Being better informed

FS regulatory bulletin

FS regulatory insights

June 2024

In this month's edition:

- Consumer Duty: FCA issues closed book warning
- Recovery planning: PRA highlights areas for improvement
- Operational resilience: FCA urges firms to prepare for 2025 deadline
- Insurance branches: PRA finalises authorisation and supervision approach

Executive summary

Welcome to this edition of ‘Being better informed’, our monthly FS regulatory bulletin, which aims to keep you up to speed with significant developments and their implications across all the financial services sectors.

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Last month brought a number of notable developments on topics including the Consumer Duty, the PRA’s expectations of third country insurance branches, and the PRA’s review of non-systemic UK banks and building societies’ recovery planning capabilities. Given the forthcoming UK general election on 4 July 2024, the coming weeks are likely to be quieter, as several publications that were expected by the end of June look set to be delayed until after the election. We expect the pace of regulatory developments to pick up again sharply post-election.

Among the most significant updates from regulators last month is a series of Dear CEO letters issued by the FCA, setting out the priority issues and actions firms should focus on ahead of the July 2024 Consumer Duty closed book deadline. The letters are addressed to all firms in scope of the Duty, with tailored letters sent to retail banks, asset managers, life insurers, consumer investment and consumer finance firms. The letters highlight issues including risks relating to firms’ customer data, fair value, treatment of vulnerable customers, and approach to gone-away customers and vested contractual rights. Please see our At a glance summary for more information.

The FCA also outlined its view of firms’ preparedness to meet its operational resilience rules ahead of the 31 March 2025 deadline. The regulator called for firms to ensure their identification of important business services and setting of impact tolerances is clearly justified in self-assessments. It also notes that firms’ scenario testing and mapping and remediation activities for vulnerabilities should be significantly progressed, and reminds firms that embedding operational resilience is not a ‘once and done’ exercise.

In banking, the PRA published a Dear CEO letter detailing the findings of a review of the recovery planning capabilities of non-systemic UK banks and building societies, underlining the crucial role of recovery planning in ensuring financial resilience for firms under stress. The PRA highlights two main areas of improvement: firms need to use recovery scenarios of sufficient severity, bringing them close to their point of non-viability; and firms must improve their calculations and presentations of recovery capacity under various stress scenarios. This should include quantification in terms of CET1 capital, Leverage Ratio, and Liquidity Coverage Ratio, considering impacts on balance sheets and profitability. By October 2025, non-systemic firms should comply with new rules and expectations related to solvent exit planning, leveraging their recovery planning efforts.

The PRA also published its final policy approach to the authorisation and supervision of overseas insurers that write business in the UK through a third country branch. The policy consolidates and clarifies the PRA’s expectations, and makes changes to reflect Solvency UK reform. Areas of clarification include meeting the Threshold Conditions, the ‘broad equivalence’ of the home jurisdiction’s supervision regime, and the home supervisor’s ability to supervise.

Further afield, there were a number of noteworthy EU developments, including the European Securities and Markets Authority’s (ESMA) position paper on ways to achieve greater progress towards an EU capital markets union. Its recommendations include measures to promote greater levels of retail investment in capital markets, boosting EU company financing, and an explicit call for EU policy making to take account of the competitiveness of EU financial markets versus other jurisdictions.

Separately, ESMA published a consultation on various Regulatory Technical Standards (RTS) under MiFIR, following amendments to the primary legislation in the EU earlier this year. The consultation covers amendments to the technical requirements on pre- and post-transparency requirements for non-equity instruments and data standards for financial instrument reference data. ESMA’s proposals diverge from the non-equity post trade transparency proposals put forward by the FCA in December 2023 in a number of areas, including the proposed rules for deferring publication of post-trade information, and the methodology for determining whether a financial instrument is considered liquid or not.

Please read on to find out more about these and other developments. You can also visit our PwC webpage for further regulatory insights, including our podcast episode on the evolving redress and remediation landscape, and our blog on the impact of the FCA’s new product sales data reporting requirements on consumer credit firms.

