scope of the data in the last few years as a result of the introduction of realistic balance sheets for with-profits business and enhanced capital requirements, using realistic valuations more generally. Individual Capital Adequacy Standards (ICAS) has also introduced risk sensitivity and economic aspects to the valuation of liabilities and technical provisions. Further, if needed, the FSA has successfully requested additional data with higher frequency. The ability to request needed data, together with the additional resources in the actuarial and supervisory areas, allows the FSA to gain a fair understanding of the adequacy of the technical provisions and to take timely action if required.

		Adequacy of liabilities for long-term business needs the opinion of a qualified actuary. This requirement should be extended to the GI liabilities.
ICP21 - Investments	O	The FSA meets all the criteria of this principle.
ICP22 - Derivatives and similar commitments	O	International best practice
ICP23 - Capital adequacy and solvency	LO	As a supplement to the current Solvency I regime, the FSA has introduced resilience capital requirements and realistic balance sheets as pillar 1 requirements and Individual Capital Adequacy assessments as a pillar 2 requirement. These have helped to gain a more risk-sensitive capital level in the industry ahead of the implementation of Solvency II. In paving the way for the implementation of Solvency II, the FSA has been working over the last 18 months with a large team of experts and a substantial budget. The implementation schedule is on target for 2013 and will result in a fully risk-sensitive and robust solvency regime for the United Kingdom, which is expected to lead to full observance of this principle.
ICP24 - Intermediaries	O	Through the FSMA and the implementation the Insurance Mediation Directive (IMD), the FSA authorizes and supervises insurance intermediaries. There are comprehensive and adequate financial resources, competency, systems and controls, client money handling, and customer disclosure requirements placed on intermediaries. Supervision is mostly offsite for smaller intermediaries, but on-site supervision does occur for the larger intermediary firms and through thematic reviews for some smaller intermediaries. The FSA actively used fines, censures, and cancellation of authorizations where needed and to convey what is unacceptable practices. The FSA's Retail

		Distribution Review to address many persistent problems observed in the retail investment market is a strong example of active regulation by the FSA to protect consumers. It will result in increased requirements on insurance intermediaries, which will be more onerous than those in most other countries.
ICP25 - Consumer protection	O	International best practice
ICP26—Information, disclosure and transparency toward markets	PO	The published standard return information has not been comprehensively revised for a number of years, even though it has been updated and improved. This is predominantly because EU developments on Solvency II have been ongoing for a few years and it was clear that, when introduced, they would significantly change and increase the data that insurers would be required to disclose. The FSA, as a response to its urgent need to acquire a more realistic view of the firms' financial position in the complex market it operates, introduced ICAS along with enhanced capital and reporting requirements in 2004. While, enhanced capital requirements for long-term business and realistic balance sheets for large with-profit insurers have been made public, additional valuable knowledge of the financial position from insurers' individual capital assessments under ICAS had to be made public. A modern and risk-sensitive regulation of firms' capitals should require details of the capital held by individual firms to be made public to provide a clearer view of their financial position than that allowed for by Solvency.
ICP27—Fraud	O	The regulation explicitly requires the FSA to take an active role in combating insurance fraud and the FSA has acted accordingly. Several thematic work projects covering fraud have been carried out. Also, the industry is actively engaged in combating fraud, detecting claim

		forms, and investigating cash fraud. Close cooperation and information exchange with enforcement agencies and other supervisors, both locally and internationally, to address fraud to preserve the integrity of the insurance sector are practiced by the FSA. Substantial fines have been imposed, prompting the whole industry to implement corrective action.
ICP28 - Anti-money-laundering, combating the financing of terrorism	LO	The AML-CFT requirements applicable to insurers are broadly in line with the FATF recommendations. While the supervisory system was generally comprehensive for the larger ("high impact" firms), there was less-adequate supervision for smaller firms. In these cases, the risk assessment and resulting level of supervision often relied too heavily on the size of the financial institutions and did not always adequately take AML/CFT risk into account. The AML regulations require that financial institutions must require their branches and subsidiary undertakings located in a non-EEA state to apply to the extent permitted by the law of that state, measures at least equivalent to those set out in the AML regulations with regard to customer due diligence measures, ongoing monitoring and record-keeping. However, no evidence of supervisory work on the compliance of this requirement was presented.
Aggregate: Observed (O)—#, largely observed (LO)—#, partly observed (PO)—#, not observed (No)—#, not applicable (N/A)—#.		

Table 11. Summary of Grading

Observed (O)	19
Largely observed (LO)	7
Partly observed (PO)	2
Not Observed (NO)	0
Total	**28**

E. Recommended Action Plan and Authorities' Response

Recommended action plan

Table 12. The United Kingdom: Recommended Action Plan to Improve Observance of the Insurance Core Principles

Principle	Recommended Action
ICP 2	There is a lack of clarity around how the "desirability to maintain the competitive advantage of the United Kingdom" and how "the need to minimize the effects on competition" are supposed to be taken into account when maintaining market confidence. This could result in compromising or slowing down prudential action, although the assessors have seen no evidence to suggest that this has been a material problem in practice. Clarifying that market confidence (which is meant to be essentially financial soundness) and financial stability and consumer protection are the primary prudential objectives with financial innovation and competition having secondary applicability (and applying essentially to rule making and not supervision) would help significantly in achieving the correct culture within a prudential regulator. Clarity on the role of the consumer protection objective in the context of prudential regulation would help significantly in judging the performance of the prudential regulator.
ICP 3	After a period when staff numbers and expertise increased substantially, some senior insurance staff are leaving and there is a considerable risk that the vacuum thus created will only exacerbate the uncertainty, resulting in more staff losses. Consideration should be given to strengthening the effort to retain expertise. Consider requiring the circumstances in which the Chairman or other Board members of the FSA are removed from office to be made public.
ICP 5	Formalize the requirement for the FSA to consult with other home (or host) supervisors before taking action. The information sharing or consultation should not depend on the relationship with the incumbent supervisor and/or circumstances.
ICP 6, 7 and 8	It is recommended that due regard be given to maintaining the high standards of the currently centralized activities like licensing, fit-and-proper assessments, changes in control, fraud detection, etc., when restructuring the supervisory authority.
ICP 11	Shortening the time to "market" of the Insurance Sector Team's reports should be considered.

Principle	Recommended Action
ICP 12	The FSA should continue to contribute to the finalization of Solvency II data requirements and work now to position itself and its insurers for effective and timely implementation of these data requirements. Shorter lodgment times for data should be considered.
ICP 13	The CPPI needs to be continued so as to embed the supervisory analysis and thinking it entails into the processes and expertise of the FSA. It should be extended to a wider range of insurers, but this will need careful adjustment, to ensure it is applied proportionately to firms of various impacts, especially in respect of the key financial risks and associated 'deep dives' when applied to general insurers. It will clearly involve extra resources. The FSA should ensure that it continues to conduct random 'transaction examinations' (in relevant areas such as underwriting, reinsurance, claims, and even investments) on both the largest insurers and even some smaller insurers on a more random basis as an effective complement to top-down driven examinations in identifying risks.
ICP 15	Consider providing the FSA with the power to arrange for a compulsory transfer of the obligations under the policies from a failing insurer to another willing insurer.
ICP 17	Consider including the regulation on holding companies of insurance groups in the regulatory framework to provide more supervisory authority over them.
ICP 19	The authorities should maintain the momentum and focus on the actuarial and supervisory-intensive activity to assess the adequacy of insurance risk's proper management by insurers and compliance with this principle.
ICP 20	Adequacy of liabilities for insurance business needs the opinion of a qualified actuary. This requirement should be extended to the GI liabilities
ICP 23	The excellent focus and quality of resources dedicated to the Solvency II work needs to continue. The approval of internal models is a crucial step for the insurance industry in this highly specialized and sophisticated market. The models will be complex and only sufficient resources and expertise will allow understanding of the sufficiency of the resulting capital levels to warrant a solvent industry.
ICP 26	A modern and risk-sensitive regulation of firms' capitals should require details of the capital held by individual firms to be made public to provide a clearer view of their financial position than that allowed for by Solvency.
ICP 28	Improve the risk assessment to avoid relying too heavily on the size of the financial institutions and to take AML/CFT risk adequately into account.

Authorities' Response to the Assessment

24. **The U.K. authorities welcome the IMF review of the U.K.'s supervisory and regulatory framework for the insurance sector.** The assessment has come at an important time for the United Kingdom, as the transition to a new regulatory structure begins, and the authorities appreciate this opportunity to comment on the review.

25. **The IMF's assessment recognizes that the U.K's supervisory framework already demonstrates a high level of compliance with the IAIS Core Principles.** Following market turbulence in 2003-04 the FSA strengthened regulation and supervision of the U.K. insurance sector. The review highlights how the FSA has built on those earlier reforms by further increasing the intensity and quality of insurance supervision through many high quality initiatives. The U.K. authorities recognize that there is some way to go to fully implement these new reforms, and agrees with the IMF's conclusion that continuing effective implementation of the programs will further improve the U.K.'s compliance with the core principles.

26. **On the 'onsite inspection' core principle, the IMF recommends that the new supervisory approach should be proportionately extended to a wider range of insurers and to increase the frequency and number of random 'transaction examinations'.** The U.K. authorities will consider these recommendations very carefully in the design of the operating model for the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). However, given the IMF has welcomed the considerable progress that has already been made on this principle**,** the authorities believe that the FSA is closer to compliance than the IMF has concluded.

27. **The assessment also noted the FSA's advanced status in the preparation for implementation of Solvency II, highlighting the "excellent focus and quality of resource" dedicated to this directive.** U.K. authorities will as required implement maximum harmonization of the directive. Therefore all recommendations that are captured by Solvency II will be adopted and any recommendations which are inconsistent with Solvency II will need to be addressed at a European level.

28. **Finally, the authorities wish to express their strong support for the role the FSAP plays in promoting the soundness of global financial systems.** The authorities want the PRA and the FCA to be compliant with international supervisory standards and look forward to a continuing dialogue with the IMF and other global counterparts to seek to improve the stability and effective supervision of the global financial system.

II. Detailed Assessment

Table 13. The United Kingdom: Detailed Assessment of Observance of the Insurance Core Principles

Conditions for Effective Insurance Supervision	
Principle 1.	Conditions for effective insurance supervision Insurance supervision relies upon: - a policy, institutional and legal framework for financial sector supervision; - a well developed and effective financial market infrastructure; and - efficient financial markets.
Description	A framework for financial stability was set out in the 1997 Memorandum of Understanding (MOU) between HM Treasury (HMT), the Bank of England (BoE), and the FSA—a publicly available document. The MOU sets out the role of each institution and explains how they will work together toward the common objective of financial stability. The division of responsibilities is based on four guiding principles: • clear accountability—each institution has unambiguous and well-defined responsibilities and is responsible for its actions in respect of these; • transparency (to parliament, the markets, and the public); • no duplication; and • regular information exchange. While the BoE is responsible for the overall stability of the financial system as a whole, the MOU establishes a high-level financial stability Standing Committee that meets monthly to discuss individual cases of significance or other developments relevant to financial stability. Meetings can be called at other times by one of the participating institutions if there is an issue that needs to be addressed urgently. HMT is responsible for the overall institutional structure of financial sector regulation and the legislation that governs it. The Financial Services and Markets Act 2000 (FSMA) provides the legal underpinning for the regulation of financial services and markets. Other key provisions concerning the scope of regulation, including the activities that fail to be regulated, are set out in secondary legislation made under the FSMA. The U.K. legal system is based on case law and domestic and EU legislation. As the United Kingdom has no written constitution, parliament is the supreme domestic law-making body; however, as a general principle, EU law overrides domestic law under the Treaty of Rome. EU directives agreed by the Council of Ministers and the European Parliament must usually be implemented into national law by member states. The United Kingdom's highly developed judicial system has a reputation for probity and professionalism. Civil commercial matters, including insurance disputes, are normally heard in one of the divisions of the high court, with appeals heard in the court of appeal. The highest court in the EU sphere is the European court of Justice and it has similar professional standing to the English upper courts. The long history of insurance actions and settlements in the United Kingdom means there is a substantial body of insurance case law and considerable experience, both within the judiciary and on the practitioners' side, of addressing complex insurance law disputes. The Institute and Faculty of Actuaries is now the combined professional body for U.K. actuaries. It has the Actuaries' Code, which applies at all times to members'

	conduct in their work as actuaries. The code consists of principles which members are expected to observe in the public interest and in order to build and promote confidence in the work of actuaries and in the actuarial profession. The code will be taken into account if a member's conduct is called into question for the purposes of professional disciplinary schemes. From May 2006, the Board for Actuarial Standards (BAS), which is an operating body of the Financial Reporting Council (FRC), and sets and maintains technical actuarial standards, while the professional body sets and maintains ethical standards. Actuaries have statutory roles in respect of life insurance and in relation to Lloyds syndicates. General insurance firms now invariably use actuaries in setting their claims reserves. Actuaries are now used more broadly and they perform a key function in the financial control and risk management of insurance firms. There are more than 20,000 members of the U.K. actuarial profession, with around 10,000 Fellows (those fully qualified to perform statutory type roles). The FRC also has the Accounting Standards Board (ASB) and the Auditing Practices Board (APB) as operating bodies, which are responsible for accounting standards and auditing practices, respectively. Another operating body of the FRC is the Accountancy and Actuarial Discipline Board (AADB), which is the independent, investigative, and disciplinary body for accountants and actuaries in the United Kingdom. The accounting, actuarial, and auditing standards are publicly available on the relevant organization's website and they are commensurate with international standards. The Office of National Statistics produces a variety of economic, social, and financial statistics, which are readily available on the internet. The BoE publishes a Financial Stability Report in June and December each year, which gives an overview of the key developments affecting the U.K. financial system. In April 2010, parliament passed the Financial Services Act 2010, which expanded the FSA's powers, and, in some cases, created new ones. EU legislation is responsive to changing circumstances in the insurance markets and to financial services more generally. EU Directives must be implemented into domestic law within the designated timeframe. The money and securities markets in the United Kingdom are amongst the most developed throughout the world, so the types of investments available are considerable and readily accessible.
Assessment	Observed
Comments	The conditions for effective supervision are adequately met—reflecting the highly developed legal system, institutional framework, financial markets, and long-standing insurance market. As part of the European Union, the United Kingdom must respond to EU directives. Solvency II, in particular, is changing very substantially the approach to insurance supervision. The United Kingdom has been heavily involved in developing Solvency II requirements and has positioned itself well for effective implementation. Also, international developments in financial regulation have been moving more rapidly since the financial crisis and the United Kingdom is heavily involved in contributing to these. However, reliance on EU and international developments as the prime drivers for change risks missing changes that are needed due to local market weaknesses or developments.

<table>
<tr><th colspan="2">The Supervisory System</th></tr>
<tr><td>Principle 2.</td><td>Supervisory objectives

The principal objectives of insurance supervision are clearly defined.</td></tr>
<tr><td>Description</td><td>The Financial Services and Markets Act 2000 (FSMA) is the primary piece of legislation for U.K. financial sector regulation. The FSA was created by the FSMA as the U.K.’s financial services regulator and derives its powers and functions from the FSMA. Rules and guidance made in the FSA Handbook are made by powers found in the FSMA. The insurance sector is part of the financial services sector and therefore it falls within the remit of the FSA. The FSA has been the sole regulator of general insurance business since January 2005, when it began to regulate insurance intermediaries.
The FSMA sets out the responsibilities and duties to which the FSA must adhere when carrying out its functions. The FSMA stipulates that the FSA must act in a manner that is compatible with its regulatory objectives, which are:

• Market confidence—confidence in financial markets and exchanges;
• Consumer protection;
• The reduction of financial crime—particularly as regards money laundering, fraud and insider dealing; and
• Financial stability—This is a new power created by the Financial Services Act 2010. It gives the FSA the new objective of contributing to the protection and enhancement of U.K. financial stability. The Act requires the FSA to cooperate with the treasury, the BoE, and other relevant bodies in pursuing this objective. Additionally, the Act requires the FSA to have a financial stability strategy, which must be reviewed regularly.

