



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP30/17

International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision

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Responses are requested by Tuesday 27 February 2018.

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Contents

1	Overview	5
2	Proposals	5
3	The PRA's statutory obligations	8
	Appendix	12

1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) seeks views on its proposed approach to authorising and supervising third-country insurers that carry on (or are considering carrying on) insurance business in the United Kingdom through a branch or by forming a subsidiary. The purpose of the proposals is to support the interpretation of the PRA Rulebook on third-country branches and to explain the PRA's policy towards authorising and supervising third-country insurers or those contemplating establishing a branch or subsidiary in the United Kingdom.

1.2 The proposals are relevant to all existing and prospective insurance firms carrying out regulated activities, but not headquartered, in the United Kingdom that are not able to benefit from passporting rights. The PRA's approach¹ to branch supervision for European Economic Area (EEA) firms that are currently branching into the United Kingdom under the passporting arrangements remains unchanged until the United Kingdom withdraws from the European Union. Subject to the outcome of the negotiations between the United Kingdom and the European Union, and in particular absent some new agreement in relation to EEA firms, these firms would have to apply for authorisation in order to undertake PRA regulated activities in the United Kingdom after the United Kingdom withdraws from the European Union. They would then be treated in the same way as other insurance branches.² At the time of this consultation, the proposals do not apply to Swiss General Insurers, as defined in the PRA Rulebook, to which different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC).

1.3 The PRA proposes to publish a supervisory statement to set out factors that would be considered relevant when considering authorisation as a third-country branch or a subsidiary (see appendix). Supervisory Statement (SS) 44/15 'Solvency II: third-country insurance and pure reinsurance branches'³ will remain unchanged.

Responses and next steps

1.4 This consultation closes on Tuesday 27 February 2018. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP30_17@bankofengland.co.uk.

1.5 The proposals in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect.

2 Proposals

2.1 The PRA proposes new factors to be considered alongside its current requirements for third-country branch authorisation.

1 www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-approach-documents-2016.

2 Under European law, the home state supervisor of an EEA insurer that operates as a branch in another EEA country is responsible for the prudential supervision of the whole firm (including the branch). As a result, the PRA, where it is the host supervisor of such branches, is currently not responsible for the prudential supervision of those branches. In accordance with the Solvency II Directive 2009/138/EC, the PRA has certain powers to act in relation to such branches in exceptional situations; and has greater rights of consultation and information in relation to EEA branches that are designated as 'significant'.

3 November 2015: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-third-country-insurance-and-pure-reinsurance-branches-ss.

2.2 When considering applications from a firm for authorisation as a third-country branch, the PRA's approach is anchored in its statutory objectives and includes an assessment of regulatory equivalence and the 'supervisability' of the insurer that seeks to operate in the United Kingdom through a branch. The PRA already considers, and needs to be satisfied that:

- the home jurisdiction's prudential supervision regime is 'broadly equivalent' in an assessment of equivalence by the PRA including assessment of the home jurisdiction's (this is not an exhaustive list):
 - rules;
 - powers;
 - supervision of individual firms and the consolidated group;
 - information sharing;
 - confidentiality; and
 - competence and independence of supervision.

(Such an assessment is likely to be linked to, but not necessarily the same as, formal determinations of equivalence in respect of Solvency II.)

- the firm is capable of being supervised effectively by the home supervisor;
- the whole firm is able to meet the Threshold Conditions;
- there is sufficient supervisory cooperation with the home supervisor;
- UK policyholders of the firm will be given the appropriate priority in an insolvency and that there is no discrimination against policyholders whose business is written in the United Kingdom in the event of a winding up; and
- the firm is able to meet relevant PRA rules, including the Senior Insurance Managers Regime and, subject to publication of the final policy from CP14/17, once the extension takes place, the full Senior Managers and Certification Regime¹ applicable to the relevant individuals responsible for the branch.

2.3 The PRA assesses these considerations in their totality, but emphasises the overall supervisability of an insurer that operates in the United Kingdom through a branch. In particular, the PRA will place considerable weight on assessing the extent and quality of cooperation with the home supervisor. In performing the assessment, the PRA will balance the overall supervisability against the nature and scale of the insurance activities that the firm proposes to carry out, including those through its UK branch.

2.4 The PRA proposes that it also considers the:

¹ The extended SM&CR for insurers will not come into effect until a commencement date has been set by HM Treasury.

- scale of UK branch activity covered by the Financial Services Compensation Scheme (FSCS) and is satisfied that the protected amount covered by the FSCS can be absorbed by insurers liable to contribute to the FSCS; and
- impact of the failure of a firm with a UK branch on the wider insurance market and financial system.

