Financial Services Regulatory Insights

PRA confirms supervisory priorities for insurers

AT A GLANCE

January 2022

What's new?

- In a Dear CEO letter dated 12 January 2022, the PRA set out its supervisory priorities for life and general insurers (including third country branches) for the year ahead.
- The letter highlights six areas of focus, detailed below. It also urges firms to mitigate against risks associated with greater specialisation, such as increased concentrations in business and/or operating models.

What does this mean?

Financial resilience

- All firms need to closely monitor credit risk within their portfolios and the impact on provisioning. The PRA expects CEOs and boards to have a clear understanding of the firm's exposure to credit downgrades and defaults, the impact this would have on the firm's financial position, and its ability to recover from losses. The regulator says firms must have adequate risk management in relation to this.
- The PRA expects insurers to monitor risks around inflation, as it notes that higher levels of general economic inflation are likely to persist into 2022.
- Among general insurers, the PRA says it has seen limited evidence of proper consideration of aggregate exposures, including from silent cyber risk.
- General insurers are also expected to manage the impact of FCA changes to pricing rules on their business models. The PRA intends to monitor the impact of these rules on business models and underwriting practices.
- The PRA will also assess the insurance sector's financial resilience through a stress test this year.

Operational risk and resilience

- The PRA says it will continue to challenge firms to develop a dynamic, effective risk and control framework to manage the hybrid working environment and operational disruptions, including from cyber attacks.
- It will continue to review firms' implementation of the operational resilience framework, and reminds firms of the 31 March 2022 deadline.
- The PRA also reminds firms of its expectations on outsourcing and third party risk management.

Financial risks arising from climate change

- The PRA recognises that some firms have made good progress in embedding its expectations under SS3/19, but says progress has not been consistent and further work is required by many firms.

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

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- This year, the PRA will incorporate supervision of climate-related financial risks into its core supervisory approach. It expects firms to take a forward-looking, strategic and ambitious approach to managing such risks across their business, including in underwriting and investment, in a proportionate manner.

Regulatory change

- The PRA highlights a number of regulatory developments which firms should be prepared to implement this year: reforms to Solvency II, developing a targeted resolution regime for the insurance sector, and improvements to its approach to authorising Insurance Linked Securities vehicles and other wholesale insurance firms.

Third country branches seeking authorisation

- The PRA expects to process around 150 third country branch applications from insurers currently in the Temporary Permissions Regime over 2022/23. The regulator urges applicant firms to cooperate with it in an open and transparent manner.

Diversity and inclusion (D&I)

- The PRA expects firms to consider the themes set out in DP2/21, challenge themselves to understand their gaps, and consider where they can make progress. The regulators are due to publish a follow-up consultation paper in H1 2022, and a policy statement in H2 2022.

What do firms need to do?

- While the priority topics set out in the letter should be familiar to firms, the letter is an important indication of how the PRA's expectations will evolve this year.
- On operational resilience and climate-related financial risks, the regulator's focus is shifting from implementation to supervision. It emphasises the importance of firms taking a forward-looking approach to climate risks, which they are able to refine as data, tools and best practice evolve. Firms should take an innovative and strategic approach to ensure they are well positioned to adapt as new risks emerge.
- Firms also need to prepare for the impact of a number of upcoming rule changes. Changes to the risk margin and matching adjustment under Solvency II reforms would have a significant impact on life insurers, especially their reinsurance capital management and investment strategies.
- While new rules on D&I are not likely to be implemented until next year at the earliest, it's clear the PRA expects firms to start making progress in this area.

Contacts

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Director

T: +44 (0) 7718 865076
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T: +44 (0) 7483 423721
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