The regulatory objective of public awareness was removed by the Financial Services Act 2010, which required the FSA to set up an independent body to take on consumer education work. The Consumer Financial Education Body (CFEB) was established in April 2010.
In discharging its general functions, the FSA is also required to have regard to the matters (“principles of good regulation”) specified in FSMA Section 2(3), such as:
• the need to use its resources in the most efficient and economic way;
• the responsibility of those who manage the affairs of authorized persons;
• the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, in general terms, which are expected to result from the imposition of that burden or restriction;
• the desirability of facilitating innovation in connection with the regulated activities;
• the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;
• the need to minimize the adverse effects on competition that may arise from anything done in the discharge of those functions;
• the desirability of facilitating competition between those who are subject to any form of regulation by the FSA; and
• the desirability of enhancing the understanding and knowledge of members of the public of financial matters (including the U.K. financial system).</td></tr>
</table>

	The FSA's process for establishing priorities and for its accountability is built round three documents: its Financial Risk Outlook, Business Plan and Annual Report. In January each year, the FSA publishes its Financial Risk Outlook, which is its assessment of the principal external risks to meeting the four statutory objectives of financial stability, market confidence, consumer protection and reducing financial crime. This sets out what the FSA judges those risks to be, and how it plans to mitigate and manage them. The FSA's Business Plan for the next year, also published in January, sets out the FSA's main programs aimed at delivering its four statutory objectives. The business plan sets out under each of these objectives the FSA's main programs with the target dates by quarter for achieving the programs. The FSA's Annual Report, published in June, enables a comparison to be made of the previous year's program targets with actual outcomes and considers the reports of the Consumer, Practitioner, and Small Business Practitioner Panels and of the Complaints Commissioner. It also provides a factual and objective basis for the FSA's Annual Meeting. Under section 8 of FSMA, the FSA must make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties. On insurance related issues, the FSA would consult with the Consumer Panel, the Practitioner Panel, the Small Business Practitioner Panel in addition to private industry members and trade bodies. This consultation allows the FSA to explain in detail how it is using its powers to meet and balance its statutory objectives.
Assessment	Largely observed
Comments	While there is clarity in the statutory objectives, it is necessary to clarify which prudential objectives are the primary ones and which are the secondary. The principles of good regulation refer to maintaining the competitive position of the United Kingdom and to facilitating competition. Thus, it is unclear where the desired balance between the important objectives of financial stability and market confidence (which is meant to be essentially financial soundness) on the one hand, and competition on the other hand, should lie. The supervisory approach of the FSA in its earlier years and its public statements indicate that financial sector firms were given considerable freedom to compete in the market, with the FSA only intervening when problems arose. The more recent inclusion of the objective of financial stability is helpful in achieving a rebalance, but it would be more helpful if it was made clearer that market confidence and financial stability were the primary prudential objectives with financial innovation and competition secondary. Clarity on this would help significantly in achieving the correct culture within a prudential regulator. Consumer protection is also an important objective, but can often be interpreted as being mostly about fostering an environment in which potential customers can obtain good deals through strong competition. Consumer protection in a prudential regulation context is actually more about maintaining the financial soundness of firms, so that they can actually deliver to customers the promises embodied in their products. For more complex financial products and the more complex financial firms, prudential regulation exists as the customers are often not in a position to make informed judgment about a firm's financial soundness or its ability to deliver on specific product promises. In some financial products the promises are clear, but in others the promises can be more aligned to firms using best endeavors to

	deliver and treating customers fairly in doing so. Clarity on this helps significantly in judging the performance of the prudential regulator.
Principle 3.	Supervisory authority The supervisory authority: • has adequate powers, legal protection and financial resources to exercise its functions and powers; • is operationally independent and accountable in the exercise of its functions and powers; • hires, trains and maintains sufficient staff with high professional standards; and • treats confidential information appropriately.
Description	The FSMA created the FSA as the regulator of the financial services sector, which covers insurance. In particular, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended, sets out those activities—including insurance—for which the FSA is the regulator. The rules and guidance made in the FSA Handbook are made by powers found in the FSMA.

	Under the FSMA, the FSA has the powers to take action such as: • withdraw a firm's authorization; discipline authorized firms and people approved by the FSA to work in those firms; • interview people and require production of documents; • impose penalties for market abuse; • apply to the court for injunction and restitution orders; • prosecute various offences; and • investigate people who are carrying on regulated activities without authorization. The FSA functions as a public authority by virtue of the statutory powers granted by the FSMA. It is set up as a private company limited by guarantee and it has complete operational independence. Section 7 of the FSMA places a duty on the FSA to have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it. The FSA Board deals essentially with regulatory policy issues and so changes to rules and guidance are approved by the Board, whereas supervisory decisions related to individual firms and persons are essentially taken by FSA management and staff. Committees of the FSA Board related to governance include the Audit Committee, Remuneration Committee, Risk Committee and Committee of the Nonexecutive Directors. There is a Regulatory Decisions Committee (RDC) that takes those enforcement, authorization and supervisory decisions that are of material significance for the firms and individuals concerned. The RDC is a Committee of the FSA Board and reports directly to the Board. The Board appointed the RDC Chairman and members, who represent the public interest and are drawn from practitioners and nonpractitioners. FSMA Schedule 1 includes details of the FSA's constitution; this includes a

	requirement (Schedule 1 paragraph 2) that the Chairman and other members (Executive and Nonexecutive members) of the FSA's Board must be appointed, and be liable to removal from office, by HMT. The HMT determines the contractual terms of the appointments, but FSA Directors must be able to act independently in the discharge of their Board duties. Removal of any Board member by HMT must be in accordance with the terms of their appointment. The requirements do not include provisions detailing the circumstances in which the Chairman or other Board members could be removed from office. Major regulatory decisions regarding potential infringements are made by the RDC on behalf of the Board. Where there are disputes between the FSA and the firms or individuals it regulates regarding a regulatory decision, the FSA has made, the matter can be referred to the Upper Tribunal (Tax and Chancery Chamber). The Upper Tribunal is an independent judicial body established by the Tribunals, courts and Enforcement Act 2007. The Tax and Chancery Chamber hears references arising from certain decisions and supervisory notices issued by the FSA. It can reconsider the relevant issues and can order the FSA to take appropriate action. All of the FSA's rules and practices are subject to competition scrutiny by the Office of Fair Trading (OFT). The OFT reports to the Competition Commission if the rules or practices have a significant anti-competitive effect. The MoU between HMT, the BoE, and the FSA sets out the division of responsibilities between these institutions and their accountability. The FSA is an independent body which funds itself by charging fees to all authorized firms that carry out activities it regulates, as well as other bodies such as recognized investment exchanges. The FSA charges firms: • periodic fees (paid yearly), which provide most of the funding needed to carry out its statutory functions; • application fees, which recover some of the costs incurred in processing certain applications under the FSA rules or FSMA; and • special project fees: (i) where the FSA undertakes regulatory activity at the request of fee-payers, and the benefit of that activity primarily accrues to them; and (ii) the FSA recovers the implementation costs of significant EU Directives where they apply to a discrete sub-set of firms within their periodic fee structure. Paragraph 17, Schedule 1 of FSMA sets out the FSA's power to charge these fees. In making such rules the FSA is required to follow the consultation procedures in FSMA (Section 155). The FSMA also gives the FSA the power to maintain sufficient reserves. The FSA can allocate its resources as it deems appropriate by reference to its four statutory objectives. The Financial Risk Outlook contains the FSA's assessment of the principal external risks to meeting its objectives, and its annual business plan sets out how it plans to mitigate and manage those risks. The FSA's regulatory processes are set out in three manuals forming part of the Authority's Handbook of rules and guidance: • the Supervision manual sets out the relationship between the FSA and

	authorized firms and persons; • the Enforcement Guide describes the FSA's enforcement powers under the FSMA and sets out the authority's policies regarding the use of its enforcement powers to ensure a focused, proportionate and consistent approach to regulatory enforcement; and • the Decisions Procedure and Penalties manual is a description of the FSA's procedures for taking statutory notice decisions, the FSA's policy on the imposition and amount of penalties, and the conduct of regulatory interviews. HMT is responsible for the overall institutional structure of financial services regulation and the legislation which governs it, including the negotiation of EC Directives. It consults on changes to the legal framework. The FSA is under a general duty to make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties (section 8 FSMA). These arrangements include the requirement to establish a Practitioner Panel and a Consumer Panel. More specifically, section 155 FSMA requires the FSA to first consult, publishing a draft of the rules accompanied by: • a cost-benefit analysis; • an explanation of the purpose of the proposed rules; • an explanation of the authority's reasons for believing that making the proposed rules is compatible with its general duties; and • a notice that representations about the proposals may be made to the FSA within a specified time before proposing to make any rules. The FSA has established a Small Businesses Practitioners Panel. The Panel represents the views and interests of smaller regulated firms and provides advice to the FSA on its policies and strategic development of financial services regulation. Its work has a specific focus on cost and practicability issues, and it also has a remit to comment—from a small business perspective—on any specific FSA output as it wishes. Senior FSA people regularly make statements at conferences and meetings explaining the FSA's objectives and approach. In addition, the FSA is required to hold a public meeting no later than three months after producing its Annual Report, so that the report can be considered. The meeting must allow for a general discussion of the contents of the report and a reasonable opportunity for those attending to place questions to the FSA about the discharge of its duties. The FSMA (Section 391(4)) states that where the FSA issues a final notice on taking enforcement action, it must publish such information about the matter. The FSMA grants the FSA wide powers to take action against insurance firms that do not comply with the requirements set out in the Act, secondary legislation under the FSMA and the rules set out in the FSA Handbook. The FSA can apply for an injunction where a requirement imposed by FSMA or any other Act for which the FSA has enforcement powers, is being contravened or is likely to be contravened. The FSA can vary an authorized firm's or person's permission to carry on regulated activities by:

	• adding a regulated activity to those for which it gives permission; • removing a regulated activity from those for which it has given permission; • varying the description of a regulated activity for which it gives permission; and • cancelling a requirement imposed under section 43 of FSMA (to require the authorized person [insurer] to take a specified action or require the authorized person to refrain from taking a specified action. The FSA can vary the insurer's permission in the ways mentioned above or cancel it if the insurer is failing or likely to fail to satisfy the threshold conditions; or it has failed, during a period of at least 12 months, to carry on a regulated activity for which it has permission; or it is desirable to exercise that power in order to protect the interests of consumers or potential consumers. Chapter 4 of the Decisions, Procedures and Penalties Manual sets out the FSA's procedures for taking regulatory decisions for dealing with cases where urgent or exceptionally urgent action is required. As an independent body, the FSA sets its own budget. Income is from fees charged on all authorized firms and persons, as well as other bodies such as recognized investment exchanges. The FSA total expenditure has increased dramatically from around £300 million in 2007/08 to almost £400 million in 2009/10 and is budgeted to reach almost £500 million in 2011/12. The increases are predominantly in staff (around 2,500 in early 2008 to nearly 3,900 today) and accommodation costs, but also in respect of information technology costs and the use of outside professionals. The FSA has the ability to offer remuneration and benefit packages to recruit and retain highly qualified staff, with salaries paid by the FSA not substantially out of line with pay levels within the financial services industry. Recruited staff comes from a variety of sources, with large numbers from the financial services industry. The authority offers a range of internal and external training opportunities for its staff. The FSA's Training and Competence Scheme (T&C) is a framework for assessing the competence of individuals on the job and delivering the needed training. There are defined standards of what individuals need to know and do in order to perform in specified roles. Accountability for assessment and training rests with line managers and is achieved via performance reviews of staff, an annual assertion of competence and learning and development plans. The Supervisory Enhancement Program (SEP) was set up to address the recommendations of the FSA's Northern Rock Internal Audit Report. The FSA produces annual audited accounts, in compliance with U.K. company law. The FSA expects that its staff will observe the highest professional standards at all times and addresses issues of skills and experience through its training and recruitment programs. The FSA's Risk Division includes numerous specialist teams to cover risk types and other specialist functions. The FSA has been able to retain and recruit adequate and highly skilled staff to supplement direct supervisory staff, where there has also been a campaign over the last two years to recruit relationship managers (especially into wholesale, major retail groups and retail firms). The FSMA provides that neither the FSA nor any member of its staff is to be liable for damages for anything done or omitted in the discharge, or purported discharge,

	of the FSA's functions. The FSA indemnifies its employees and anyone who is seconded to the FSA or is otherwise acting as a member of its employees against any liability that they incur in connection with claims or proceedings brought against them in relation to anything done or not done when working for the FSA. However, this protection does not apply if the act or omission is shown to have been in bad faith or so as to prevent an award of damages if unlawful under Section 6(1) of the Human Rights Act 1998. The FSA has a Code of Conduct, administered by an Ethics Officer, applicable to all staff. The Code includes provisions detailing the management of conflicts of interest, for example in relation to dealing in shares or investing in supervised entities. Furthermore, the FSA's General Counsel Division (GCD) has issued guidance, which is easily accessible on the organization's intranet, regarding confidentiality and the circumstances in which employees may, in the course of their duties and for regulatory and other purposes, disclose confidential information. The FSA is able to hire or contract external specialists, and has a specific power to appoint one or more competent persons to conduct investigations on its behalf. Firms can also be required to provide the FSA with specified reports by "skilled persons" nominated or approved by the authority, and appearing to the FSA to have the skills necessary to make a report on the matter concerned. Supervisory responsibility remains with the FSA. The FSA also uses outside experts to deal with peaks and troughs in nonregular supervision work. Section 348(1) of FSMA prevents the FSA from disclosing confidential information unless a gateway applies. If the FSA does not have a gateway, the FSA is not permitted to release confidential information without the consent of the person who provided the FSA with the information and the person to whom the information relates (if they are not one and the same). Section 348(2) defines confidential information as information which relates to the business affairs of any person and which was received by the FSA in the discharge of its functions. A gateway is an exception to the FSA's duty of confidentiality, which allows the FSA to disclose confidential information in certain circumstances, such as where the information is going to other EEA regulators. A full list of the gateways can be found in the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188) ["the Disclosure Regulations]. External specialists engaged by the FSA must sign an FSA Code of Conduct before commencing activities. A section in that Code deals with maintaining absolute confidentiality on FSA affairs, including the firms and individuals the FSA regulates.
Assessment	Largely Observed
Comments	As would be expected of the financial services regulator responsible for the regulation and supervision of a highly developed, large, and diverse financial market as the United Kingdom, the FSA has adequate powers and protections to exercise its functions. It also has a very high degree of operational independence, but is subject to numerous and adequate accountability mechanisms so that it has to demonstrate the appropriateness and effectiveness of the exercising of its powers and functions. Clearly, the FSA has been able to react to the financial crisis and the exposed shortcomings of its 'light touch' approach by increasing resources as it has

	intensified its supervision. The FSA has clearly demonstrated over the last few years its ability to increase its budget and obtain significant numbers of qualified and experienced and specialist staff. Over the last two years, the FSA has been able to recruit significant numbers of actuaries for its life and general insurance actuarial teams, but also to dramatically increase its actuarial modeling expertise, which is needed for its implementation of Solvency II. Insurance supervisory staff increases have been substantial with many experienced industry people being attracted to the FSA. The current level of uncertainty around the precise form of the new financial regulatory arrangements and the remit, culture, and supervisory approach of the new financial regulatory bodies could be a destabilizing factor. Some senior insurance staff are leaving and there is a considerable risk that the vacuum thus created will only exacerbate the uncertainty, resulting in more staff losses. Consideration should be given to further strengthening the retention of expertise. The lack of a formal requirement to detail the circumstances in which the Chairman or other Board members could be removed from office does not meet one of the essential criteria and is the main reason for the Largely Observed rating.
Principle 4.	Supervisory process The supervisory authority conducts its functions in a transparent and accountable manner.
Description	Sections 152-156 of FSMA set out clear procedures for the FSA when exercising its rule-making power. The FSA has set up a rigorous internal process for drafting and making rules and guidance on rules. Any new or revised rules and guidance are subject to public consultation, which usually involves discussion papers, consultation papers, feedback statements, and policy statements. The FSA Handbook of rules and guidance is updated regularly in order to respond to market conditions and regulatory requirements quickly. All the regulated firms are provided with a copy of the Handbook (with updates). The consolidated Handbook is also available to the public via the FSA website, along with other FSA publications and consumer information. The FSA Register is a public record of financial services firms, individuals, and other bodies which fall under its regulatory jurisdiction as defined in the FSMA and the Money Laundering Regulations 2007. It has information on all authorized firms currently doing business in the United Kingdom and the individuals within firms who are authorized to carry out a particular function. It includes U.K. authorized firms and firms authorized in another European Economic Area (EEA) state that conducts business in the United Kingdom. It can also be accessed through the website and appears alongside full information on the role and responsibilities of the FSA. Within the FSA, many regulatory and administrative decisions are not the sole province of individual supervisors. There are a range of internal panels and committees that become involved in vetting or giving prior approval of supervision activity in order to ensure its effectiveness, but also to ensure its consistent application. Taking account of the size, scale, and nature of the firm is common in much of the FSA requirements and internal manuals, so one size does not fit all, but judgment is employed to achieve consistency across similar firms. The FSA is required to maintain a complaints scheme for the investigation of

	complaints arising from the exercise of its functions, and there is an independent person appointed as the Complaints Commissioner to conduct investigations into complaints. The Upper Tribunal (Tax and Chancery Chamber) deals with referrals from firms and individuals on matters related to authorizations and permissions, penalties, disciplinary matters, and official listings. In deciding a case, the Tribunal may uphold the FSA's decision, may direct the FSA not to take the action which was the subject of the decision referred or may direct the FSA, within certain limits, to take different action. The Tribunal may also make recommendations about the FSA's regulating provisions and procedures. Decisions by the FSA are also subject to judicial review.
Assessment	Observed
Comments	There is an enormous amount of information on the FSA's website about its role, how it proposes to undertake its role, and how it has in fact performed against its plans. Even with the FSA's many and varying powers and consequential internal panel and committee mechanisms to achieve consistency, decision making appears to occur quickly once a supervisory need is evident. There is a leaflet, easily accessible on the FSA's website, which details the enforcement process, including on appealing decisions made by the FSA. When the FSA issues a Supervisory Warning or Decision Notice, it includes information on how to appeal the decision. In combination, the FSA's Financial Risk Outlook, Business Plan and Annual Report adequately cover the conduct of its policy and the explanation of its objectives and how performance against them is pursued. The Financial Risk Outlook does list on a regular basis the risks facing the financial sector and customers and major developments in the financial and insurance markets.
Principle 5.	Supervisory cooperation and information sharing The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.
Description	The FSA's policy is to deliver effective supervision of cross-border businesses, recognizing the importance of home and host supervisors working in tandem for this purpose. The implementation of the Solvency II Directive (expected by January 1, 2013) will introduce further obligations for European supervisors to work together in the supervision of insurance groups. The FSA recognizes that achieving strong relationships with supervisors is crucial and will take time. College networks are the FSA's desired mechanism for promoting the timely exchange of information, discussing supervisory plans and identifying opportunities for joint work, sharing analysis of potential macroeconomic vulnerabilities to/from the firm, and agreeing how supervisors would work together in a crisis situation. For European colleges, the FSA is working to follow the requirements in the Solvency II Directive, level 2 measures and EIOPA guidance. In colleges for non-European firms, the FSA seeks to do this on a more informal basis by engaging all relevant foreign supervisors. The FSA runs supervisory colleges for its eight largest cross-border insurers.