2.5 The PRA's approach to broad equivalence of a home supervisor, policyholder discrimination and relevant PRA regulation has been published in SS44/15 and the PRA's Approach to Insurance Supervision.¹

The scale of UK branch activity covered by the FSCS

2.6 The FSCS is the last resort provider of compensation to eligible policyholders in the event of an insurer becoming insolvent. It is an important element in the United Kingdom's arrangements for protecting policyholders. The level of FSCS liabilities is a strong indicator of the risk of a branch to both policyholders and FSCS levy payers.

2.7 For non-life insurance, the FSCS protects policies held by individuals and micro-businesses (turnover up to £1 million) and all policyholders in respect of compulsory insurance (mainly motor and employer liability). For life policies, essentially all policyholders are protected.

2.8 Levies on insurers writing FSCS-protected business are used to cover the costs of compensation. The size of these levies is limited to prevent insurers becoming unprofitable as a result of their FSCS levy obligations. The FSCS has a borrowing protocol in place with HM Treasury for access to the National Loans Fund for funding requirements in excess of these annual limits. Given this, the PRA expects a greater level of supervisory oversight for firms writing FSCS-protected business. The PRA has a greater ability to mitigate risks in subsidiaries as it has access to a wider range of supervisory tools and legal powers. Accordingly, we expect a firm above a certain threshold to subsidiarise.

2.9 When assessing the value of an appropriate threshold for branches, the PRA has considered current third-country branches and potential applications for branch authorisation that it may expect in the future. Although not a hard limit, it proposes that firms which are likely to have more than £200 million of FSCS-protected liabilities should apply for authorisation as a UK subsidiary rather than conducting business through a branch.

2.10 A threshold of £200 million is a straightforward measure and a single failure at this level could be absorbed by the industry in comparison to the caps on FSCS annual levies.²

2.11 The PRA is proposing using all FSCS protected liabilities (rather than a sub-set) as a threshold after considering that:

- levies on the industry due to default of a firm will reflect all FSCS liabilities; and
- obtaining data splitting out different types of FSCS-protected liability might be onerous for firms.

2.12 The PRA also welcomes views on alternative approaches to defining a threshold eg one focussed on a narrower set of liabilities which are directly 'retail' and might exclude some

¹ March 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/pr-a-approach-documents-2016.

² www.prarulebook.co.uk/rulebook/Content/Chapter/214237/24-11-2017.

insurance liabilities protected by the FSCS such as compulsory insurance taken out by larger, commercial firms. However this may not be appropriate as the end recipients of compulsory insurance held by commercial firms are likely to be individuals.

The impact of a branch failure on the wider insurance market and financial system

2.13 If a branch's FSCS-protected liabilities are below £200 million it could still pose a risk to the wider insurance market and financial system of the United Kingdom depending on the types of policy and significance of the branch in its market.

2.14 In retail business the PRA generally has a lower tolerance for failures in annuity and long-term business (among others) than some other non-life or reinsurance products. This reflects the importance to many policyholders of continuing to receive benefits from annuity and long-term policies over a long timescale.

2.15 For commercial business, there is a risk that, in some cases, the interruption of provision of a particular product could have an impact on financial stability. In practice this is most likely to arise where a firm has a large market share in a niche market and there is low product substitutability. Failure of the firm could then disrupt the real economy through product withdrawal. Disruption could also arise across a product category serviced by multiple firms.

2.16 To account for these risks, the PRA proposes to consider additional factors to assess a third-country branch's potential impact against its objectives and risk to financial stability including the:

- availability of substitute products that would offer a policyholder a similar level of protection;
- branch's position in the market, particularly assessing the size of the market share in a niche market;
- level of connectivity of a branch in the industry it operates within: for example, the extent and complexity of inter-firm transactions; and
- significance of the UK operations of the third-country branch compared to the amount of business within other jurisdictions.

2.17 These factors will be considered when reviewing an application for third-country branch authorisation. The PRA believes that no third-country branch currently operating in the United Kingdom would, as a result of these factors, be deemed sufficiently significant to the wider insurance market and financial system for it to be required to subsidarise.

