Financial Services Regulatory Insights

PRA clarifies its approach to authorising and supervising third-country branches

AT A GLANCE

October 2023

What's new?

- The PRA published a consultation paper (CP21/23) on 4 October 2023, clarifying and setting out more detail on its authorisation and supervisory expectations in respect of third-country branches (TCBs). The PRA confirms its substantive approach to TCBs remains materially unchanged.
- The PRA explains its proposals are informed by the UK's departure from the EU; the PRA's lesson learned from authorising and supervising TCBs during the Temporary Permissions Regime; and its review of Solvency II.
- CP21/23 applies to TCBs of entities headquartered outside the UK or Gibraltar that wish to be authorised to operate as a branch in the UK. Swiss General Insurers are not in scope as they are subject to different requirements under the Swiss Treaty Agreement.
- The PRA confirms it is still considering responses to its June 2023 consultation paper (CP12/23), where among other things, it proposed removing TCB capital requirements. Through its proposals the PRA aims to maximise reliance on home supervisors, focus on the importance of the financial resources of the TCB's parent undertaking (the undertaking), and ensure a proportionate approach to supervision.

What does this mean?

- The PRA proposes to remove SS2/18 and replace it with a new Statement of Policy (SoP). The SoP will consolidate and clarify the PRA's approach to the authorisation and supervision of TCBs.
- The SoP provides more information on the factors that the PRA considers when assessing the risks of a TCB. This includes setting out further detail on the TCBs' undertaking's ability to meet the Threshold Conditions. The PRA will assess that business is conducted in a prudent manner by reviewing the financial resources information that the TCB's undertaking provides.
- The PRA notes that the financial resources of TCBs are managed by their undertakings, which means the financial resources of both the TCB and undertaking are inherently linked to each other. This includes asset portfolios and reinsurance arrangements.
- The PRA continues to consider that where a undertaking writes the majority of its business in the UK through a TCB, the ability of the home supervisor to supervise the whole firm may be compromised. Therefore, the PRA clarifies that it will assess the proportion of the undertaking's business that has been written by the TCB, and consider whether a subsidiary may be more appropriate than a branch structure.
- The PRA makes no change to its expectation that the FSCS liabilities of the TCB should remain below the £500m threshold.
- The PRA notes reinsurance can be an important risk management tool, but equally notes that overreliance on this tool by a firm can impact the incentives for prudent risk selection and management. As such, the PRA

Contacts

Will Gerritsen
Director

T: +44 (0) 7718 865076
E: will.gerritsen@pwc.com

Anirvan Choudhury
Senior Manager

T: +44 (0) 7483 423721
E: anirvan.choudhury@pwc.com

Sania Hussain
Manager

T: +44 (0) 7483 916259
E: sania.hussain@pwc.com

AT A GLANCE

October 2023

also proposes to set out its approach to considering the implications of the reinsurance arrangements of an undertaking when assessing the risks of a TCB.

- The PRA additionally proposes to amend SS44/15 to set out the PRA's expectations in relation to notifications, ORSA reporting, governance and senior management functions (SMFs), re-domiciliation, outsourcing and operational risk, and reinsurance counterparty risk.
- On ORSA reporting, the PRA proposes to allow a TCB to submit its undertaking's ORSA instead of a separate TCB ORSA. The undertaking's ORSA must clearly identify and address any material risks arising from the TCB as well as the undertaking, to the TCB's operations.
- On SMFs, the PRA confirms all TCBs are required to have a SMF19 head of TCB (and, where relevant, a with-profits actuary). The FCA SMF16 compliance oversight function is also required. The PRA further states if an undertaking has individuals in specific roles dedicated to the TCB's operations, then they will also require approval. These specific roles are: chief finance officer, chief risk officer, chief actuary, chief underwriting officer, or head of internal audit functions.
- A prerequisite of the PRA's TCB authorisation is that the TCB's undertaking must be capable of being effectively supervised by the home supervisor; therefore the PRA clarifies that it expects a new TCB application to be submitted where an undertaking re-domiciles to another home jurisdiction. To prevent this from being burdensome for firms, the PRA states that it would use its existing knowledge of the TCB's operations as part of its assessment. However, firms should ensure that they provide detail on any changes arising from the re-domiciliation in their new authorisation application.

What do firms need to do?

- TCBs should review CP21/23 and consider performing a gap analysis against their existing policies and procedures. For example, firms should consider whether current PRA notification processes are in line with the PRA's clarified expectations. Another example is whether SMFs have been appropriately assigned to individuals that are performing roles dedicated to the TCB's UK operations, taking in account the nature, scale and complexity of the TCB's operations.
- When seeking authorisation, international firms should consider the most appropriate structure for their business. The PRA makes its concern clear that where the undertaking underwrites a large proportion of its business through the UK TCB compared to its own home jurisdiction, then the failure of the undertaking is likely to have a larger impact on the UK. In this instance, it would be more appropriate for the business to take the form of a subsidiary rather than a TCB.
- The PRA will put increased reliance on information from the undertaking to satisfy itself that the TCB satisfies the Threshold Conditions. TCBs therefore may wish to engage with their undertakings to ensure they fully understand the PRA's expectations of them.
- TCBs should be aware of the reinsurance arrangements their undertakings have in place, and ensure that any risks arising from these arrangements to the TCB are appropriately assessed and mitigated.

Next steps

CP21/23 closes on 12 January 2024. The changes are expected to take effect by Q2 2024.

Contacts

Will Gerritsen
Director

T: +44 (0) 7718 865076
E: will.gerritsen@pwc.com

Anirvan Choudhury
Senior Manager

T: +44 (0) 7483 423721
E: anirvan.choudhury@pwc.com

Sania Hussain
Manager

T: +44 (0) 7483 916259
E: sania.hussain@pwc.com