	For firms that do not have colleges, the FSA works to maintain contact with the relevant supervisors on a more informal and ad hoc basis to share information at key stages and if any issues arise. Given the size and sophistication of the U.K. insurance market, the FSA receives information requests more than it sends them. The ARROW is the FSA's risk-based approach to supervision, which supervisors use in relation to all firms—regardless of whether they are domestic or international. The ARROW includes the exchange of information as one of its policies. Formal agreements to exchange information are not required where EEA supervisors are involved. For this purpose, the FSA is party to two multilateral protocols dealing with cooperation and information exchange within the EEA in respect of insurers (General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union) and insurance groups supervision (Helsinki Protocol). This will be enhanced when the Solvency II Directive is implemented. In respect of non-EEA supervisors, a cooperation agreement would normally be required before confidential information could be exchanged. This involves determining if there is a legal gateway to share confidential information at least equivalent to that imposed on the FSA by the EU single-market directives. The FSA also consider materiality (is there sufficient cross-border business) and reliance (the supervisor's ability to share, credibility and track record) before establishing a formal memorandum of understanding. While the FSA is not yet a signatory to the IAIS Multilateral Memorandum of Understanding (MMoU) it has bilateral MoUs in place with a number of foreign supervisors responsible for insurance supervision. These include such supervisors in Australia, Bermuda, Canada, Hong Kong, Korea, Singapore, Taiwan, Switzerland, and the U.S. States of Florida, Maryland, Michigan, Nebraska, and New York. However, in times of crisis, the FSA can use the so-called 'self-help gateway' that allows the FSA to disclose confidential information to another supervisor for the purpose of enabling or assisting the FSA to discharge any of its public functions. The use of this gateway must not be in breach of any of the confidentiality regimes in the EU single-market directives. In practice, the FSA has been proactive in providing information on firms to supervisors on which it can place reliance as a result of its Home Country Supervisory Assessments. It has been less proactive in relation to supervisors on which it cannot place similar reliance, but has provided information on firms on an ad-hoc basis to such foreign supervisors. Where the FSA passes on confidential information, it can put restrictions on the use of the confidential information by another supervisor and it can require that the other supervisor does not use the information in breach of any restriction without the consent of the FSA. This is its practice even though it is not required to impose such restrictions. There are formal requirements (FSMA 2000(Consultation with Competent Authorities) Regulations 2001 for the FSA to consult other EEA regulators where it proposes to take action that constitutes a major sanction or exceptional measure and the action is of importance for the supervisory tasks of the home-state regulator. In certain scenarios, including where there is an urgent need to act, the

	FSA may inform the home-state regulator as soon as reasonably practicable. There are also formal requirements requiring FSA to consult relevant EEA regulators in respect of applications for changes in control. However, there is no overall requirement for the FSA to consult or inform the other supervisor if it is necessary to adopt remedial action based on the information provided by the other supervisor. Nor does the FSA have to inform the host supervisor before taking any action or making material changes in supervision that will affect the local office of the foreign establishment in the host jurisdiction. However, where possible, the FSA's practice is to consult host supervisors that in the context of home/host approach to supervision and in colleges.
Assessment	[Largely] Observed
	The FSA's policy is to share information to ensure an efficient and effective supervision of the relevant firm or group, including communicating its overall supervisory view of the firm and key messages from the risk assessment of the firm. The FSA's practice does not require strict reciprocity in terms of the level, format, and detailed characteristics of the information exchanged. When providing confidential information, the FSA is not required to impose restrictions so that the information is treated confidentially and used only for supervisory purposes. The FSA has the power to do this and, in practice, does so. Supervisory colleges for cross-border insurance firms have been developing and the FSA both runs such colleges as the lead supervisor and participates in others. Further development of supervisory college work should occur to ensure it is commonplace for college participants to all be aware of the FSA's comprehensive supervisory view of an insurer firm.
Comments	There are formal requirements for the FSA to consult with other EEA supervisors before taking action or approving changes in the control of certain scenarios. However, there is no formal requirement for the FSA to consult with other home (or host) supervisors before taking action. The information sharing or consultation will depend on the relationship with the incumbent supervisor and/ or circumstances.
The Supervised Entity	
Principle 6.	Licensing An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.
Description	The FSMA (Regulated Activities) Order 2001 (RAO) sets out activities that are regulated for the purpose of the FSMA. These activities include effecting and carrying out a contract of insurance as a principal. What constitutes the regulated activities of effecting and carrying out of contracts of insurance is, ultimately, for the courts to determine, but there is a large body of existing case law. Schedule 1 of the RAO sets out distinct classes of what are contracts of general insurance (Part I) and what are contracts of long-term assurance (Part II). The FSMA (Section 19) provides that no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is an authorized person or an exempt person. Persons are exempt essentially if they are authorized representatives of firms authorized to carry on a regulated activity. So all firms intending to conduct insurance business in the United Kingdom must apply to and receive authorization from the FSA. The Glossary of the FSA Handbook defines insurer as a firm with permission to effect or carry out contracts of insurance. The

	FSA can vary or cancel permissions after they have been given its authorization. Under EU law, insurers authorized to conduct insurance business in an EEA member state can conduct business in another EEA state without needing to satisfy the host-state's own prudential requirements. This is called EU passporting. The passporting insurer has to satisfy the host regulator's notification requirements, so that the host regulator can inform the insurer of the conditions under which it can conduct business before it commences. The promotion of insurance contracts in the United Kingdom is a regulated activity. Under FSMA requirements for nonpassporting firms, the FSA must ensure that applicants will satisfy and continue to satisfy the "threshold conditions" set out in Schedule 6 of the FSMA in relation to all regulated activities for which they will have permission. The Threshold Conditions (detailed in the FSA Handbook) represent a framework against which an applicant is thoroughly assessed on all relevant criteria, and for insurers they cover: • appropriate legal status—body corporate, registered friendly society, member of Lloyds or EEA state-authorized insurer; • location of offices—U.K. corporate entities must have a head office or a registered office in the United Kingdom; • close links to other persons, especially in third-party countries, must not prevent proper FSA supervision; • adequate financial and nonfinancial resources—quality, quantity, and availability of resources must be adequate; • adequate systems and controls; and • suitability—integrity and competence of senior management, directors, and controllers, and the applicant's regulatory history and necessary internal procedures, controls, and risk assessments to ensure compliance with all applicable regulatory requirements.

	The FSA also considers whether the applicant is ready, willing, and organized to comply with the regulatory requirements to which it will be subject if it is granted permission. In particular the FSA will assess: • the firm's ability to comply with the obligations in the FSA's Senior Management Arrangements, Systems and Controls Sourcebook (SYSC); • the firm's ability to comply with the requirements in the General Prudential Sourcebook, the Prudential Sourcebook for Insurers and the Prudential Sourcebook for Mortgage and Home Finance Firms and Insurance Intermediaries. Chapter 9 of the Interim Prudential sourcebook for Insurers (IPRU(INS) 9), the Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC)); • whether the other members of the applicant-firm's group pose a risk to the adequacy of the applicant firm's resources; and • whether the firm has adequate anti money laundering systems and staff training in place. Where the applicant firm is a non-EEA firm wishing to conduct insurance business in the United Kingdom, the FSA can stipulate that additional threshold conditions be met in order to be authorized. Detailed provisions on the authorization process to be followed by the FSA are set out in the FSMA (Parts II, III and IV) and the Handbook. The documents which the FSA requires to be submitted at the time of application are set out in detail in the application pack. As part of its application for permission, an applicant is required in Section A3 of the application to submit a regulatory business plan, including three year financial projections. In the application for permission, an insurance company, as part of its business plan, will be required to provide information on its proposed products, the obligations it proposes to incur, the nature of risks covered, its insurance and reinsurance program, set-up costs, financial resources, projected business and capital development, including solvency margins and details of its auditors/reporting accountants. The FSMA sets out criteria for determining whether a person may perform a Controlled Function as an Approved Person. Any outsourced performance of Controlled Functions must be approved by the FSA. The requirements are set out in Chapter IV of the Supervision Manual. Information from other regulators is taken into account in coming to a judgment on an application for the authorization to conduct insurance business. Permission to carry on both long-term and general insurance business is not granted unless the applicant's business will be restricted to reinsurance, a company's ability to do so has been grandfathered, or the applicant's general insurance business will be restricted to accident or sickness contracts (or both). In such cases, risks are required to be handled separately. • Under the FSMA, the FSA may limit the permitted regulated activities or require specific action (e.g. additional capital, specific director appointments) or it may simply refuse an application. The FSA is subject to a six-month statutory deadline for determining applications for authorization. However, the FSA's published service standard is to determine

	70 percent of applications within 16 weeks. A warning notice is issued if it is proposed that an authorization be refused, and representations can be made by the applicant. A subsequent decision notice to refuse authorization can be appealed to the Upper Tribunal (Tax and Chancery Chamber). If it appears to the FSA that an authorized person is failing, or is likely to fail, to satisfy the threshold conditions, then the FSA may vary or cancel that person's permission. The FSA Handbook requires an authorized firm to notify the FSA immediately it becomes aware that it may fail to satisfy one or more of the threshold conditions.
Assessment	Observed
Comments	The licensing requirements are numerous, detailed, and transparent. The licensing process is carried out by a central authorizations area within the FSA with input from the firm's assigned FSA supervisors. Assessments of applications are thorough without causing undue delay. There is a risk that the licensing process in the new structure might not be as thorough and consistent.
Principle 7.	Suitability of persons The significant owners, Board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfill their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.
Description	The FSA defines controlled functions as those which have a particular regulatory significance and they are referred to as **significant influence functions** or 'SIFs.' They cover Board members, senior executives, auditors, and actuaries. In order to be approved to perform a controlled function, an individual must satisfy the FSA that he/she can meet the criteria for approval (the 'fit and proper test' (FIT)). This is based on the individual's honesty, integrity and reputation; competence and capability; and financial soundness. Once approved, individuals must maintain their fitness and propriety—their competence is liable to be critically reviewed on an ongoing basis as part of the FSA's normal supervisory process. If any person is no longer deemed to be fit and proper, the FSA has the power to withdraw an approved person's permission to carry out a controlled function. The insurer makes the application to the FSA for approval of a candidate, is responsible for ensuring that the candidate is fit and proper for the role in question, and must undertake their own sufficient due diligence on the candidate. Application details normally include: • responsibilities that the role involves and the competencies that it requires; • recruitment, referencing, interviewing, and appointment processes; • due diligence undertaken by the firm to ensure the candidate is fit and proper; • the firm's rationale for concluding that the candidate is fit and proper to perform the role in question, including an assessment of the competence of the candidate and information about any action to be taken post-appointment to address any developmental gaps or training needs that have been identified; and • supporting documentation or reports from third parties, such as a head-hunter, or other similar reports.

	The FSA's assessment of a candidate includes 'intelligence' checks, such as credit checks, enquiries of other regulators, and other checks for any existing negative indicators or concerns. Following the financial crisis, the FSA has intensified supervision in this area, particularly in terms of technical skills, where the FSA will often conduct its own searching, competence-based interview of the individual. This is actively considered for candidates applying for any of the following roles in larger, more complex or risky firms: Chairman; chief executive; senior independent director; finance director/chief finance officer; risk director/chief risk officer; and nonexecutive directors (NEDs) whose responsibilities include Chair of Audit, Risk or Remuneration Committees. A not-insignificant number of candidate applications are withdrawn when an FSA interview is requested. The FSA maintains a Shared Intelligence System (SIS), a mechanism for regulators and designated professional bodies within the United Kingdom to share information regarding individuals. This is routinely checked when processing applications for approved person status. The FSA's Policy Statement (PS10/15—Effective corporate governance: Significant influence controlled functions and the Walker Review) states that "effective management of conflicts of interest is at the heart of maintaining fair, orderly and efficient financial markets." This reminds firms and individuals acting in a dual capacity of their regulatory duties to identify and manage conflicts of interest. The FSA's SYSC contains detailed requirements covering appropriate apportionment and oversight of responsibilities, and requires that all employees are capable of performing and are aware of their operational risk-management responsibilities, and that there is appropriate segregation of duties. The FSA's Supervision Manual (SUP) states that a firm must take reasonable steps to ensure that an actuary does not act as chair or chief executive of the firm. If the actuary is performing a with-profits actuary function, he/she cannot be a member of the firm's governing body. Actuaries must be Fellows of the Institute and Faculty of Actuaries and hold relevant practicing certificates, and have the relevant experience to undertake the actuarial function. SUP also specifies the qualifications and experience required of auditors, including that they must perform the audit task with independence. Actuaries and auditors can be disqualified by the FSA, as these functions are controlled functions.
Assessment	Observed
Comments	The U.K. regime for suitability of persons is very strong, with both high requirements and a rigorous approval process, made more robust after the financial crisis through numerous FSA interviews of candidates for senior roles in insurers. There is a risk that the rigor in this process and the robustness of the suitability of persons' regime may be reduced in a smaller prudential regulator.

Principle 8.	Changes in control and portfolio transfers The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer. The supervisory authority approves the portfolio transfer or merger of insurance business.
Description	The EU Acquisitions Directive 2009 led to changes in the U.K. legislation, rules, and procedures for dealing with changes in control to meet the directive. The status of controller is defined together with the different levels of control (10 percent, 20 percent and 50 percent) which will trigger the need to seek approval. The assessment process and criteria are set out in sections 185 and 186 of the FSMA as amended by Statutory Instrument 2009 N0. 534 on March 21, 2009, which gives the FSA the power to approve or reject (object to) any proposal to acquire or increase control (within defined parameters) in an authorized insurer. More detail is contained in SUP 11.4.2(R) and the glossary definition of a controller. The FSA has recently issued guidance for firms in respect of those it would consider to be “acting in concert.” An insurer is under an obligation to inform the FSA of anything relating to the firm of which the FSA would reasonably expect notice and this covers changes in control. For EEA states, the FSA has the power to, and does, discuss changes in control with the relevant European supervisor. Where there is an MMOU with a non-EEA state, cooperation and disclosure are also straightforward. Changes in control assessments are made in the same area in the FSA as license assessments, and the assessment criteria for changes in control are essentially the same as the licensing criteria, namely:
	• the reputation of the section’s proposed controller; • the reputation and experience of any person who will direct the business of the U.K. authorized person as a result of the proposed acquisition; • the financial soundness of the proposed controller, in particular in relation to the type of business that the U.K. authorized person pursues or envisages pursuing; • whether the U.K. authorized person will be able to comply with its prudential requirements (including the threshold conditions in relation to all of the regulated activities for which it has or will have permission); • if the U.K. authorized person is to become part of a group as a result of the acquisition, whether that group has a structure which makes it possible to: o exercise effective supervision; o exchange information among regulators; and o determine the allocation of responsibility among regulators; and • whether there are reasonable grounds to suspect that in connection with the proposed acquisition: o money laundering or terrorist financing is being or has been committed or

	attempted; or o there is a risk that such activity could increase. Usually, there is a pre-application meeting between representatives of the proposed controller and the FSA to give the FSA's initial reactions and determine the detailed application requirements. The FSA applies a risk-based approach to the level of detail it scrutinizes and the priority it gives to the application. Internet searches, financial checks, criminal checks, SIS and other regulators are sources of information used in the FSA assessment. Warnings are given if the application is likely to be rejected and, if the FSA objects to a proposed controller the proposed controller, can challenge this decision, firstly through the FSA and then through an independent body established by the Lord Chancellors office, The Upper Tribunal (Tax and Chancery Chamber). If through the FSA's annual checks the FSA were to identify a controller about whom it had not been notified, it would require full-form disclosure from the insurer in question. After reviewing the documents the insurer has sent, the FSA would decide on an appropriate enforcement action should any be required in its view. Transfers of insurance business are considered by the high court under Part VII of the Financial Services and Markets Act 2000 and covered in SUP 18 with the court deciding whether or not to sanction the proposed scheme of transfer. There is an initial directions hearing and then a final hearing. The FSA has a right to be heard at both hearings. In practice, the FSA is heavily involved in the process and liaises closely with the insurance companies concerned. The FSA will consider how material is communicated to policyholders. There is always an independent actuary's report of the impact on the proposed scheme on policyholders (both of the transferring and receiving insurer and policyholder groups within these). The FSA approves the independent actuary, but also has its internal actuaries assess the proposed scheme and can obtain its own external actuary report if needed. The Changes and Control Area of the FSA has specialist portfolio transfer staff, and the FSA General Counsel Division provides legal advice when needed. The FSA advises the court whether or not it objects to the scheme, but in practice any FSA objections are dealt with before the court hearing. The FSA has a responsibility to consider the scheme and the process by which the transfer is to be effected to ensure that the scheme does not disadvantage the interests of the policyholders. The FSA has the right to appear in court and raise an objection to the transfer, but the final decision to approve the transfer or not rests with the court. The FSA does inform the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Service (FOS) about Part VII (FSMA) insurance transfers. Most portfolio transfers are intra-group, usually after acquisitions, but Solvency II is driving rationalization as insurers consider the likely Solvency II capital, governance and risk management requirements.
Assessment	Observed
Comments	As with authorizations and changes in control, the United Kingdom has a robust regime, which is applied thoroughly and with disregard to external pressure. The current structure allows the FSA to draw on expert staff in dealing with this type of regulatory transactions or other specialist advice (risk, actuaries, and legal) when needed. Processes and requirements are well documented and applied.