3 The PRA's statutory obligations

3.1 The PRA is required by FSMA to consult when setting its general policies and practices.¹ In doing so, it is required to comply with several statutory and public law obligations. The PRA meets these obligations by providing the following in its consultations:

- a cost benefit analysis (CBA);²

1 Section 2L of FSMA.

2 Section 138J (2) of FSMA.

- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective, insurance objective (if applicable), and secondary competition objective;¹
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;² and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.³

3.2 The PRA should have regard to aspects of the Government's economic policy as recommended by HM Treasury.⁴

3.3 The PRA is also required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

Cost benefit analysis

3.4 The PRA is required to publish an analysis of the costs and benefits and an estimate of those costs and benefits. The PRA is not required to perform a CBA if it considers that the impact on costs and benefits is of minimal significance. The PRA aims to provide a CBA on material policies even when it is not proposing changes to its rules, such as in this case.

3.5 The proposals contained in this CP relate to the PRA's appetite for subsidiarisation. The tools available to the PRA are more wide ranging when supervising a subsidiary and hence if a firm's business is deemed to generate a significant exposure for the FSCS and impact on policyholders, it may be asked to create a subsidiary. This will promote the safety and soundness of firms and contribute to securing an appropriate degree of protection for policyholders. The PRA believes the proposals set out in this CP advance its objectives.

3.6 Costs for the PRA in implementing this supervisory approach are expected to be minor as an authorisation process is required whether a firm applies for authorisation as a branch or subsidiary.

3.7 The PRA estimates that these proposals may lead to additional one-off and ongoing costs to branches which subsidiarise. One-off costs consist of costs such as the legal costs to incorporate a firm in the United Kingdom. Ongoing costs cover the additional cost of the day-to-day business of a subsidiary, such as holding capital, maintaining a board, tax, and compliance with regulations.

3.8 The PRA believes there would be no immediate impact on firms that are currently authorised to operate in the United Kingdom through third-country branches. It is anticipated that it may impact decisions of firms that would look to apply for third-country branch authorisation in the future. Given the number of factors that affect the estimated cost to individual firms and the uncertainty in how many firms would apply for branch authorisation, the PRA is unable to provide an estimate of costs for all the possible cases of subsidiarisation.

1 Section 2B, section 2C and section 2H (1) of FSMA.

2 Section 2H 2 of FSMA.

3 Section 138K (2) of FSMA.

4 www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-spring-budget-2017.

3.9 The PRA's secondary objective is to facilitate effective competition between providers of PRA regulated activities, and competition is effective when it is fair and prudent. The PRA expects a minimal impact on competition in the United Kingdom from its proposals. The PRA envisages that there will be little, if any, impact on third-country branches currently authorised by the PRA, and that this policy will lead to only a small number of subsidiarisations in the future. The PRA believes any burden on firms to subsidiarise is proportionate to the risk to its other objectives.

3.10 In conclusion, the proposed approach is expected to generate little cost to firms that currently operate in the United Kingdom as third-country branches, but may impose some additional cost to firms that may wish to operate as third-country branches in the United Kingdom in the future, accompanied by some possible effects on competition; however the PRA expects that these will be outweighed by the benefits to the safety and soundness of firms as articulated in paragraph 3.5.

Compatibility with the PRA's objectives

3.11 The proposals would ensure the PRA promotes the safety and soundness of the firms it regulates by reducing the risk of failure for branches with high FSCS-protected liabilities. In the event of insolvency a call on the FSCS is covered by levies on the insurance industry, therefore significant levies could cause some insurers to become unprofitable.

3.12 Policyholders that have been identified as requiring additional protection are covered by the FSCS. By considering the risk to these policyholders the PRA is contributing to an appropriate degree of protection for policyholders.

3.13 The PRA has assessed whether the proposals in this CP facilitate effective competition. The PRA is willing, in principle, to allow third-country insurers to set up branches in the United Kingdom as it recognises the benefits in terms of competition that this will bring. The PRA has focussed its policy on areas where it believes the potential costs to the UK system of firms operating as a branch are outweighed by the associated benefits.

Regulatory principles

3.14 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Four of the principles are of particular relevance.

3.15 The principle that the PRA's resources should be used in the most efficient and economical way possible. The PRA has followed this principle when considering equivalence of other regulatory authorities and whether information and supervision provided and implemented by another body is likely to be sufficient for the PRA to rely upon when assessing whether a firm meets the Threshold Conditions for authorisation.

3.16 The principle that any burden or restriction that the PRA imposes on a person, firm or activity is proportionate to the benefits expected as a result. The PRA will only require subsidiarisation where there is an unacceptable level of risk to its objectives. The PRA has considered the benefits to the firm that operating as a branch can bring, particularly in terms of its competitive benefits. The proposals consider all significant factors and allow a proportionate approach to be adopted before considering subsidiarisation.

