SLAUGHTER AND MAY/

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SOLVENT EXIT PLANNING FOR INSURERS

On 23 January 2024 the PRA published a consultation on Solvent exit planning for insurers (CP2/24). The consultation adds to a range of recent developments in recovery and resolution requirements for insurers, including the introduction into FSMA in September 2023 of new write-down powers of the court in respect of insurers in financial difficulties and the ongoing Treasury project for the introduction of an Insurer Resolution Regime.

Background to the consultation

The current consultation has been expected for some time. In its January 2023 Dear CEO letter to insurers on priorities for insurance supervision, the PRA said that it intended to consult on exit planning during 2023, aimed at ensuring compliance with Fundamental Rule 8 (a firm must prepare for resolution). This is part of wider work looking at the orderly exit of financial institutions from the market, including the PRA's June 2023 consultation on solvent exit planning for non-systemic banks and building societies.

What is a solvent exit for an insurer?

The PRA envisages that a solvent exit may involve a solvent run-off or another option such as a Part VII transfer or a solvent scheme of arrangement. A firm may enter into a solvent exit process as the result of stressed circumstances, including restricted access to capital or liquidity, or a strategic decision to cease carrying on insurance business.

Which firms are within scope of the proposals?

The proposals will apply to both Solvency II firms and non-directive insurance firms (i.e. those below the thresholds for application of the Solvency II regime in the UK). It will also apply to the Society of Lloyd's and to Lloyd's managing agents. Excluded from scope will be:

- "passive run-off firms"; and
- UK branches of third country insurers.

A passive run-off firm is one which has ceased effecting contracts of insurance and no longer has permission to do so <u>but</u> which is not a "run-off acquiror" (run-off acquirors are firms which are actively running off contracts of insurance but do not normally intend to exit the market themselves). The PRA's view is that it is unlikely that any further useful solvent exit planning can be done for firms already in passive run-off.

UK branches of third country insurers are excluded from scope on the basis that any useful plans would need to cover the entire legal entity and introducing such plans would be disproportionate to the risk of branch failure.

What are the proposals?

The solvent exit analysis (SEA)

The central proposal is that all in-scope firms will be required to plan for a solvent exit, including preparing and maintaining a "solvent exit analysis" (**SEA**). This requirement will be set out in a new Preparation for Solvent Exit Part of the PRA Rulebook. A new supervisory statement will set out details of what should be included in the SEA.

Key aspects of the SEA include:

- the SEA should set out how the firm would carry out a solvency run-off of its liabilities, as well as any appropriate alternatives such as transfer of all or part of its business or a solvent scheme of arrangement
- the SEA should set out any actions needed to cease PRA-regulated activities while remaining solvent
- the SEA should identify and monitor indicators that would inform the firm about when it may need to initiate a solvent exit and the likelihood of success
- the SEA should set out any potential barriers and risks to the execution of a solvent exit, both market-wide and firm-specific. The firm should take reasonable steps in BAU to mitigate or remove any material barriers or risks. The PRA gives a number of examples of potential barriers and risks, including:
    - a complex legal and corporate structure
    - illiquid or very long-term liabilities which cannot be settled within the anticipated timeline for executing a solvent exit
    - the existence of untraceable or uncontactable policyholders
    - the provision of services by the firm which cannot be easily stopped or substituted by another firm – e.g. services provided to vulnerable policyholders or to a particular community or sector
- the SEA should set out the financial and non-financial resources required to execute a solvent exit, the identity of internal and external stakeholders, and a plan for communications with stakeholders in the event of a solvent exit.

Firms should also set up clear governance arrangements, including identification of a Senior Manager responsible for solvent exit planning, and undertake adequate assurance activities for its preparations.

The solvent exit execution plan (SEEP)

The draft supervisory statement sets out the PRA's proposed expectations for firms to produce a "solvent exit execution plan" (**SEEP**) within one month where there is a reasonable prospect that the firm may need to execute a solvent exit or when the firm is requested by the PRA to produce one. The new Preparation for Solvent Exit Rulebook Part does not include a requirement to produce the SEEP – the supervisory statement suggests that the PRA may request this to be produced using existing powers to impose requirements under section 55M of FSMA.

The SEA should be used as a starting point for the SEEP. The supervisory statement sets out further details on what should be in the SEEP, including:

- actions and timelines for the solvent exit
- identification and mitigation or removal of barriers and risks to exit
- communication plan for stakeholders

- detailed action plan for execution of the solvent exit, including: identification and transfer or payment of insurance liabilities; sale or transfer of all or part of the business; disposal of fixed assets; communication with shareholders
- assessment of the financial and non-financial resources needed to complete the solvent exit - this should include projections to ultimate of future premiums and claims cashflows and of the SCRs and MCRs; analysis of composition of assets and liabilities; and realistic exit valuations of assets and liabilities
- governance arrangements.

Throughout the solvent exit process firms must continue to comply with the Threshold Conditions and other applicable PRA rules.

How does this fit in with other initiatives?

There are currently no formal exit planning requirements for UK insurers. The introduction of the write down powers in section 377A of FSMA last year is likely to have required some internal analysis by insurers, but does not have any tangible implications until an insurer is, or is likely to become, unable to pay its debts.

Firms which are part of an Internationally Active Insurance Group (IAIG) will already have developed resolution plans under IAIS requirements. The PRA considers that firms can build on these existing resolution plans in developing the SEA and, if required, SEEP, but that some additional work may be required.

HM Treasury published a consultation on introducing an Insurer Resolution Regime in January 2023 and in August published the outcome of that consultation. At that time it stated that the government intended to legislate for the proposals when Parliamentary time allowed. No legislation has yet been brought forward. The PRA comments in the exit planning consultation that it will consider the need for any amendments to its solvent exit planning policy as and when any legislation to introduce an IRR is enacted. It should be borne in mind, however, that the PRA's solvent exit planning proposals apply to a wide range of firms, whereas under the Treasury's proposals resolution plans would be developed for a much smaller number of insurers.

Comment

Firms within scope will need to consider how the new rules may affect their business and how and whether they should respond to the consultation. The consultation closes to responses on 26 April 2024, and the PRA has indicated that it intends to publish a policy statement in the second half of 2024, with the implementation date for changes resulting from the consultation in Q4 2025.

The proposals in the consultation focus on the need for solvent exit planning as part of BAU activity. Smaller firms, which do not already have existing resolution or exit plans, may need to formalise exit plans for the first time, and while some firms (including IAIGs) may be able to leverage existing resolution plans, additional work will be necessary to ensure exit plans are developed in line with the new requirements as well as being consistent with existing plans.

Firms will therefore need to ensure that sufficient resource and management focus can be deployed to comply with the proposals once implemented. The consultation acknowledges and discusses the expected costs for firms as a result of the proposals, including initial costs to establish necessary governance procedures, conduct analysis and prepare the first SEA, and subsequent ongoing costs to monitor and adjust the SEA as the business and market evolves. The PRA notes in this context that the proposals are intended to apply proportionately to the nature, scale, and complexity of a firm.

The proposals also specifically envisage that firms will need to identify barriers and risks to solvent exit and take steps to remove or mitigate such barriers and risks as part of BAU. This may require firms to undertake analysis and stress testing of existing legal structures in exit scenarios and, potentially, associated work to pre-emptively amend structures or operations. Ultimately, therefore, the proposals are focussed on

embedding exit planning into BAU activity and (rather than being relevant only or predominantly in an exit or insolvency context) have important implications for firms' ordinary course operations.

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