	There is a risk that in the new structure access to such specialist staff and robust processes might be challenging.
Principle 9.	Corporate governance The corporate governance framework recognizes and protects the rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.
Description	Within the United Kingdom, insurance firms are subject to a range of corporate governance requirements, which are contained within the: • FSA Principles for Business; • FSA Threshold Conditions; • FSA Statements of Principle for Approved Persons and a Code of Practice (APER) and its associated Code of Practice; • FSA Senior Management Arrangements, Systems and Controls (SYSC); • U.K. Companies Act (2006); and • U.K. Corporate Governance Code—for companies with premium listing of equities. The FSA's Principles for Businesses (following) are fundamental obligations placed on firms, deriving from the FSA's general rule-making power in the FSMA, and principles 1, 2, 3, 6, 7, 8, and 11 are particularly related to corporate governance issues. 1 Integrity—A firm must conduct its business with integrity. 2 Skill, care, and diligence—A firm must conduct its business with due skill, care, and diligence. 3 Management and control—A firm must take reasonable care to organize and control its affairs responsibly and effectively with adequate risk-management systems. 4 Financial prudence—A firm must maintain adequate financial resources. 5 Market conduct—A firm must observe proper standards of market conduct. 6 Customers' interests—A firm must pay due regard to the interests of its customers and treat them fairly. 7 Communications with clients—A firm must pay due regard to the information needs of its clients, and communicate information to them in a way that is clear, fair, and not misleading. 8 Conflicts of interest—A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

	9 Customers: relationships of trust—A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. 10 Clients' assets—A firm must arrange adequate protection for clients' assets when it is responsible for them. 11 Relations with regulators—A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect to have notice. The FSA Threshold Condition 5 on suitability specifically deals with conducting business with integrity and in compliance with proper standards and competent and prudent management and exercise of due skill, care and diligence. The FSA APER contains the following principles which are highly relevant to personal behavior for good corporate governance: Statement of Principle 1 An approved person must act with integrity in carrying out his controlled function. Statement of Principle 2 An approved person must act with due skill, care, and diligence in carrying out his controlled function. Statement of Principle 3 An approved person must observe proper standards of market conduct in carrying out his controlled function. Statement of Principle 4 An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice. Statement of Principle 5 An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organized so that it can be controlled effectively. Statement of Principle 6 An approved person performing a significant influence function must exercise due skill, care, and diligence in managing the business of the firm for which he is responsible in his controlled function. Statement of Principle 7 An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system. The threshold conditions are complemented by high-level systems and control requirements, contained in Senior Management Arrangements, Systems and Controls (SYSC). Rule SYSC 3.1.1 states that a firm must take reasonable care to

	establish and maintain such systems and controls as are appropriate to its business. The nature and extent of the systems and controls that a firm will need to maintain will depend on a variety of factors, including: the nature, scale, and complexity of the business; the diversity of its operations, including geographical diversity; the volume and size of its transactions; and the degree of risk associated with each area of its operations. There is considerable detail in SYSC, which covers much more than corporate governance issues. In respect of corporate governance SYSC does contain requirements relating to: • senior management responsibilities and their apportionment; • robust governance arrangements, which include a clear organizational structure with well defined, transparent, and consistent lines of responsibility; effective processes to identify, manage, monitor and report the risks it is or might be exposed to; and internal control mechanisms, including sound administrative and accounting procedures; and effective control and safeguard arrangements for information-processing systems; • compliance, internal audit and financial crime; • risk control; • conflicts of interest; • public interest disclosure and whistle-blowing; and • remuneration. Sections 170-181 of the Companies Act 2006 (2006 Act) set out the seven general duties of directors: • to act within powers; • to promote the success of the company; • to exercise independent judgment; • to exercise reasonable care, skill and diligence; • to avoid conflicts of interest; • not to accept benefits from third parties; and • to declare an interest in a proposed transaction or arrangement. Where the company has a premium listing of equity shares, the U.K. Corporate Governance Code would apply to the Directors. The main principles in the code deal with leadership, effectiveness, accountability, remuneration, and relation with shareholders. It covers the following. • There should be a balance of executive and nonexecutive directors on Boards (including independent nonexecutives) such that no individual or small group of individuals can dominate the Board's decision taking. • There should be a strong presence on the Board of both executive and nonexecutive directors and, except for smaller companies, at least half the Board, excluding the Chairman, should comprise nonexecutive directors determined by the Board to be independent, one of whom should be appointed the 'senior independent director.' • The Board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the

Board's composition can be managed without undue disruption.

- The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding Chairmanship and membership of committees.
- There should be a clear division of responsibilities at the head of the company between the running of the Board and the executive responsibility for the running of the company's business.
- No one individual should have unfettered powers of decision. The roles of Chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the Chairman and chief executive should be clearly established, set out in writing, and agreed by the Board.
- The Chairman should upon appointment meet the independence criteria set out in the U.K. Corporate Governance Code. A chief executive should not go on to be Chairman of the same company. If, exceptionally, a Board decides that a chief executive should become Chairman, the Board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.

Companies subject to it must also disclose how they have complied with it in the annual reporting.

As part of its approval of the suitable-persons-process, the FSA conducts interviews of individuals applying for SIF positions in insurance firms. Applications are assessed against honesty, integrity, and reputation; competence and capability; and financial soundness. There are no conditions on approval. An individual is either fit or proper or not. Over 80 percent of SIF candidates have pre-approval interviews.

In the case of friendly societies, there are requirements relating to some of the above corporate governance issues laid down in the Friendly Societies Acts 1992. These include provisions that prevent the combination of the Chairman and Chief Executive role. Mutual companies may also be governed by specific statutory provisions.

SUP 4.2 in the FSA Handbook defines the relationship between firms and their actuaries and clarifies the role that actuaries play in the FSA's monitoring of firms' compliance with the requirements and standards under the regulatory system. The chapter sets out rules and guidance on the appointment of actuaries, and the termination of their term of office, as well as setting out their respective rights and duties. The purpose of the chapter is to ensure that:

- long-term insurers (other than certain friendly societies) have access to adequate actuarial advice, both in valuing their liabilities to policyholders and in exercising discretion affecting the interests of their with-profits policyholders;
- other friendly societies carrying on insurance business (and which have traditionally relied upon actuarial expertise) employ or use an actuary of appropriate seniority and experience to evaluate the liabilities of that business; and
- managing agents of Lloyds syndicates employ or use an actuary of appropriate seniority and experience to evaluate the liabilities associated with insurance

	business carried on at Lloyds. In allocating duties to actuaries, firms are to take account of their obligation Under SYSC 2.1.2R to maintain a clear and appropriate apportionment of significant responsibilities so that it is clear who has which of those responsibilities and that the business and affairs of the firm can be adequately monitored and controlled by the directors, relevant senior managers and the governing body of the firm. The FSA supervisors use ARROW—the FSA's risk-based approach to regulation—to carry out their risk assessment of an insurance firm. ARROW contains a section on oversight and governance, which covers the firm's control functions and its management, governance, and culture. So, these functions are assessed by the FSA both off-site and on-site, with the latter including interviews with senior management from 'front-line' business units and the key control functions (e.g., heads of internal audit, compliance and risk management) as well as nonexecutive directors, especially if they chair a key Board committee (e.g., Audit Committee, Risk Committee). From a few sighted ARROW packs, it is clear that governance structures, as well as the effectiveness of the people in the firm in making those structures work, are key element of the FSA's risk assessment of a firm. Where inadequacies are found, the FSA requires insurance firms to make changes to their governance structures and/or personnel through its ARROW letters to firms, which contain detailed Risk Mitigation Programs (RMPs) with the FSA checking via follow-up visits and communications that the detailed RMP is delivered.
Assessment	Observed
Comments	Insurance firms are required to meet numerous and detailed governance requirements covering structures, controls, and personnel. Firms must meet these both at the time of licensing and ongoing. These governance requirements and standards should be appropriate for the nature, scale, and type of the individual insurance firm. Through ARROW, the FSA assesses a firm's risk in relation to oversight and governance, actively requires changes where deficiencies are found and follows through to ensure deficiencies are rectified. The FSA is very robust in its assessment and treatment of oversight and governance of insurance firms.
Principle 10.	Internal control The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the Board and management to monitor and control the operations.
Description	Requirements on insurers regarding internal controls are contained within the following components of the FSA's Handbook: • Principles for Business; • SYSC; • Threshold Conditions; • Prudential Sourcebook for Insurers; • Interim Prudential Sourcebook for Insurers; and • Interim Prudential Sourcebook for Friendly Societies. Assessment of a firm's internal controls is through a combination of off-site and on-site monitoring. The FSA assesses whether the insurer has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times.

	Under ARROW the following controls have to be assessed and risk rated separately: • Customer, product and market controls; • Financial and operating controls; and • Prudential risk controls. Insurers are required to notify the FSA of major changes that affect its systems and controls. Chapter 15 of the FSA's Supervision Manual sets out guidance on the type of event or change in condition of which an insurer should notify the FSA. This sets out the examples of any proposed restructuring, reorganization or business expansion, which could have a significant impact on the insurer's risk profile, and any significant failure in the insurer's systems or controls, including those reported to the insurer by the insurer's auditor. SYSC Section 3.2 covers some of the main issues which a firm is expected to consider in establishing and maintaining the systems and controls appropriate to its business. SYSC 13 deals specifically with operational risk as regards systems and controls for insurers. Principle 5 in the Statement of Principles and Code of Conduct for Approved Persons (APER), as it relates to directors or senior managers, requires that they must take reasonable steps to ensure that the business of the firm for which they are responsible is organized, so that it can be controlled effectively. Principle 7 requires that they must take reasonable steps to ensure that the business complies with the relevant requirements and standards of the regulatory regime. It is made clear that the responsibility for internal controls rests with the Board of Directors. Requirements for the appropriate apportionment of significant responsibilities among its directors and senior managers, and the allocation of responsibility to one or more individuals for dealing with the apportionment and overseeing the establishment and maintenance of control systems are contained within SYSC. It deals specifically with segregation of duties and supervision of employees. The directors of insurance companies have to certify that the key information they provide in their annual return to the supervisory authority has been prepared in accordance with the relevant rules; that proper accounting records have been maintained and adequate information has been obtained by the company; and that an appropriate system of control has been established and maintained by the company over its transactions and records. The external auditor has to give an opinion on the required directors' certificate and whether it was reasonable for the directors to have made the statements contained within it. The relationship between firms and auditors, and firms and actuaries, is set out in SUP Chapters 3 and 4, respectively. These chapters also clarify the roles these functions play in the FSA's monitoring of firms' compliance with the requirements and standards under the regulatory system. The General Prudential Sourcebook (GENPRU 1.2) requires an insurer to identify and assess risks to its being able to meet its liabilities as they fall due, how it intends to deal with those risks and the amount and nature of financial resources the firm considers necessary. These assessments must be documented for easy review by the FSA as part of its assessment of the adequacy of capital resources.

	Guidance and rules in SYSC make it clear that ultimate responsibility for the management of prudential risks rests with a firm's governing body and relevant senior managers, and in particular with those individuals that undertake the firm's governing functions and the appointment and oversight functions. In particular, these responsibilities should include: • overseeing the establishment of an appropriate business plan and risk management strategy; • overseeing the development of appropriate systems for the management of prudential risks; • establishing adequate internal controls; and • ensuring that the firm maintains adequate financial resources. The Conduct of Business Sourcebook (COBS) set out what is expected regarding those life insurance firms that are conducting designated investment business in terms of their relationship with customers. For nonlife insurance and pure protection policies, the Insurance Conduct of Business Sourcebook (ICOBS) applies. Section 59(2) of FSMA requires that an authorized person must take reasonable care to ensure that, in relation to regulated activities, no person performs a controlled function under a contractual arrangement unless the FSA approves the performance by that person of the controlled function. The table of controlled functions is listed in the Supervision Manual. Under Principle for Business 3, a firm should take reasonable care to supervise the discharge of outsourced functions by its contractor, and take steps to obtain sufficient information from its contractor to enable it to assess the impact of outsourcing on its systems and controls. SYSC provides additional guidance on outsourcing. However, a firm cannot contract out its regulatory obligations. The SYSC includes guidance on the establishment of an audit committee and its potential functions, and on internal audit and its role. The creation of either an audit committee or an internal audit function is dependent on the nature, scale and complexity of the business. They are not an FSA requirement on all firms but may be deemed appropriate for the larger entities. The SYSC guidance makes it clear that where an internal audit function exists, this should have clear responsibilities and reporting lines to an audit committee or appropriate senior manager, be adequately resourced and staffed by competent individuals, be independent of the day-to-day activities of the firm, and have appropriate access to the firm’s records. This guidance also notes that, depending on the nature, scale, and complexity of the business, it may be appropriate for a firm to delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. The FSA does request internal audit reports where appropriate, and can require their production under the powers in Section 165 of the FSMA. Section 340 of the FSMA gives the FSA power to make rules requiring an authorized person, or an authorized person falling into a specified class, to appoint an actuary. SUP Chapter 4 contains rules and guidance on the appointment of actuaries and defines the relationship between firms and their actuaries. Rules in SUP 4.3 cover the actuarial function and the with-profits actuarial function and the

	advice to be provided. The rules in Chapter 9 of IPRU-INS regarding financial reporting require a periodic investigation of long-term insurers (once in every period of 12 months). Incorporated friendly societies are covered by a similar provision in Chapter 5 of IPRU-FSOC. An actuary appointed to carry out the actuarial function must advise the firm's governing body on the methods and assumptions to be used for these investigations, and the calculation of the with-profits insurance capital component where applicable, and report to the governing body on the results of those investigations.
Assessment	Observed
Comments	The FSA requirements for insurers to have adequate internal controls are comprehensive and detailed. They also make clear that ultimate responsibility lies with the Board of Directors. The FSA's overview of insurer's internal controls occurs predominantly through its ARROW assessments of insurers, which require separate identification and assessment of the underlying risks of the insurers, but also a separate assessment of the quality and effectiveness of a range of risk controls. From viewing a few ARROW packs, it is clear that the FSA robustly assesses internal control mechanisms and requires rectification where these are inadequate.
Ongoing Supervision	
Principle 11.	Market analysis Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws the conclusions and takes action as appropriate.
Description	Market analysis occurs within the FSA and in respect of insurance the FSA's Insurance Sector Team (IST) is the area primarily responsible for identification, assessment, and oversight of mitigation. This team sits within the FSA's Risk Division, which is separate from the Supervision Division, and so it provides a somewhat independent view of insurance risk issues. The FSA's Macro-Prudential Department in the Financial Stability Division also carries out high-level surveillance of environmental developments and trends in the United Kingdom (and other jurisdictions) and then liaises, when appropriate, with the FSA's sector-specific teams for deeper analysis of possible implications. A main product of the IST is its biannual reviews of publicly available financial results for peer groups of major insurance players, commenting on trends, identifying outliers, and teasing out risks and vulnerabilities. Separate financial analyses for each of the three main insurance sub-sectors—Life Insurance, Retail General Insurance and Wholesale General Insurance are produced. The financial analyses of 2009 full year results ran to 35–45 pages and included sections and data on income levels, profitability, results by location, balance sheet analysis, debt/debt maturity, cash flow analysis, profitability, cash flow movements, capital movements, operating ratios, expense ratios, return on premium ratios, group (i.e., Insurance Group Directive) regulatory solvency positions, product sales data, market share by product and distribution channel, complaints analysis, financial strength ratings, and outlooks for the second half of 2010 and beyond. Also included were some suggested lines of enquiry for supervisors to use in discussions with firms derived from our analysis.

	These financial analyses are designed primarily to help supervisors to assess insurer's risk, make comparisons with individual insurer regulatory returns, and to generally inform them about key financial trends in the market. They are also used to inform FSA's regular external communications such as speeches and newsletters, and to identify areas where 'Dear CEO' letters may be appropriate to advise insurers of FSA's particular concerns about certain industry-wide issues or practices. The IST was established around 2005 and now consists of about 16 people who are experts in particular aspects of insurance and have strong analytical skills or communication skills. It maintains the dashboard of insurance sector risks, which is used by the FSA's Insurance Risk Committee and Executive Risk Committee to manage dashboard risks. As well as insurance sector risk identification and management of the mitigation of those risks, IST is involved in external liaison with the insurance industry and with insurance training and competence within the FSA. Each month, the IST filters out emerging issues to update the dashboard and inform its other work. It taps into experts and supervisors with a range of expertise from within the FSA as well as using internal and external data sources and market intelligence gathered from industry contacts and others. As well as the above financial analyses, the IST produces or is involved in the production of the following: • Insurance Sector Digest—this is public and is a part of the FSA's annual Financial Risk Outlook and it contains (for each sub-sector of life insurers, general insurers, and whole insurance intermediaries) an overview of the macroeconomic background and outlook, the sector's operating environment, the regulatory and legislative environment, key risks and key messages; as well as a section on Solvency II and a section on international developments; • Special risk analyses—specific topical risks may be more deeply analyzed from data or external information to provide FSA supervisors with up to date information on such issues; • Thematic project work—deeper research and review of an issue of concern across the sector. It will often involve on-site review of relevant insurer practices as well as general research; • Panel pack supplements—these are IST's own views (i.e., separate from the supervisor's view) of an individual insurance firm's key risks to assist ARROW planning panels so that an ARROW assessment is comprehensive; • Relevant market material—information such as ratings agencies reports are collected and disseminated to individual supervisors, sometimes with IST's specific views added; • Speeches given by senior FSA executives; • Insurance sub-sector quarterly newsletters—to update insurance firms on FSA regulatory developments; and • 'Dear CEO' letters—to inform firms of FSA's concerns on a particular industry-wide issue or practice. Special risk analyses are often used by a variety of internal FSA areas such as supervision, policy or conduct risk departments to inform their day-to-day activities

	and influence the direction of risk assessment or mitigation work. Examples of risk analyses published in 2010 include Reinsurance Renewals, Impact of the Government's Budget Statement(s) on the Insurance Sector, Private Motor Market analysis, analysis of with-profits issues, the Impact of the Deepwater Horizon incident on the Insurance Sector and the Impact of the Jackson Review of Civil Litigation Costs. The IST manages one-off projects to consider particularly significant industry issues. Of particular note is a project currently underway ('LB12') to consider the potential aggregate impacts on different parts of the life insurance industry of several significant converging markets and regulatory developments (e.g., Solvency II, Retail Distribution Review, Pensions Reform), which are to be implemented in or around 2012. The output from this project will be considered by the Insurance Risk Group and by the Executive Risk Committee of the FSA to establish what actions may be needed, both by the industry and by the FSA (and successor organizations) to be best prepared for the possible combined downside effects of all of these developments in the market. The project will signal where there may be a need to address gaps in the actions already being taken by the FSA or by firms in order to reduce (or to be better prepared for) the implications of possible future market scenarios. Project work can also encompass assessments of systemic risk, and in 2010 a project was commissioned for external consultants to consider the wider implications of the failures of a large insurer or reinsurer. The FSA holds a biennial Insurance Sector Conference for the insurance industry and the FSA's Insurance Sector Leader usually gives a speech outlining the main points covered in the FSA's Insurance Sector Digest document. The insurance section of the main FSA risk dashboard holds details of the most important risks to FSA statutory objectives across the insurance sector. These are normally those risks carrying higher scores for both impact (the scale of the issue in terms of spread or consumer detriment) and probability (the likelihood of certain events occurring). These risks and the effect of FSA mitigation actions over a target period are tracked until the risk is within FSA appetite. The dashboard comprises risk descriptions, outcome statements, scoring, and mitigation workstreams. Each of these risks are considered and updated monthly by IST, and risk owners (such as Supervision Heads of Department) are consulted quarterly to ensure the actions are on track, and remain appropriate, proportionate and outcome focused. A periodic review is also carried out by both FSA's internal Risk Division and the FSA Insurance Risk Group. IST is responsible for providing a monthly risk report to FSA's Risk Management Division to include a commentary on recent market developments, which is then summarized for the FSA Board. The FSA undertakes a broad span of external stakeholder engagements to keep up to date with market developments and emerging risks as seen through the eyes of key industry trade bodies, government departments, and consumer bodies, and also arrange meetings with key CEOs, nonexecutive directors, chairmen, and chief risk officers, either as groups or on a one-to-one basis. Relevant senior FSA staff periodically meet with the large consultancy, advisory and audit firms within the insurance sector to maximize intelligence from this source.
Assessment	Observed