3.17 The principle that the PRA should exercise its functions as transparently as possible. The PRA has outlined the proposed approach to the supervision of third-country branches alongside its reasoning. This CP attempts to ensure the regulatory approach is open and accessible.

3.18 The principle that consumers should take responsibility for their decisions. The PRA imposes fewer restrictions on firms writing commercial or reinsurance business and therefore expects their consumers to take a greater responsibility for their decisions.

HM Treasury recommendation letter

3.19 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.¹

3.20 The aspect of the Government's economic policy most relevant to the proposals in this CP is competitiveness and trade.

3.21 The Government wishes to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as a leading international financial centre. The Government considers that achieving this aim in a manner that is consistent with robust institutions and a resilient system will support its aims for sustainable economic growth.

3.22 The Government also aims to encourage trade and inward investment to the United Kingdom that can help boost productivity and growth across our economy. This can be supported by improved competition opening the United Kingdom to new ways of doing things and being seen as a good place to do business.

3.23 The PRA believes that these proposals are consistent with robust institutions and a resilient system, and will not materially affect London's position as a leading international financial centre. This is because the proposals aim to maintain the quality of supervision applied to the UK branches of insurers in scope. The proposals in this CP strengthen the supervisory framework to secure a sustainable presence of UK branches of insurers. The PRA's view is that this is an important component of an open world economy which in turn benefits the UK economy.

Impact on mutuals

3.24 In the PRA's opinion, the impact of the proposed supervisory statement on mutuals is expected to be no different from the impact on other firms.

Equality and diversity

3.25 The PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

¹ Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Appendix: Draft supervisory statement 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision'

1 Introduction

1.1 This supervisory statement adds to the Prudential Regulation Authority's (PRA's) Approach to Insurance Supervision¹ and supplements Supervisory Statement (SS) 44/15 'Solvency II: third-country insurance and pure reinsurance branches'.² It clarifies how the PRA will authorise and supervise third-country insurance branches. Third-country insurance branches are branches of insurers operating, but not headquartered, in the United Kingdom that are not able to benefit from passporting rights. In particular, this statement sets out the PRA's expectations on when a subsidiary would be more appropriate than a branch for a third-country insurer wishing to carry out insurance business in the United Kingdom.

1.2 This supervisory statement is relevant to all third-country insurance branches, as well as to any insurer not headquartered in the United Kingdom looking to operate in the United Kingdom in the future. As at the date of publication, this statement does not apply to Swiss General Insurers, as defined in the PRA Rulebook, to which different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC).

1.3 Setting out the PRA's proposed approach to branch supervision in a supervisory statement helps all firms to understand the PRA's expectations, and so uses the resources of the PRA efficiently. In addition, the benefits set out at consultation advance the PRA's objectives of promoting safety and soundness and policyholder protection of PRA authorised firms, in order to protect and enhance the stability of the financial system of the United Kingdom.

Background

1.4 The approach to the supervision of insurers that operate in the United Kingdom was set out in the PRA's Approach to Insurance Supervision and further clarified in SS44/15. In the Approach document, the PRA explains how its supervisory approach is anchored in its objectives to promote the safety and soundness of firms, and contribute to securing an appropriate degree of protection for policyholders.

Insurers in the United Kingdom

1.5 If authorised to do so, insurers headquartered outside of the United Kingdom can operate in the United Kingdom either through a branch or by forming and operating through a subsidiary. This can either be through direct PRA authorisation or, in some circumstances, through passporting rights. A subsidiary is a separate legal entity from its parent and, as such, must meet its regulatory capital requirements with its own funds and requires its own governance and risk management. A branch forms part of a legal entity headquartered abroad.

1.6 Third-country insurers operating through a branch in the United Kingdom are subject to the PRA's rules on third-country branches as set out in the PRA Rulebook with additional background in the Insurance Approach document and SS44/15. For example, such branches need to have sufficient assets attributed to their branch business to meet branch liabilities and

1 March 2016: www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-approach-documents-2016.

2 November 2015: www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-third-country-insurance-and-pure-reinsurance-branches-ss.

to have a local branch manager. The PRA also requires that the legal entity as a whole has sufficient financial resources. Supervisory powers reflect the differences in how a firm is structured. Insurance subsidiaries are subject to the PRA's solo insurance regime. In contrast, responsibilities for the prudential supervision of branches are split between the supervisor where the insurer is headquartered (the home supervisor) and the PRA (the host supervisor).

1.7 In promoting its statutory objectives of safety and soundness and policyholder protection, the PRA focuses principally on the harm that firms can cause to the stability of the UK financial system. Aspects of both life and non-life insurance can be deemed critical to ensuring a stable financial system. The PRA's view is that, subject to certain safeguards, the ability of financial services firms to branch into other countries is an important component of an open world economy which in turn benefits the UK economy.