Comments	Through the establishment and substantial growth of the FSA's Insurance Sector Team, an impressive capability exists to conduct quality market analysis and link it to supervisory objectives and outcomes. There is a well-controlled process to identify, prioritize, and produce market analysis and special risk analysis work. Numerous and effective mechanisms exist and appear to operate effectively to convey this work to supervisors and bring it into the supervisory process. There is effective communication to industry and senior people in insurance firms of the industry key risks, issues and trends identified through these processes. The IST's financial analysis reports are primarily based on statutory accounts data, so there is limited reliance on FSA returns. These reports provide a different perspective to supervisors to complement their review of annual returns. This approach allows the FSA to update the analysis during the year, e.g., on half-yearly and quarterly bases. Nevertheless, shortening the time to "market" of the IST reports should be considered to make them more effective.
Principle 12.	Reporting to supervisors and off-site monitoring The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	Authorized insurance firms, other than firms passporting in, are required to submit returns as detailed in the FSA's Supervision Manual (detail in FSA Interim Prudential Sourcebook for Insurers (Chapter 9) and Interim Prudential Sourcebook for Friendly Societies (Chapter 5)) and at the various frequencies according to the type of return, also as detailed in the Manual. The FSA has the power to, and does, collect supplementary information from firms during the regulatory period between returns being submitted. The returns required to be submitted include detailed financial and accompanying statements, actuarial reports, and statistical returns (including complaints data). There are special requirements for group as well as solo data. Special requirements also apply where enhanced capital requirements are applied to an insurance firm. There are separate specific requirements for Lloyds managing agents. The data reporting requirements vary by type of business written (i.e., long-term and general insurance) and between insurers and friendly societies. Every long-term insurer must have an annual investigation into its financial condition. This investigation must include the valuation of any assets, liabilities, exposures and equity or income statements in accordance with accepted standards in financial reporting. Consolidation techniques are also set out for firms to calculate group capital resources and establish group capital resource requirements. The SYSC contains detailed requirements on systems and controls for reporting and senior management responsibilities, including for accuracy. Details on certification and lodgment of returns are laid down for the variety of returns. Under the FSMA, individuals may be held accountable for deliberate misreporting. Return information is lodged via either paper or electronic form and is entered into databases by a service provider that the FSA uses. A dedicated unit in the FSA then runs validation checks against the data, which are then made available to

	supervisors in the FSA. For about three years, supervisors have been able to use the internally developed Data Analysis and Review Tool (DART) to examine and analyze individual insurer return data. DART provides easy and quick access to the various types of data contained in annual returns. Supervisors can quickly view information on issues such capital adequacy, business volumes and types, revenue data, asset and investments profiles, liability profiles, persistency (for life insurers), reinsurance and complaints. Supervisors can easily see trends over the last few years in an insurer's metrics, but can also easily have an insurer's metrics compared with a set peer group, or the supervisor's selected peer insurers. DART also generates automatic alerts, which are highlighted in red on the introductory DART screen for an insurer, so supervisors are quickly drawn to certain issues for further analysis. Supervisors are required to complete the Supervisory Data Review and Firm Strategy Document (SDA—Supervisory Data Analysis) each year for each insurer. This is to demonstrate that they have analyzed the annual return data, brought together certain up to date basic information of the insurer (e.g., the business it is writing, the auditor, any external ratings) and thought about and documented their views on basic issues (e.g., key risks from the data, persistency, complaints, group capital, Solvency II, remuneration structures, actuarial review) and any specific issues peculiar to the insurer. The supervisor must also identify key risks for follow up, comment on the effectiveness of the FSA's previous year's supervisory strategy for the insurer and propose the supervisory objective for the coming year (intended outcome, proposed supervisory action, and date for action). This SDA is then considered and signed off by the supervisor's manager and a moderation panel, if applicable. The SDAs for all insurers are required to be completed and signed off before September each year. Annual return data are not usually available within DART until around May, so the SDAs have to be completed within a four-month window. Once the SDA is completed, that fact is logged into the FSA's Interim Risk Manager (IRM) with links to the SDA. The supervisory actions for the coming year with action dates are also logged into IRM. IRM therefore provides an audit trail mechanism for finding and managing all major supervisory tasks in relation to an insurer, plus all the interactions between the FSA and an insurer, as well as providing links to all relevant files and notes so that they can be easily accessed. Off-site analysis within the FSA is also conducted as part of an ARROW assessment before on-site and other work is carried out to arrive at the final ARROW assessment of an insurer. Under the FSA's Principle for Business (Principle 11) insurers are required to notify the FSA of major changes affecting the insurer. The FSA has the power to request additional information as needed from insurers and it has used this power extensively. When the FSA introduced, in 2004, Individual Capital Adequacy Standards (ICAS) requirements for many insurers it required insurers to provide detailed information on a regular basis to the FSA on the insurer's Individual Capital Assessment (ICA). When the FSA introduced its Core Prudential Program for Insurers (CPPI), which applies to high impact rated insurance groups, it requested them to provide significant extra information including internal audit, risk and audit committee reports, and realistic financial reporting information and packs sent regularly to the insurer's Board.

Assessment	Observed
Comments	There is substantial return information required to be produced, certified, audited, and lodged with the FSA. This has been supplemented with additional required information as needed given the type and size of insurer and as its financial and organizational position changes. While the standard return information required of insurers has been updated and improved, there has not been any comprehensive revision of the information required for a number of years This is predominantly because EU developments on Solvency II have been ongoing for a few years and it was clear that, when introduced, they would significantly change and increase the data that insurers would be required to lodge with insurance supervisors. Solvency II requirements are not yet finalized and neither are the data requirements which will need to accompany Solvency II's implementation. In 2004 the FSA introduced ICA requirements for most of its insurers along with extra reporting requirements including realistic balance sheets for large with-profit insurers. This was a step toward the approach to be taken under Solvency II and means U.K. insurers and the FSA are well placed for Solvency II implementation, which will further improve reporting requirements. It is recommended that the FSA continue to contribute to the finalization of Solvency II data requirements and work now to position itself and its insurers for timely and effective implementation of these data requirements.
Principle 13.	On-site inspection The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.
Description	The FSMA (Part XI "Information Gathering and Investigations") provides the FSA's power to undertake on-site inspections through its information gathering powers. On-site inspection work is but one component of the FSA's risk-based approach to supervision of authorized firms, which is embodied in the FSA's ARROW. Through ARROW the FSA assesses the risk a firm poses to the FSA's statutory objectives of maintaining market confidence, consumer protection, financial stability and reducing the incidence of financial crime. The FSA assesses a firm's impact ('regulatory footprint') and the probability that risks within the firm will crystallize and lead to a breach of FSA objectives. A firm's impact determines the minimum intensity of FSA risk assessment and supervision work with the following ARROW approaches applying: • Low Impact—ARROW Small Firms; • Medium-Low Impact—ARROW Light; • Medium-High Impact—ARROW; and • High Impact—ARROW plus Close and Continuous. Close and continuous monitoring involves a more detailed on-site assessment than for standard ARROW and it means firms or the group will be subject to a series of meetings (at least quarterly but often more frequently) and assessment work that is designed to test the key control functions in the firm/group. From this minimum work, the probability of the firm generating a failure of one of the FSA's statutory objectives is assessed. ARROW requires an assessment of a comprehensive range of a firm's individual risks (environmental, customer, product,

	markets, business processes and prudential), controls (market conduct, financial, operating, prudential), oversights (control functions, management, governance, culture) and mitigants (capital, liquidity) so that a net probability rating can be assigned to each firm. This then drives any additional supervisory work carried out on the firm. For insurers classified as small firms (low impact), ordinarily no on-site work is carried out. Supervision usually involves only an analysis of returns and consideration of information from the Financial Ombudsman. These insurers are not relationship managed with a specific FSA supervisory contact although they may be subject to thematic reviews along with other insurers. For medium-low-impact insurers, ARROW Light is applied and on-site work lasts for about one day and covers only core areas of the firm and issues that are priorities for the firm's sector. Firms with a medium-low and above impact rating are relationship managed. For medium-high-impact insurers, ARROW is applied and on-site work last about three days to one week and reviews all aspects of the firm's business, with particular regard to sector priorities. For high-impact firms ARROW plus Close and Continuous applies with on-site work for the full ARROW assessment lasting longer than three days to one week and reviewing all aspects of a firm's business with particular regard to sector priorities. Also, the firm/group will be subject to a regular series of meetings and assessment work that is designed to test the key control functions of the firm/group. On-site supervision consists of high-level reviews by the supervisory team and focused reviews carried out by specialist teams to examine specific risks and the supporting data. Insurers' financial statements must be audited and there is regular contact between the FSA and external auditors, who have a duty to inform the FSA of any material concerns that have arisen during the course of their work. ARROW panels, comprising FSA staff who are independent of the supervisory line involved, are used at both the planning stage (i.e., before the on-site work) and at final sign-off of the assessment stage (includes approval of the final letter to the firm). The size of the panel will vary according to the version of ARROW used, but for high impact firms it will include independent supervisors, senior advisers, sector and risk specialists and the risk management division. FSA's Supervision Risk Committee and the Executive Risk Committee receive a summary of each high impact firms' ARROW panel pack, including a review by the senior adviser present at the panel. After the final ARROW panel has signed off the assessment, a letter is sent to the firm which sets out key findings; the assessment of the main risks and controls; a summary of the ARROW rating and the time to the next ARROW assessment of the firm. Attached will be a detailed Risk Mitigation Program (RMP) with intended outcomes; actions to be taken and a timetable for action. The firm has the opportunity to correct factual errors but not challenge the judgment in the assessment. The supervisory team will often (always for firms under Close and Continuous

	supervision) present the findings to the Board of the firm to highlight key messages, answer questions and discuss their findings. The tasks emanating from the RMP will be entered into the FSA's IRM to track and manage progress and ensure firms are followed up. The FSA's Supervision Handbook covers the level of cooperation required by firms when the FSA gathers firm information, including from appointed representatives and in respect of outsourced functions. Flowing from the Supervisory Enhancement Program (SEP), in early 2010 the Core Prudential Program for Insurers (CPPI) commenced. It has three major elements consisting of an analysis of the insurer's business model, stress testing of both capital and cash flow, and 'deep dive' reviews into seven key inherent financial risks for insurers. The financial risk reviews involve substantial offsite analysis followed by 3–4 days on-site work. While this activity is owned and run by the supervisors, it involves FSA risk specialists and actuaries. So far CPPI has only involved the six largest life insurers (which comprise about 85 percent of the life insurance business). For those insurers it is still only about 75 percent complete so implementation is at an early stage. It is envisaged that CPPI, or a form of it, will be extended more broadly across the life insurers and across the general insurers. It has not yet been decided how far down the insurer impact scale this will be extended. It is culturally different from much of the FSA's previous work and is challenging the FSA staff. About 12 extra full time equivalent staff has been needed to deliver this program. Some of the on-site reviews related to risks and controls and thematic reviews have examined representative samples of individual transactions (e.g., looking at the underwriting files of some commercial risks in an insurer). Such 'transaction examination' is highly effective in establishing if the control mechanisms around a particular risk are actually working to ensure that the risk is properly managed in accordance with the policy and controls laid down by the insurer. Deep dives or Financial Risk Reviews (FRR) carried out as part of CPPI, are not be triggered by particular concerns or specific risk drivers, but are carried out periodically. The FRR which looks at intra group exposures and risk transfer, typically reviews key reinsurance treaties in detail. On the nonlife side, the FSA undertakes file reviews as part of ARROW assessments or on an ad hoc basis. A specific example of the approach is e-reviewing underwriting files. FSA asks for policy lists, from which it takes a random selection (usually a dozen or so to begin with), and reads through the files and the underwriting slips for evidence of: • File management; • Customer detriment in claims decisions; • Documented evidence that internal procedures and authority levels are being followed;

	• Pricing method—is it clear to the reader how the rate was arrived at; • Risk selection—is it clear to the reader how the decision to underwrite was reached; and • Aggregate management. The FSA does not use a checklist for this, but guidance is available to supervisors. The FSA's use of such 'transaction examinations' is sometimes driven from a top-down assessment of inherent risks and any concerns arising from other sources of information (e.g., complaints, risk and audit reports). For example FSA may ask to review a reinsurance treaty if it becomes aware of a specific transaction. A current example is where FSA is reviewing a treaty to confirm that an intra-group transaction is at arm's length, in response to a report from the firm that it is. FSA also requires firms to commission investigative work from a skilled person (skilled person (FSMA section 166) reports). This can be risk-specific, but can also more general assurance activity. For instance, if a firm has radically changed its risk management framework, FSA may ask for a skilled person to advise on the appropriateness of what the firm has done. Such reports typically involve the accountants in carrying out some element of detailed testing. Some of the skilled person reviews the FSA has done on Board effectiveness have involved observing Board meetings, as well as reviewing documentation. The FSA's thematic projects often involve file reviews, and the recent with-profits regime review assessed a sample of 17 firms (80 percent of the market in terms of assets held) against FSA requirements in COBS 20 and relevant principles, with regard to the intended outcomes. This involved conducting in-depth visits to firms to interview their management and other individuals who are key to operating with-profits funds. Moreover, a key component of this work was obtaining and reviewing a significant amount of documentation to validate that firms were in practice operating in accordance with FSA rules and guidance. The sample of firms was not selected on the basis of pre-existing concerns, but was chosen to provide a broad cross-section of the with-profits market, and included a mixture of large, medium and small firms of mutual, friendly society and proprietary status. It also provided coverage of both open and closed funds. Other examples of supervisory activities that typically involve file checking are the projects run in response to emergent risks such as on capital management and credit and property exposure in life insurers, where FSA uses multi-disciplinary teams of supervisors, actuaries and Prudential Risk Division (PRD) specialists, and FSA's review of reserving in general insurers, which is currently underway, where the FSA intends to carry out on-site evidence reviews (alongside other data gathering).
Assessment	Partially Observed
Comments	ARROW provides a well-structured approach to risk-based supervision through its use of firm impact ratings, which drive the minimum amount of supervisory work and the firm's probability rating. The latter then drives the amount of additional supervisory work to deal with identified specific risks and issues in the firm. ARROW therefore is the driver of the amount of and type of on-site work that is

	conducted on an individual insurer. The FSA process for planning on-site reviews and finalizing ARROW assessments is thorough and requires a substantial amount of thinking and challenge from outside the direct supervisory team, including from risk and sector specialists and senior supervisory executives.

	ARROW findings and assessments are communicated promptly and clearly to firms via a letter and, for high-impact firms, a presentation to the firm's Board. The desired supervisory outcomes, including how and when they should be achieved are made clear to firms via the Risk Mitigation Program attached to the letter. The introduction of the CPPI was a good step toward getting a deeper understanding of the major life insurers, in particular how sustainable, financially resilient and well governed and controlled they are. CPPI needs to be continued to become an integral part of the supervisory culture and expertise of the FSA. It provides a greater degree of forward looking supervision, and thus has greater preventative capacity than the analysis and risk assessment techniques applied outside of CPPI. It should be extended to a wider range of insurers, but this will need careful adjustment to ensure it is applied proportionately to firms of various impacts, especially in respect of the key financial risks and associated 'deep dives' when applied to general insurers. It will clearly involve extra resources. Some of the FSA's on-site inspection activity is relatively recent, arising from an increase in intensity of FSA's supervisory approach. The FSA should ensure that the further development of its approach maintains an emphasis on random 'transaction examinations' (in relevant areas such as underwriting, reinsurance, claims, and even investments), on both the largest insurers and some smaller insurers. This will often bring to the surface unknown (to both the FSA and the insurer) problems, so it is an effective complement to top-down driven examinations. When insurers are aware that the FSA undertakes such examinations, it also is a force for keeping insurers on their toes, rather than having them concentrate on areas where they think on-site work will occur.
Principle 14.	Preventive and Corrective Measures The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	The ARROW assessment of a firm leads to a Risk Management Program (RMP) of desired supervisory outcomes, actions that are to be taken, and a timetable for action. The details are communicated in writing to the insurer and either presented by the FSA supervisory team to the insurer Board or communicated to the Board by the insurer's senior management. Through its IRM, the FSA supervisors follow up with insurers on the elements of the RMP. Any difficulties would normally involve discussions with the insurer's senior management before any formal action is taken by the FSA. Through the RMPs, the FSA actively conveys to firms what corrective or improvement action needs to be taken and by when. From the sighting of RMPs, it is clear that the FSA is often very specific about the needed remedial action and at times requires independent experts to be engaged by insurers to advise on, or report on the remedial action. The regular offsite analysis, which is controlled via the SDA, may also lead to the FSA requiring insurers to take corrective action, which is then logged into IRM and subject to FSA compliance reports from IRM showing compliance with the follow-up processes. Compliance rates are contained in the regular reports and there is nested reporting up through departments, to divisions, to the Supervision Risk

	Committee and eventually to the Executive Risk Committee on these issues. Thematic reviews on industry sector issues may lead to firm specific, or broader, supervisory action being required. The identification, prioritization and management of horizontal work (such as thematic reviews) in the FSA are now controlled through the FSA's internal risk management processes and reporting. The Executive Supervision Committee also receives weekly reports reviewing the latest developments across the portfolio of regulated firms. There is a watchlist of firms meeting either fixed criteria or of being included at the discretion of the Executive Risk Committee, because they pose a significant and imminent risk. Reviews take place weekly with fuller discussions monthly. The regular Risk Management Reporting within the FSA is another vehicle through which inaction on regulatory issues would be identified and reported. There is a Specialist Supervision Unit (SSU), within the FSA, which has been operating for about two years and was set up as part of the SEP to improve the quality of supervision of high-impact firms. SSU consists of about 25 people made up of experienced FSA supervisors, some savvy financial accountants recruited from the market, some staff with enforcement experience and some secondees from other parts of the FSA. It operates by conducting deep reviews of supervision work to check that the appropriate supervision assessment has been made, the appropriate supervision strategy is being delivered, and the appropriate actions have been taken. It is essentially a peer review of supervision which involves considerable supervisory judgment, rather than a compliance check that supervisory processes have been followed. Just over 20 reviews have been conducted to date, with only a small number of major shortcomings identified. It is planned to cover all the high impact firms over a 24-month period. The SSU reports directly to the FSA's CEO; has regular meetings with the divisional heads and heads of departments, and works closely with the FSA's internal audit. Under Part IV of the FSMA, dealing with permission to carry on regulated activities, the FSA has a wide range of powers available to it to ensure the timely taking of preventive or corrective action. These include the possibility of refusing or withdrawing authorization; the addition, variation or removal of regulated permitted activities, and the imposition of requirements, for example to require an authorized person to take, or refrain from taking, specified actions. A firm's management is held accountable for ensuring that the firm acts in compliance with regulatory requirements and the FSA does not hesitate in taking action in relation to individuals, especially those holdings SIF positions.
Assessment	Observed
Comments	The FSA processes flowing from ARROW assessments and ongoing supervisory monitoring appear to be adequate to provide confidence that the supervisory action which was decided on is taken, and firm required actions are followed up. Through the ARROW panels, the SSU and the FSA's own risk management processes, considerable confidence can be gained that the appropriate supervisory assessments are being made, supervisory strategies being delivered, and supervisory and firm actions being taken. While the FSA does not have a structured framework for the types of remedial action that should generally be considered and taken for each or at least the most common of the major ARROW assessment outcomes, it does utilize the expertise of the senior people involved in panels and other review mechanisms to achieve consistency in its supervisory responses.

Principle 15.	Enforcement or sanctions The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	Under s.45 FSMA, the FSA can vary or cancel an authorized firm's permission to carry on regulated activities. It can also impose requirements on a firm. This power is known as an OIVoP (Own Initiative Variation of Permission) and can be used for a variety of purposes. This may, for example, impose asset requirements on a firm, increase capital requirements, or restrict a firm's sales of a particular product or its dealings with a particular category of client. Failure to adhere to the requirements imposed by an OIVoP can lead to a firm's authorization being withdrawn. This power has been used successfully on a number of occasions although, in certain cases, the threat of an OIVoP is sufficient to prompt the firm to approach the FSA for a Voluntary Variation of Permission (VVoP), which has the same effect as the OIVoP. The OIVoP power can be used to prevent an insurer from issuing new policies. The FSA does not have the power to arrange for athecompulsory transfer of the obligations under the policies from a failing insurer to another willing insurer. It can, in respect of friendly societies, direct a "transfer of its engagements" where there is a willing transferee. This power is contained in the Friendly Societies Act 1992, section 90. It also can facilitate the transfer where appropriate and where there is a willing transferee. The FSA has effective means to address insurer management problems through its supervisory processes and ultimately it has the power to remove unsuitable controllers and remove unsuitable persons exercising Significant Influence Functions. The FSA itself does not take control of a failing insurer. However, it has the power to apply to the court for the appointment of a liquidator or administrator and the FSA has a right to be heard in those proceedings. Through the IRM the FSA monitors the remedial measures being taken under the RMP required of an insurer. Under ss 205 and 206 FSMA, the FSA may censure or fine authorized insurance firms for misconduct. The FSA's penalty policy is contained within its Decisions Procedure and Penalties manual (DEPP). It covers, amongst other things, how the FSA decides whether to impose penalties; whether penalties should be imposed on the insurance firm or the individual or both; whether it should be a financial penalty or a public censure; and what is the appropriate level of financial penalty. Examples of fines (some very substantial) imposed on insurers and insurance intermediaries for market conduct problems, and breaches as well enforcement actions against unauthorized insurers were cited. It is an offence to falsify, conceal, destroy or otherwise dispose of documents relevant to an FSA investigation or to knowingly or recklessly provide false or misleading information. If a person is found guilty of either of these two offences they are subject to a maximum of two years in prison and/or an unlimited fine. In addition, approved individuals who work in an authorized firm must adhere to a code of practice (APER), which sets out various high level principles such as, "an approved person must act with integrity" and "an approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice." Under s. 66 FSMA, the FSA can impose a public censure or a penalty on an approved person who breaches the principles set out in the APER. It is likely

	that an approved person who misleads the FSA will be breaching both of the APER principles set out above. In order to hold certain positions within an authorized insurer (e.g., the chief executive and director) a person needs to be approved by the FSA. Once approved, the FSA can withdraw this approval, or prohibit a person, if they are no longer considered fit and proper. The factors relevant to the consideration of whether a person is fit and proper are set out in the FSA's Handbook. As the OIVoP power described above is a standalone power, there is no need for enforcement action to have been commenced for it to be used. Nor is there any need to show that any FSA rules have been breached in order to impose an OIVoP. The FSA may cancel an authorization from a firm where it fails the Threshold Conditions. Examples of where the FSA has cancelled an authorized firm's permission in the insurance sector were sighted. The FSA's OIVoP powers can be used in conjunction with powers in section 48 of FSMA to import an "assets requirement" prohibiting the disposal of, or other dealing with, assets or requiring a firm's assets to be transferred to and held by a trustee. DEPP contains details on the processes the FSA uses to achieve consistent decision making in relation to enforcement actions, as well as to afford due process to those against which action is being taken.
Assessment	Largely Observed
Comments	Sanctions and enforcement are actively used when needed by the FSA to achieve corrective action and to act as a deterrent to others. A wide range of sanctions are available, including variations of permission, directions, fines, public censure, disqualifications, and removal of authorizations. The FSA does not have the power to arrange for the compulsory transfer of the obligations under the policies from a failing insurer to another willing insurer. However, it can direct a "transfer of engagements" in the case of a friendly society under the power contained in the Friendly Societies Act. It also can facilitate the transfer where appropriate and where there is a willing transferee
Principle 16.	Winding-up and exit from the market The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedures for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.
Description	The Insolvency Act 1986 provisions mean an insurer is insolvent if it cannot pay its debts as they fall due or if its assets are less than its liabilities, including contingent and prospective liabilities. This is the point at which an insurer would normally conclude that it must enter into formal insolvency proceedings, and is also a ground on which the FSA can petition the court for the insurer to be wound up. The FSA also has powers to stop an insurer continuing to write new business even if it has not become insolvent. The FSA might take this action if the insurer's capital resources fell below the minimum level set out in the insurance directives or specific FSA rules (even if the EU minimum has not been breached) or if the FSA determined the insurer did not have adequate financial resources. In such cases the insurer would move into run-off, remain authorized and continue to be supervised by the FSA. Procedures for dealing with the insolvency and winding up of an insurer are set out in the Insurers (Reorganization and Winding up) Regulations 2004 and the Insurers

	(Winding Up) Rules 2001. These regulations, implementing the EU's directive on the winding up of insurance undertakings, provide for insurance creditors to be paid before ordinary creditors of the insurer, but after preferential claims—being mainly claims arising out of contracts of employment. The Financial Services Compensation Scheme (FSCS) is the U.K.'s compensation program for customers of authorized financial services firms. The Scheme exists to protect customers where a firm is unable, or unlikely to be able, to pay claims against it. The FSCS protects insurance policies and insurance broking (for business conducted on or after January 14, 2005). The FSCS provides for eligible claimants (generally individuals and small businesses) to be compensated for losses up to 90 percent of the value of their insurance contract (100 percent in the case of compulsory insurances). The FSCS has the power to arrange for the transfer of insurance contracts to other firms in order to protect policyholders. If this is not possible, compensation is paid to the policyholders. The FSCS is established under the FSMA, has operational independence (including from the FSA), although the FSA is the competent authority, which sets the rules for the FSCS. The rules cover such matters as the types of financial claim which are protected, the categories of claims to be compensated, overall funding limits for categories, any limits on individual compensation payments and how industry levies to fund the FSCS are determined.
Assessment	Observed
Comments	There are clear provisions for the exit and winding up of insurers in the United Kingdom. Insurers would usually be forced into runoff by the FSA if they did not have adequate financial resources including capital. They would then remain authorized and supervised by the FSA. In the event that an insurer was insolvent, it would be placed into liquidation. Policyholders have preference in a windup over other creditors except employees. Where ultimately an insurer's claims cannot be paid the FSCS exists to compensate eligible claimants (generally individuals and small businesses) for losses up to 90 percent of the value of their insurance contract (100 percent in the case of compulsory insurances).
Principle 17.	Group-wide supervision The supervisory authority supervises its insurers on a solo and a group-wide basis.
Description	The FSA supervises insurance groups and financial conglomerates, as a supplement to solo supervision of insurers and reinsurers, in accordance with the European Insurance Groups Directive (IGD) and Financial Conglomerates Directive (FCD). Chapter 6 of the FSA's Prudential Sourcebook for Insurers (INSPRU) implements the IGD provisions and contains detailed requirements on insurance group capital. The FCD provisions have been implemented in the United Kingdom in Part 3 of the Financial Conglomerates and other Financial Groups Regulations 2004 (FCFG Regulations). Insurance groups and financial conglomerates are clearly and adequately defined in the FSA glossary. So effective quantitative requirements regarding group solvency, and qualitative requirements regarding intra-group transactions and the fitness and propriety of certain individuals are applied to an insurance group or financial conglomerate as a whole. The FSA assesses whether a financial conglomerate is subject to equivalent conglomerate supervision in its home jurisdiction (if outside Europe). The objectives of these assessments are to: • determine whether the conglomerate, of which the U.K. firm is a member, is subject to equivalent conglomerate supervision in its home jurisdiction; and • consider what alternative supervisory measures, if any, may be appropriate for

	a conglomerate that is not subject to equivalent conglomerate supervision. Cooperation and coordination of group-wide supervision with relevant European supervisors takes place in accordance with the Helsinki protocol and more generally in accordance with high level handbook requirements in the FSA's Supervision Manual. This includes provisions for home/host supervisory arrangements, the use of MoUs and supervisory colleges. For insurance groups that are not financial conglomerates, group supervision is undertaken in line with the IGD so that supervision at the group level is carried out by a single supervisory authority, chosen by the supervisors of the insurance undertakings. If the FSA is the EEA lead supervisor, then the FSA takes the lead in establishing appropriate cooperation and information-sharing arrangements with the home (non-EEA) regulatory authority for the group and with any other EEA supervisors. Information on and consideration of group structures and interrelationships, including ownership and management structures forms part of the FSA permissions and change of control regimes and, thereafter, an important part of the ongoing regulatory process. If the FSA decides that a group structure is not supervisable, it will not authorize or approve a change in control in the insurance undertakings in the group or else it will require changes to the group structure to remedy this. Group-wide capital adequacy requirements and the details on how actual group-wide capital needs to be calculated are contained in Chapter 6 of INSPRU. Under the ICAS regime in the United Kingdom, insurance groups are required to determine their group ICA, which the FSA reviews and as a result may issue group capital guidance. Market risk and counterparty exposure limits are applied to insurers at the adjusted solo level (i.e., the insurer and its related undertakings) with the result that such exposures in excess of the limits must be deducted from the solo insurer's available capital. Where large reinsurance exposures emerge (e.g., due to catastrophe events occurring) the insurer is required to report these to the FSA along with an explanation of how they are safely managed by the insurer, including what extra provisions have been made against such exposures. Where the reinsurance is with another part of the insurance group this would trigger further examination by the FSA. Reporting requirements for insurance groups and financial conglomerates are contained within the FSA's Interim Prudential Sourcebook for Insurers (IPRU(INS)). These require, amongst other things, that all material intra-group transactions are reported with details such as names of the transacting parties, the relationship between the parties, a description of the transaction, the amounts involved and any amounts written off in respect of debts due. This enables the FSA to examine such transactions in detail to determine what, if any, further supervisory action needs to be taken. Chapter 12 of the SYSC lays down group risk systems and controls requirements so that if a firm is a member of a group it should be able to assess the potential impact of risks arising from other parts of the group as well as from its own activities. The supervisory processes in ARROW allow supervisors to choose to assess risks to the group on a group-wide basis or semi group-wide basis, if appropriate. Groups that have a high impact rating are also assessed as part of the Core Prudential Program for Insurers (CPPI).
Assessment	Largely Observed

Comments	The FSA supervises insurance groups and financial conglomerates, as a supplement to solo supervision of insurers and reinsurers, in accordance with the European Insurance Groups Directive (IGD) and Financial Conglomerates Directive (FCD). Effective requirements exist for group capital, financial reporting, material intra-group transactions and risk and control systems to assess intra-group risks. High-impact insurance groups are subject to Close and Continuous supervision through the CPPI. The FSA leads or participates in supervisory colleges for insurance groups and financial conglomerates and in recent years has implemented its home supervision role in a more intensive way by conducting inspections in branches outside the United Kingdom and thus gaining a better understanding of the whole group operation. The FSA has no direct jurisdiction to supervise unregulated holding companies and needs to operate indirectly through the regulated entities, thus adding complexity to their supervision and monitoring activities of groups.
Prudential Requirements	
Principle 18.	Risk assessment and management The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.
Description	The FSA sets as a high level standard the requirement on insurers to take reasonable care to organize and control their affairs responsibly and effectively, with adequate risk management systems. The FSA Handbook requires a firm to take reasonable care to establish and maintain such systems and controls as are appropriate to (SYSC 3) (a) the nature, scale and complexity of its business; (b) the diversity of its operations, including geographical diversity; (c) the volume and size of its transactions; and (d) the degree of risk associated with each area of its operation. The FSA defines minimal standards on the risk management systems for the main risks of the insurance activity: Liquidity, Group, Operational, Prudential, Credit Market and Underwriting risks. Without claiming completeness and based on current best practice the FSA provides detailed guidance on the risk management systems and procedures. This includes mandatory stress testing, proper documentation, Board and senior management accountability, a whistle blowing supportive environment, detailed business plan requirements including a risk appetite definition and follow up duties. The minimum standards are concrete and explicit. Contravention of these standards could trigger violation of general prudential principles. For instance, stress scenarios are required with a cash-flow projection for each scenario tested based on reasonable estimates of the impact (both on and off-balance sheet). Contravention of this requirement may be regarded on as tending to establish contravention of GENPRU 1.2.42R (the general stress and scenario testing rule). Market environment considerations are explicitly required in the minimum standards set for the main risks. For example, in the case of assessing the liquidity risk, the FSA requires that insurers should take into account possible changes in the market's perception of the insurer and the effects that this might have on access to the markets or that general market turbulence may trigger a substantial increase in the extent to which financial options are exercised against the insurer. The FSA also requires Insurers to have an adequately documented contingency funding plan, which among other important actions, considers the impact of stressed market conditions for instance on the behavior of any credit-sensitive liabilities the insurer has.