1.8 The Financial Conduct Authority (FCA) is the conduct regulator for all insurers operating in the United Kingdom. All branches are subject to the FCA's conduct of business rules; these are not affected by this supervisory statement.

2 Assessing risks of a third-country branch to the United Kingdom

2.1 When considering applications from a firm for authorisation as a third-country branch, the PRA's approach is anchored in its statutory objectives and includes an assessment of regulatory equivalence and the supervisability of the insurer that seeks to operate in the United Kingdom through a branch. The PRA considers, and needs to be satisfied that:

- the home jurisdiction's prudential supervision regime is 'broadly equivalent' in an assessment of equivalence by the PRA including assessment of the home jurisdiction's (this is not an exhaustive list):
 - rules;
 - powers;
 - supervision of individual firms and the consolidated group;
 - information sharing;
 - confidentiality; and
 - competence and independence of supervision.

(Such an assessment is likely to be linked to, but not necessarily the same as, formal determinations of equivalence in respect of Solvency II.)

- the firm is capable of being supervised effectively by the home supervisor;
- the whole firm is able to meet the Threshold Conditions;
- there is sufficient supervisory cooperation with the home supervisor;
- UK policyholders of the firm will be given the appropriate priority in an insolvency and that there is no discrimination against policyholders whose business is written in the United Kingdom in the event of a winding up;

- the firm is able to meet relevant PRA rules, including the Senior Insurance Managers Regime and, subject to publication of the final policy from CP14/17, once the extension takes place, the full Senior Managers and Certification Regime¹ applicable to the relevant individuals responsible for the branch;
- the scale of UK branch activity covered by the Financial Services Compensation Scheme (FSCS) and is satisfied that the protected amount covered by the FSCS can be absorbed by insurers liable to contribute to the FSCS; and
- the impact of the failure of a firm with a UK branch on the wider insurance market and financial system.

2.2 The PRA's approach to broad equivalence of a home supervisor, policyholder discrimination and relevant PRA regulation has been published in SS44/15 and the PRA's Approach to Insurance Supervision. The final two factors above, which will be considered in parallel to the others when reviewing an application for third-country branch authorisation, are explained further below.

2.3 The PRA assesses these considerations in their totality, but emphasises the overall supervisability of an insurer that operates in the United Kingdom through a branch. In particular, the PRA will place considerable weight on assessing the extent and quality of cooperation with the home supervisor. In performing the assessment, the PRA will balance the overall supervisability against the nature and scale of the insurance activities that the firm proposes to carry out, including those through its UK branch.

The scale of United Kingdom branch activity covered by the FSCS

2.4 Eligible policyholders of insurers operating in the United Kingdom which are authorised by the PRA are covered by the FSCS. Therefore, regardless of whether third-country insurers operating in the United Kingdom do so through branches or subsidiaries, the potential cost to the FSCS of an insurer default would be the same.

2.5 The level of FSCS-protected liabilities is a strong indicator of the risk of a branch to both policyholders and FSCS levy payers.

2.6 Levies on insurers writing FSCS-protected business are used to cover the costs of compensation. The size of these levies is limited to prevent insurers becoming unprofitable as a result of their FSCS levy obligations. The FSCS has a borrowing protocol in place with HM Treasury for access to the National Loans Fund for funding requirements in excess of these annual limits. Given this, the PRA expects a greater level of supervisory oversight for these firms and the PRA has a greater ability to mitigate risks in subsidiaries as it has access to a wider range of supervisory tools and legal powers. While not a hard threshold, the PRA expects third-country branches to have under £200 million of insurance liabilities covered by the FSCS when operating as a branch and may consider authorisation as a subsidiary as an alternative where this is not the case.

The impact of a branch failure on the wider insurance market and financial system

2.7 If an insurer's FSCS liabilities are below the threshold of £200 million of FSCS liabilities, it could still pose a significant risk to the financial stability of the United Kingdom. The PRA will consider other relevant factors when reviewing the potential impact of a third-country branch on financial stability, including the:

¹ The extended SM&CR for insurers will not come into effect until a commencement date has been set by HM Treasury.

- availability of substitute products that would offer a policyholder a similar level of protection;
- branch's position in the market, particularly assessing the size of the market share in a niche market;
- level of connectivity of a branch in the industry it operates within: for example, the extent and complexity of inter-firm transactions; and
- significance of the UK operations of the third-country branch compared to the amount of business within other jurisdictions.