	The FSA does not consider the size of the insurer as the parameter triggering the need for a separate risk management function responsible for assessing the firm's risks and advising the Board and senior management on them but rather the nature, scale and complexity of its business. Peer comparison is used by the FSA to monitor compliance.
Assessment	Observed
Comments	The recently introduced deep dives as well as the allocation of more resources, have brought to light additional internal control weakness in a few companies. These have been addressed and corrections enforced.
Principle 19.	Insurance activity Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.
Description	The FSA allocates the ultimate responsibility for the management of prudential risks to the governing body of the insurer with individual accountability of the persons performing those governing functions. In particular, these responsibilities include: overseeing the establishment of an appropriate business plan and risk management strategy, overseeing the development of appropriate systems for the management of prudential risks, establishing adequate internal controls and ensuring adequate financial resources. The insurer's business plan as required by the FSA should spell out the insurance risk policy outlining its objectives in carrying out insurance business, setting the tolerance level for insurance risk and defining its policies for identifying, measuring, monitoring and controlling insurance risk. A detailed assessment and understanding of the business plan of the very high impact life companies is part of the CPPI program. The intensity on the assessment of business plans is done following a risk based approach. The FSA is explicit about the content of an insurance risk policy. It should cover any activities that are associated with the creation or management of insurance risk like underwriting, claims handling, assessing technical provisions, risk mitigation and risk transfer. In particular, it should determine the underwriting criteria, including how these can influence its rating and pricing decisions. The sufficiency of the level of premiums together with the provision of adequate systems to control expenses and to manage claims, is explicitly mentioned as part of the insurance risk policy content requirements : • the pricing approach should include the determination of the appropriate level of any reviewable premium; • the approach to managing its expense levels, including acquisition costs, recurring costs, and one-off costs, taking account of the margins available in both the prices for products and in the technical provisions in the balance sheet, should be spelt out; Other pricing and risk managing relevant aspects are also required by the FSA to be defined in the insurance risk policy, like the treatment of discretionary benefits, the proper inclusion of options within long-term contracts, the approach to managing persistency risk as well as its approach to limiting significant aggregations of insurance risk. Compliance with the risk-taking activity requirements is supervised using the ARROW risk framework, which includes a proportional approach to monitoring of each area including C&Cs, regular MI analysis, stress testing, IGD/P1 checking, together with an ICAS and ARROW Discovery review in each regulatory period. The regulatory frequency is set up based on the risk profile of the firms. This

	process includes monitoring the trends in loss ratios between product lines and analyzing the adequacy of premium adjustments and reserving levels. Pricing and underwriting strategies employed by the insurer are also reviewed alongside assumptions used. In addition, frequency and appropriateness of changes to those assumptions and strategies are monitored. The link to underwriting and pricing strategies is also tested and analyzed, as is the Board and Executive Committee understanding, the latter point forming part of the ICAS Use Test as well as regular supervisory activity. Supervisors review the reinsurance program under ARROW II, taking into account the degree of supervision of the reinsurer and the level of risk mitigation including collateralization. Sound requirements and guidance on credit risk in reinsurance/ risk transfer contracts are contained in the FSA Handbook including the overall limitation of credit risk and notification and explanation requirements for large reinsurance exposures.
Assessment	Observed
Comments	The with-profits business has been under close supervision for several years with respect to all technical aspects, such as reserving and, investment strategies. In the last few years, with the increased resources in the supervisory and actuarial area as well as the introduction of ARROW 2 and CPPI, the FSA has focused more intensively on pricing and underwriting deficiencies. The results and actions taken to monitor and enforce compliance by insurers with the insurance risk management requirements in the last few years have led to the observance of this principle. The authorities are recommended to maintain the momentum and focus on actuarial and supervisory activity to be fully compliant with this principle.
Principle 20.	Liabilities The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.
Description	The FSA regulates the adequacy of technical provisions and the valuation of liabilities, including both technical provisions and other liabilities with general and specific prudential regulation contained in their Handbook in GENPRU and INSPRU. Current regulation has implemented requirements of the EU insurance directives and the reinsurance directive for both general and long-term insurance with regard to the technical provisions. Regulation provides for the use of agreed current sound accounting and actuarial standards, further it requires systems and control to be in place to ensure reliability of the valuation of liabilities. Policies and procedures are in place for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month-end and ad-hoc verification procedures, appropriate reporting lines, and segregation of duties. Prudent rules for the valuation of liabilities are in place, such as the requirement to match in case of coinsurance at least the lead insurer's liability assessment, it also only allows in general insurance discounting in limited circumstances and includes equalization provisions in addition to the standard positions. For long-term insurance business, insurers must establish adequate technical provisions rules and guidance is given for calculating the mathematical reserves

	using sound actuarial methods such as those issued or adopted by the Board for Actuarial Standards. The choice of the discount rate for the valuation of the mathematical reserve follows prudential principles. Such requirement is not to exceed 97.5 percent of the risk-adjusted yield expected to be obtained by the underlying assets and future premium payments. Further, ICAS and realistic balance sheet requirements have introduced realistic economic risk-sensitive valuations of liabilities. Supervisory review of the sufficiency of technical provisions is supported by information contained in the FSA returns. Both onsite inspections and offsite monitoring are used in the supervision of the liabilities and technical provisions. In the last few years and as a result of the crisis, quarterly reporting has been requested on several parameters and for selected firms. The FSA has sufficient powers to require technical provisions to be increased if they are deemed not sufficient. An insurer may only take credit for reinsurance if and to the extent that there has been an effective transfer of risk as defined in detail by the FSA. Sound accounting principles exist and are required by regulation in respect of reinsurance arrangements. These accounting principles provide limits/credits referred to in the essential criterion by establishing the appropriate accounting valuation basis for amounts recoverable under reinsurance arrangements. Reinsurance recoverable and similar arrangements involving an SPV will only be considered under special circumstances and require an explicit waiver from the FSA. Stress testing is required to determine general financial adequacy and effective risk management.
Assessment	Observed
Comments	The reporting forms required by the FSA have added detail and increased the scope of the data from a few years ago, as a result of the introduction of realistic balance sheets for with-profits business and enhanced capital requirements using realistic valuations more generally. The ICAS has also introduced risk sensitivity and economic aspects to the valuation of liabilities and technical provisions. Further, if needed, the FSA has successfully requested additional data with higher frequency. The ability to request needed data together with the additional resources in the actuarial and supervisory area allow the FSA to gain a fair understanding on the adequacy of the technical provisions and take timely action if required. Adequacy of liabilities for long-term business needs the opinion of a qualified actuary. This requirement should be extended to the GI liabilities.
Principle 21.	Investments The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.
Description	The FSA Handbook sets the requirements regarding the management of investments. General requirements on the prudential risk management and associated systems and controls for insurers are contained in SYSC 14, including credit risk, market risk, and liquidity risk. SYSC 14.1.27R requires the insurers to take reasonable steps to establish and maintain adequate internal controls including the safeguarding of assets as referred to under SYSV 14.1.28G. Insurers should have in place rigorous audit procedures that include full coverage of their investment activities.

	The required business plan and risk policies of an insurer should provide a clear indication of the amount and nature of credit risk the firm wishes to incur, including the level of diversification required by the firm and the firm's tolerance for risk concentrations. The FSA assigns ultimate responsibility of an insurer's investment policies and procedures to the Board of Directors. The investments are valued either using marking to market or marking to model with independent price verification. The ICAS requires a market consistent valuation of the assets. Stress testing is required. Insurers can hold any type of investment with few exceptions. However, these are subject to capital charges which act as a disincentive to holding riskier investments. Investments are subject to admissibility requirements for capital purposes under GENPRU Annex 7. Admissible assets are subject to large exposure limits and market risk and counterparty exposure limits. Insurers should employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them in all areas. This includes the investments. (SYSC 2.1.1R) Compliance with these requirements is checked via C&C program through Investment Committee minutes, use of Arrow and the ICAS work. For very high-impact life insurers, the FSA has started to carry out comprehensive Financial Risk Reviews.
Assessment	Observed
Comments	Regulatory requirements are in place for insurers to manage their investment risks in a manner proportionate to the nature, size, complexity, and risk profile of their operations. This is checked on- and off-site using for instance peer comparisons. The investments valuation is audited on a needs basis using FSA or external experts. Deviation from the documented investment strategy is monitored and has led to FSA action, in particular where solvency deterioration or detriment of policyholder's interests was feared. The ultimate responsibility for investment activities lies with the Board. Where this was not the case, the FSA has acted to push it to the Board level and, as best practice, to the nonexecutive Board members. Thematic and market analysis has led to detailed examination of investment positions held by insurers in the last few years. Solvency II will add granular knowledge of the investment position on a regular basis.
Principle 22.	Derivatives and similar commitments The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.
Description	The FSA defines the derivative as admitted assets if held for the purpose of efficient portfolio management or reduction of investment risk. Admissible derivatives must be covered and issued under rules of a regulated market or by an approved counterparty. In the latter case, the ability to value the instrument must be demonstrated. Disclosure requirements for derivatives and similar commitments are established under IPRU(INS). Detailed information on swaps, futures in the money and out of the money options needs to be reported.

	The risk management policies and control principles are required to include capabilities to assess nonlinear and geared market risk coming typically through the use of derivatives (SYSC 16.1.8G) Supervision monitors and assesses Board level understanding of all investment strategies, risk appetites, and tolerance breaches, including derivatives policies employed across the firm. This is achieved via an initial fit-and-proper test and ongoing assessment, for instance through C&C supervision and the ICAS Use test. The FSA returns are used for offsite monitoring. These returns can be complemented with further details on asset exposures if necessary. Market wide conditions are taken into consideration and can lead to in-depth supervision or analysis of derivative positions.
Assessment	Observed
Comments	The regulatory policy and requirements for the use of derivatives by insurers are aligned with international best practice. Misuse of derivatives has been identified in the last few years and corrective action enforced. Understanding at the Board level is rigorously checked during the fit and proper interviews and examples of the negative recommendation on individuals could be pointed out. The use and understanding of ICAS at the Board level is assessed during onsite inspections and enforced through temporary capital levies.
Principle 23.	Capital adequacy and solvency The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.
Description	Currently, the solvency regime for insurers is based on Solvency I, with enhancements to gain a more risk-sensitive capital level in the industry ahead of the implementation of Solvency II. Realistic balance sheets have been introduced to determine the with-profits insurance capital component and resilience capital requirements used for long-term business generally to provide for the risks arising from the mismatches between assets and liabilities. These enhancements have proved to be necessary as the minimum requirements under Solvency I do not address the full complexity of risks when defining the capital requirements. This has been supplemented by the FSA by special capital requirements for long-term business and for with-profits business. With the introduction of ICAS in 2004 as a pillar 2 requirement, the FSA has addressed other deficiencies of Solvency I via pillar 2. In 2009, the Solvency II Directive was adopted by the European Parliament and the Council (2009/138/EC). Implementation of Solvency II is planned to commence on January 1, 2013. The valuation of assets and liabilities follows accounting principles used for general purpose financial reporting, unless otherwise stated (including IFRS where applicable), and is addressed in detail in the FSA Handbook (GENPRU and INSPRU). Valuation is required to be carried out by marking to market wherever possible or by marking to model with an independent view when deemed necessary. Admissible assets for capital purposes are listed. Counterparty exposure limits are indicated, which are more restrictive for assets of lower liquidity. Requirements for the matching of assets and liabilities are included. Suitable forms of capital together with minimum levels for high quality capital and

	maximum levels for lower quality capital are defined in detail in GENPRU 2.2. Prudent rules are in place that (i) allow a firm to take credit for reinsurance only if and to the extent that there has been an effective transfer of risk, and (ii) require the firm to only rely upon a loss mitigation technique where it has good reason to believe that, taking into account the possible circumstances of default, it is likely to be effective(INSPRU 1.2).

	Prudential rules for reserving are part of the FSA requirements. For instance, technical provisions for long-term business should include provisions for margins for adverse deviation, and discounting on GI reserves are only allowed under certain circumstances. The FSA's individual pillar 2 capital guidance (ICG) is set on the basis of ICAs performed at a 200-year event confidence level over a one-year timeframe that the value of assets exceeds the value of liabilities. Capital expected to be held is the higher of pillar 1 and pillar 2 capital, although only pillar 1 figures are published. Supervisory intervention points related to the level of solvency are set out in the supervision manual. Capital below the ICG would trigger communication with the FSA to consider appropriate action. The requirements of the Insurance Groups Directive and Financial Conglomerates Directive with respect to capital adequacy of insurance groups and insurance conglomerates at group and sub-group levels have been implemented through INSPRU 6.1.6G and 6.1.17R. This directive addresses effectively inflation of capital by setting a group capital requirement for insurers that are members of insurance groups. The group capital position has to be calculated by all groups and group capital resources greater than or equal to the group capital requirements have to be maintained at the European level. INSPRU 6 has specific requirements in the calculation of group capital resources which deal with intra-group creation of capital and, inter alia, double counting as well as the risk of assets not being transferable between undertakings in the group. All material intra-group transactions are required to be reported under IPRU(INS), and group risk is one of the major risk types that is required to be taken into account in GENPRU 1.2.30R. Stress and scenario testing for an appropriate range of circumstances is required for general financial adequacy purposes under GENPRU 1.2.42R. Reverse stress tests are part of the systems and controls requirements, which require a firm to identify and assess events and circumstances that would cause its business model to become unviable. This is expected to help the firm's senior management to identify the firm's vulnerabilities and design a strategy to prevent or mitigate the risk of business failure. The FSA is vigorously engaged in the convergence of solvency requirements through active participation in leadership positions at the IAIS and other international fora.
Assessment	Largely Observed
Comments	Paving the way for the implementation of Solvency II, the FSA has been working over the last 18 months with a team of 250 people and a budget of £100 to £150 million. The FSA expects around 104 insurers to apply for the approval of their internal model and a group of 150 experts are currently assigned to cope with this

	coming task. While the ICA is a pillar 2 requirement, the intensity and scrutiny that the FSA has put behind, it de facto treats this capital requirement as a pillar 1 requirement. As such, the transition into a Solvency II regime should be accomplished by 2013. This will result in a more risk-sensitive and robust solvency regime for the United Kingdom, which is expected to lead to full observance of these principles. The excellent focus and quality of resources dedicated to the Solvency II work needs to continue. The approval of internal models is a crucial step for the insurance industry in this highly specialized and sophisticated market. The models will be complex and only sufficient resources and expertise will allow understanding of the sufficiency of the resulting capital levels.

Markets and consumers	
Principle 24.	Intermediaries The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.
Description	The EU Insurance Mediation Directive (IMD) also requires the relevant competent authorities to register intermediaries that carry on insurance mediation activities, as defined within the scope of the directive. The U.K.'s Regulated Activities Order sets out the activities that the FSA regulates, which includes the activities that insurance intermediaries require FSA authorization to carry out. So, as the competent authority, the FSA licenses and supervises insurance intermediaries. The Threshold Conditions are used as the basis for judging whether to authorize an intermediary and by supervisors to assess on an on-going basis whether an intermediary should continue to be authorized. The Threshold Conditions cover a wide range of matters, including the applicant's connection to other parties; ownership; fitness and propriety of the Board and senior management; governance arrangements and adequacy of resources (both financial and nonfinancial). The United Kingdom has implemented IMD, which sets out the minimum professional requirements for insurance intermediaries in relation to their knowledge and ability and conduct. Insurance intermediaries are subject to the requirements in the FSA Handbook and the Fit and Proper Test for Approved Persons (FIT) which sets out the minimum standards for becoming and remaining an approved person. This cover: • Honesty, integrity, and reputation; • Competence and capability; and • Financial soundness. Insurance intermediaries are also subject to our high-level requirements in the FSA's Training and Competence sourcebook (TC). In this regard, competence means having the skills, knowledge, and expertise needed to discharge the responsibilities of an employee's role. This includes achieving a good standard of ethical behavior. In addition to this high-level requirement, insurance intermediaries who mediate insurance-based packaged retail investment contracts are subject to specific qualification requirements. The FSA has wide ranging powers under FSMA to take action against individuals or entities carrying on insurance intermediation activity that are not authorized to do so. The potential enforcement action is wide, varied and potentially severe and

	includes: public censure and fines (Part XIV), injunctions and restitution (Part XXV), the variation including cancellation and hence ending authorization, and information and investigation powers (Part XI). In addition to its supervisory and whistle blowing activity to detect and encourage the reporting of unauthorized activity, the FSA has a team in its enforcement area dedicated to the identification, ending and pursuance of enforcement action against unauthorized persons conducting regulated activities. Numerous examples of fines being imposed and intermediary authorities being cancelled have been cited. FSA Business Principle 10 requires firms to arrange adequate protection for clients' money when they are responsible for it. Chapter 5 of the FSA's Client Assets Sourcebook (CASS) provides the requirements for the client asset segregation regime in relation to insurance mediation. Subject to certain exceptions (including for reinsurance mediation activities and firms that are approved banks holding money in an account with themselves), these rules apply to a firm that receives or holds money in the course of or in connection with its insurance mediation activity. Money that is held on behalf of an insurance undertaking is not normally client money for the purposes of the FSA's rules. The CASS rules specify: the permissions, disclosures and documentation requirements for a firm holding client money or assets; the type of accounts in which money can be held; and how often these accounts need to be audited and reconciled. Firms which hold client money are required to hold regulatory capital, as set out in the Prudential sourcebook for Mortgage and Home Finance Firms and Insurance Intermediaries (MIPRU) and are required to notify the FSA immediately if there is any short fall in their client money account which cannot be rectified within 12 hours. The FSA views the holding of client money to be a high risk activity and has enhanced its dedicated teams dealing with CASS Policy and CASS Supervision issues. It has recently issued consultation papers seeking industry views on proposals to (i) establish a CASS Oversight and Control Function within firms that hold client money permissions; (ii) reestablish a dedicated Client Money Return; and (iii) establish a separate regulatory fee block to pay for the oversight and supervision of firms that hold client money permissions. The IMD that sets out the minimum information requirements that intermediaries should be provide, prior to the conclusion of any initial insurance contract, and, if necessary upon amendment or renewal, about their status, the services they provide and the capacity in which they are acting. These requirements are transposed into the FSA Handbook in the Insurance Conduct of Business Sourcebook (ICOBS) Chapter 4. Insurance intermediaries who mediate insurance-based packaged retail investment contracts are also subject to requirements in the FSA's Conduct of Business Sourcebook (COBS) Chapter 2, which contains information disclosure before providing services and information about the firm, its services and remuneration, in particular requirements for firms that wish to hold themselves out as independent in regard to the advice they provide. FSA Business Principle 8 requires firms to manage conflicts of interest fairly, between both themselves and their customers and between customers and another client and these requirements apply to insurance intermediaries. Furthermore, through SYSC, firms (including insurance intermediaries) are required to have governance arrangements and systems and controls in place in order to manage their affairs effectively, including the management of conflicts of

	interest. Insurance intermediaries would mostly be low impact firms and thus subject to ARROW Small Firms, which will only involve on-site inspection of controls if other sources of information suggest problems. There are some larger intermediary firms which are subject to other forms of ARROW and thus receive closer FSA scrutiny of their systems and controls. Through FSA thematic reviews, some smaller insurance intermediaries would be subject to closer FSA scrutiny. The FSA launched a Retail Distribution Review (RDR) in June 2006 to address many persistent problems observed in the retail investment market. In June 2009 the FSA issued a consultation paper (CP09/18) on Delivering the RDR, which sets out the following three measures most fundamental to delivering market outcomes and which materially improve the interactions between consumers and the industry: • improve the clarity with which firms describe their services to consumers; • address the potential for adviser remuneration to distort consumer outcomes; and • increase the professional standards of investment advisers. Some final FSA policy and rules have been issued with more detail to come before the new framework comes into effect at the end of 2012. Firms will be required to make clear whether they are providing independent or restricted advice, and firms giving independent advice will have to consider all types of packaged retail investment products when analyzing the market. In addition, all firms selling/advising on pure protection 'in association' with investment advice will be required to explain how they are remunerated for the sale/advice and disclose the amount of any commission if there is a subsequent sale.
Assessment	Observed
Comments	Through the FSMA and the implementation of IMD, the FSA authorizes and supervises insurance intermediaries. There are comprehensive and adequate financial resources, competency, systems and controls, client money handling and customer disclosure requirements placed on intermediaries. Supervision is mostly offsite for smaller intermediaries, but on-site supervision does occur for the larger intermediary firms and through thematic review for some smaller intermediaries. The FSA actively used fines, censures and cancelation of authorizations where needed and to convey what is unacceptable practices. The FSA's Retail Distribution Review to address many persistent problems observed in the retail investment market is a strong example of active regulation by the FSA to protect consumers. It will result in increased requirements on insurance intermediaries which will be more onerous than those in most other countries.
Principle 25.	Consumer protection The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.
Description	High-level principles stated in the FSA Handbook require insurers and intermediaries to conduct business with integrity, skill, care, and diligence, and with

	due regard to customers' interests and information needs. The FSA has implemented the relevant EU directive that sets out the minimum professional requirements for insurance intermediaries in relation to their knowledge and ability and conduct. The FSA conducts a fit and proper test for approved persons in both insurers and insurance intermediaries. For the intermediation of products prone to misunderstandings like the bundled retail investment products, specific qualification are required. The FSA has supplemented, where necessary, the relevant EU insurance directives that set out the requirements for insurers and intermediaries to appropriately assess their customers' demands and needs in order to make an informed decision about their insurance purchases in either an advised or non-advised sale. For instance, an insurance intermediary is required prior to the conclusion of the contract to specify, on the basis of the information provided by the customer, the demands and needs of the customer and the reason for any advice. Further, the FSA requires firms to take reasonable steps to ensure that customers only buy products for which they are eligible to claim benefits (ICOBS). The FSA requires every regulated firm to conduct business with due regard to the interests of its customers and treat them fairly and pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading. Firms are required to have appropriate systems and controls in order to manage their affairs effectively, including policies on training and competence for their employees and agents. Where necessary, the FSA has supplemented the relevant EU requirements to ensure that customers receive adequate information in order to make an informed decision about their insurance purchases. For instance, detailed information about the price of the product, its main benefits, exclusions and limitations, and cancellation rights is required. Further, for pure protection contracts, if information is provided orally on the main characteristics of the policy, the information should include all the policy's main characteristics. The FSA requires insurers to provide reasonable guidance to help a policyholder make a claim, handle claims promptly and fairly, not unreasonably reject a claim and settle claims promptly once settlement terms have been agreed. In addition, for more complex products like long-term care, contracts, and with-profit contracts special provisions apply for handling claims. The FSA requires authorized firms to abide by the rules on dispute resolution that require a fair treatment of complainants. This includes the establishment of The Ombudsman Scheme to allow disputes with a limit value of £100,000 to be resolved quickly and with minimum formality by an independent person.
	The Data Protection Act 1998 ensures data held about individuals processed and used by organizations are managed properly. Breaches in the control system that violate this Act need to be reported. The FSA requires further from insurers and intermediaries to take reasonable care to make and retain adequate records of matters and dealings which are the subject of requirements and standards under the regulatory system. Firms operating cross-border are recorded on the FSA's Public Register and have

	to abide by the FSA supervision with respect to consumer protection regulation. The FSA has wide ranging powers under FSMA to take action against individuals or entities carrying on regulated activities that are not authorized to do so. A dedicated team is in charge of identification, ending, and pursuance of enforcement action against unauthorized persons conducting regulated activities. Details of any sanctions are usually made public. The Consumer Financial Education Body (CFEB) is an independent organization established by statute (FSMA). Its objective is to improve public awareness of financial services. To that end, it helps consumers to understand finance related matters by providing impartial information, education and advice nationally. Its webpage (www.moneymadeclear.org.uk) explains financial terminology and product in simple clear language without making recommendations about any specific financial products. The FSA web page contains warnings on particular products or entities offering unregulated products. The Financial Services Compensation Scheme (FSCS) is the United Kingdom's compensation Program for customers of authorized financial services firms. The scheme exists to protect customers where a firm is unable, or unlikely to be able, to pay claims against it. For eligible claimants (generally individuals and small businesses) the FSCS compensated for losses up to 90 percent of the value of their insurance contract (100 percent in the case of compulsory insurances).
Assessment	Observed
Comments	One of the four FSA statutory objectives is consumer protection. Complying with this objective, the FSA has implemented and, where necessary, supplemented relevant EU directives in the consumer protection area. The FSA has a strong focus on the supervision of consumer protection matters and has allocated sufficient resources to this activity. When necessary, intrusive supervision is applied. For instance, to supervise compliance with the appropriateness of the information actions like monitoring recorded sales or expert analysis for complex products are conducted. There is strong follow up on the implementation of sales practices and remedial actions are taken. Insurers and insurance intermediaries complains' data is monitored on a regular basis and if necessary interventions are carried out. Redress requirements, when imposed, are monitored for their appropriateness and completeness. Standards on the claim handling systems are supervised and, if needed, remedial orders are issued. Violations on consumer protection issues have resulted In substantial monetary fines and consumers appropriate redress. In case of events leading to a large number of claims like the recent volcanic ashes event, the FSA starts close monitoring of the process. Aggregation web platform comparing insurance products are currently under the FSA scrutiny with respect to the information quality and disclosure requirements. The Retail Distribution Review (RDR) is currently under consultation where higher professional and ethical standards, as well as a banning of commission based remuneration, are required for intermediaries that provide insurance products with investment components.

Principle 26.	Information, disclosure and transparency toward the market The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.
Description	All companies in the United Kingdom are registered at Companies House, an Executive Agency of the Department for Business, Innovation and Skills (BIS). Every company must prepare annual accounts that report on the performance and activities of the company during the year, and submit these to the Companies House. Generally, accounts must include: • a profit and loss account (or income and expenditure account if the company is not trading for profit); • a balance sheet signed by a director; • an auditors' report signed by the auditor; • a directors' report signed by a director or the secretary of the company; • notes to the accounts; and • group accounts (if appropriate). For listed insurers, there is a requirement to publish: • An annual report (within four months of the year end) which must include (among other requirements) audited financial statements and a management report that sets out a fair review of the business and the principal risks and uncertainties, consistent with the size and complexity of the business (DTR 4.1). The annual report must bear an opinion by the independent auditor as to the completeness and accuracy of the financial statements. (SUP 3.1.2R, SUP 3.3.2R) and must have been prepared following national accounting standards or International Accounting Standards (IAS). Own accounts and consolidated accounts if the own accounts contain additional significant information must be published. • A half-yearly financial report within two months of the half year-end which must include (among other requirements) (i) condensed financial statements; and (ii) an interim management report that sets out an indication of the important events that have occurred in the first half which have had a material effect on the financial position or performance (DTR 4.2). • Interim Management Statements in their first and third quarter periods (i.e., the periods that fall between their annual and half-yearly reports). The firm's FSA returns include a profit and loss account, revenue account and balance sheet, together with notes and the auditor's report and must be available on request to the public (IPRU(INS) 9.7). The FSA examines the regulatory returns provided by insurers. Statutory accounts are monitored for compliance with disclosure requirements by the Financial Reporting Council. Further, listed insurers are subject to rules under which, subject to certain conditions, they are required to disclose as soon as possible relevant information which directly concerns the firm (DTR 2.2).

	The FSA's rules require that an insurer's processes and systems must enable the firm to identify the major sources of risk to its ability to meet its obligations. The FSA can review this material, but it is not required to be publicly disclosed. External auditors also have a statutory duty to inform the FSA whether any concerns of material significance have arisen during the course of their work (FSMA Sections 342(5) and 343(5) and SUP 3.8.10).
Assessment	PO
Comments	For a number of years the published standard return information has not been comprehensively revised even though it has been updated and improved. This is predominantly because EU developments on Solvency II have been ongoing for a few years and it was clear that, when introduced they would significantly change and increase the data insurers would be required to disclose. The FSA, as a response to its urgent need to acquire a more realistic view of the firms' financial position in the complex market it operates has introduced ICAS along with enhanced capital and reporting requirements in 2004. While, enhanced capital requirements and realistic balance sheets for large with-profit insurers have been made public, additional valuable knowledge of the financial position from insurers' individual capital assessments under ICAS has not been required to be made public. Modern risk-sensitive capital requirements should be public to cope with the complexity of the business in a better way than through the current enhanced Solvency I metrics.
Principle 27.	Fraud The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.
Description	One of the four statutory objectives for the FSA is the reduction of financial crime. Financial crime includes fraud, money-laundering, corruption and market abuse. Insurers and insurance intermediaries all fall within the supervision of the FSA. The FSA Handbook contains provisions that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to promote financial crime. Firms must report events that may adversely affect the firm, including fraud against the firm and its customers. The FSA applies a range of supervisory techniques ranging from desk based reviews to on-site visits. Financial crime specialists provide support and technical advice to supervisors as well as conducting thematic reviews on specific financial crime-related topics. The top 100 high impact firms receive targeted and regular scrutiny from their supervisors. Over 20,000 lower-impact firms are reviewed through a computerized checking system of firms' self-assessment reports. The FSA also carries out ad hoc reviews to examine closely anticrime awareness and standards among the small firm population. The FSA has a wide range of administrative sanctions against both individuals and firms. These powers are used applying substantial fines to companies as well as banning individuals from authorized positions. The FSA deploys resources across the organization to address financial crime. It

	also has a dedicated Financial Crime and Intelligence Department within the Enforcement and Financial Crime Division. Regulation allows the FSA to disclose confidential information to any person (including the FIU): • for the purposes of any criminal investigation or proceedings whatever, which are being or may be carried out, whether in the United Kingdom or elsewhere; • for the purposes of any proceedings under Part 2, 3 or 4 of the Proceeds of Crime
	Act 2002 (criminal confiscation proceedings), which have been or may be initiated; for the purposes of initiating or bringing to an end any such investigation or proceedings or of facilitating a determination of whether it or they should be initiated or brought to an end. The FSA has in place a wide range of MoUs with domestic and international authorities. The Fraud Act 2006 establishes generic fraud offences, which also cover insurer fraud. In addition, FSMA makes it a criminal offence to conduct financial services business in the United Kingdom without being authorized by the FSA . The FSA has established 11 principles for businesses that all regulated financial businesses must comply with. Principle 1 requires that a firm must conduct its business with integrity, principle 5 requires that a firm must observe proper standards of market conduct and principle 6 requires that firms must have due regard to the interests of their customers and treat them fairly. Further insurers are required to satisfy themselves of the suitability of anyone who acts for them. This includes an assessment of honesty, competence and suitability. The FSA Handbook sets out requirements for firms to notify the FSA if it becomes aware of events that may adversely affect the firm. Such events include fraud against the firm, fraud committed by an employee as well as irregularities in its accounting or other records, whether or not there is evidence of fraud. The FSA interacts regularly with industry bodies on matters related to financial crime. FSA maintains internal databases which contain details in respect to fraud and those committing fraud. Specific requirements with regard to money laundering are set out in ICP 28.
Assessment	Observed
Comments	Legislation requires the FSA to take an active role in combating insurance fraud and the FSA has acted accordingly. Several thematic work projects covering fraud have been carried out. The focus in 2010 was on small firms and on anti-bribery and corruption in commercial insurance broking. During 2009, 236 onsite visits included financial crime experts from Financial Crime and Intelligence Department. Of these visits, 196 related to thematic assessments and 40 were in support of supervisory or enforcement reviews. Also, the industry is actively engaged in combating fraud, detecting claim forms, and investigating cash fraud schemes. Close cooperation and information exchange with enforcement agencies and other

	supervisors, both locally and internationally, to address fraud to preserve the integrity of the insurance sector are practiced by the FSA. Substantial fines have been imposed, prompting the whole industry to implement corrective action.
Anti-money laundering, combating the financing of terrorism	
Principle 28.	Anti-money laundering, combating the financing of terrorism (AML/CFT) The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).
Description	The AML/CFT legal framework is set out in the Proceeds of Crime Act 2002, the Terrorism Act 2000, the Counter-Terrorism Act 2008 and the Money Laundering Regulations 2007 (MLR). The Money Laundering Regulations transpose European Directive 2005/60/EC. These laws and regulations reflect the FATF recommendations and are applicable to all insurers and intermediaries offering life insurance products or other investment-related insurance. The obligation to report knowledge or suspicion of money laundering under POCA also applies to general insurers. The FSA is the designated supervisor on these matters. The latest mutual evaluation by FATF was published in 2007. The only strategic deficiency identified related to Recommendation 5. In the 2009 follow-up report FATF concluded that the United Kingdom had taken sufficient action to bring its compliance to a level essentially equivalent to largely compliant with regard to Recommendation 5. At the time of the publication of the MER, the United Kingdom was rated as compliant with Recommendation 28 (Powers of competent authorities) and largely compliant with Recommendations 17 (Sanctions) 23 (Regulation, supervision and monitoring) and 29 (Supervisors). The FSA has the authority to conduct on-site inspections, require documents and information and to conduct investigations. It can also apply disciplinary measures and a wide range of administrative sanctions against both individuals and firms. These range from the imposition of unlimited financial penalties to public censure, and removal of authorization to conduct financial services business. The FSA's supervision, sanction, and enforcement powers under FSMA also apply to its financial crime work. The FSA can take civil or criminal action against firms for failure to meet their legal and regulatory AML/CFT obligations. With regard to the authorization of individuals and change of control, the FSA applies measures to verify the integrity of the owners of financial institutions and their fitness and properness, which includes honesty, integrity, and reputation of all persons occupying "Significant Influence Functions." These functions include compliance and money laundering reporting officers. There are no barriers to providing mutual legal assistance (MLA). In the event that a request is declined, the reason or reasons why the request cannot be executed will always be stated and, where appropriate, the requesting authority will be invited to modify the request so that assistance may be provided. The FSA has entered into a number of MoUs with international authorities. Further, by legislation

	the FSA is allowed to disclose confidential information to any person, including the FIU, for the purposes of any criminal investigation or proceedings whatever, which are being or may be carried out, whether in the United Kingdom or elsewhere. The Joint Money Laundering Steering Group (JMLSG), a group of financial sector trade associations, has issued detailed guidance for firms on how to comply with their legal and regulatory AML/CFT obligations. This guidance has been approved by the Government through provisions in relevant legislation and is also explicitly referred to in the FSA's Handbook of Rules and Guidance. The MER concluded that "the FSA as a whole seems adequately funded, staffed and has sufficient technical and other resources to fully and effectively perform its functions." The FSA deploys financial crime resources directly and indirectly across the organization to address risk to its financial crime objective. The teams working directly on financial crime include the Financial Crime and Intelligence Department, plus a proportion of the Market Monitoring Department and the Enforcement Division. Ongoing supervision of financial institutions is determined by a risk-based approach (ARROW). Financial crime is one aspect of the supervisory process and a specific internal manual, the Supervisor's Guide on Financial Crime has been developed for this purpose. This continuous approach applies to the top 100 firms. Over 20,000 small firms are reviewed through a computerized checking system of firms' self-assessment reports. The FSA carries out ad hoc reviews to examine closely AML/CFT awareness and standards among the small-firm population. Financial crime specialists from FSA regularly take part in the monitoring procedures in order to assess AML/CFT controls. All insurers are subject to the reporting requirements in the Terrorism Act 2000 and the Proceeds of Crime Act 2002 (POCA). They are also under additional, regulatory obligation to put in place systems and controls to prevent financial crime (SYSC 3.2.6R). Legislation clearly lays out the requirements relating to customer due diligence (CDD) and verification of customers' identities, including circumstances for enhanced CDD for any situation which, by its nature, can present a higher risk of money laundering or terrorist financing. Firms are also required to conduct ongoing monitoring of the business relationship on a risk-sensitive basis. The MLR includes a requirement that relevant records are retained for a period of five years. FSA requires firms to have a separate compliance function and to appoint a money laundering reporting officer, who may also be the nominated officer under POCA, where firms are subject to the FSA's rules on money laundering. The FSA requires the MLRO to have a level of authority and independence within firms sufficient to carry out his functions effectively and the MLRO is a controlled function. The MLR require that financial institutions must require their branches and subsidiary undertakings, which are located in a non-EEA state, to apply to the extent permitted by the law of that state, measures at least equivalent to those set out in the MLR with regard to customer due-diligence measures, ongoing monitoring, and record-keeping. The FSA supervisory visits include a review of controls over all foreign branches and subsidiaries as part of the ARROW assessment. This review includes looking at instructions to and requirements on

	foreign branches and subsidiaries as well as reviewing internal audit programs and reports. The scope of the assessment includes review of controls to prevent fraud and money laundering, including customer due diligence measures, ongoing monitoring and record-keeping.
Assessment	Largely Observed
Comments	The AML-CFT requirements applicable to insurers are broadly in line with the FATF recommendations. The number of FSA disciplinary sanctions has increased from 14 enforcement actions including warnings and the cancellation of one license for the period of 2001-2007 to 84 disciplinary sanctions concerning financial crime matters, including 11 against insurers and insurance intermediaries from 2007 to 2010. Aggregate fines of £12,562.477 were levied on insurers and insurance intermediaries. While the supervisory system was generally comprehensive for the larger ("high-impact" firms), there was less adequate supervision for smaller firms. In these cases, the risk assessment and resulting level of supervision often relied too heavily on the size of the financial institutions and did not always adequately take AML/CFT risk into account. While the AML regulations require that financial institutions must require their branches and subsidiary undertakings located in a non-EEA state to apply, to the extent permitted by the law of that state, measures at least equivalent to those set out in the AML regulations with regard to customer due-diligence measures, ongoing monitoring and record-keeping. However, no evidence of supervisory work on compliance with this requirement was presented.