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Conduct

FCA issues Consumer Duty closed book warning

The FCA issued a set of Dear CEO letters on 16 May 2024 outlining the priority issues firms should focus on ahead of the July 2024 Consumer Duty closed book deadline. The letters are addressed to all firms in scope of the Consumer Duty, with tailored letters sent to retail banks, asset managers, life insurers, consumer investment and consumer finance firms.

The letters remind firms of FCA expectations in relation to five key themes most relevant to the closed book: customer data, fair value, treatment of vulnerable customers, gone-away or disengaged customers, and vested contractual rights.

The FCA reminds firms they must address any material gaps in customer data and ensure they are taking proactive measures to hold up to date basic details. The regulator challenges life insurers, in particular, to improve their core data quality and flow of monitoring, noting that strategic investment may be required.

The FCA notes the heightened risk of harm for vulnerable customers in the closed book and reminds firms of its expectations in its FG21/1 guidance. For retail banks, the FCA notes weaknesses in approaches to vulnerable customers in the open book and expects them to consider what further action may be needed to support their vulnerable customer cohort.

The FCA also expects firms to identify less engaged or gone-away customers and take proportionate steps to contact them and assess the effectiveness of their approaches. The FCA also expects firms to consider alternative ways to prevent or manage any customer harm where vested contractual rights exist.

Firms' boards and senior management are expected to consider their approach to the risks in the letters and take any necessary remedial action ahead of the July deadline.

For more information, please see our At a glance publication.

Financial crime

FCA warns firms on market surveillance failures

The FCA published Market Watch 79 on 9 May 2024, warning firms of market abuse surveillance failures and variations in model testing.

The FCA shares examples of faulty data and issues in the implementation and testing of automated alert models, which have led to undetected and unreported potential market abuse. The regulator also reports on its peer review of firms' testing of front-running models. The FCA expects firms to have robust and effective surveillance systems and arrangements, and to comply with UK MAR reporting obligations. It advises firms to review their surveillance practices and benchmark them against their peers and warns of regulatory action for failures.

For more information, please see our At a glance publication.

Operational resilience

FCA issues operational resilience reminder

The FCA published its view of the financial sector's preparedness to meet its operational resilience rules in PS21/3 on 28 May 2024. The update is a reminder of the regulator's expectations and details steps firms should take to comply by the end of the transition period on 31 March 2025.

The FCA highlights the need for firms to thoroughly identify Important Business Services (IBS) and document justifications for their choices. Firms should set clear impact tolerances using various metrics, not just time-bound ones, and differentiate these from recovery time objectives.

The FCA also emphasises the importance of detailed resource mapping, effective management of third-party relationships, and continuous scenario testing. Firms should address identified vulnerabilities with funded remediation plans and maintain effective response and recovery strategies. Operational resilience should be integrated into the firm's risk frameworks and strategic planning, supported by regular horizon scanning to manage current and future risks.

The operational resilience policy transition period ends on 31 March 2025. Ahead of this deadline, firms must ensure that they can remain within impact tolerance in severe but plausible scenarios for any identified important business services. Please see our At a glance publication for more information.

Supervision

ESMA sets out views on progressing capital markets union

European Securities and Markets Authority (ESMA) published a position paper on 22 May 2024, setting out 20 recommendations for ways to achieve greater progress towards an EU capital markets union. ESMA's recommendations were agreed at its Board of Supervisors and represent a common view among EU national regulators.

ESMA's recommendations encompass measures to promote greater levels of retail investment in capital markets, boost EU company financing, and improve the regulatory framework to support supervisory consistency. Notable recommendations include ESMA's call for harmonisation of key aspects of related national law, such as insolvency and shareholder rights regimes, and an explicit call for EU policy making to take account of the competitiveness of EU financial markets versus other jurisdictions.

Speaking at a launch event to mark the publication of the position paper, ESMA Chair Verena Ross noted that ESMA's recommendations will set the tone for its engagement with the new European Commission and Parliament over the coming five years. Christine Lagarde, President of the European Central Bank, also repeated her previous calls for a single EU rulebook for capital markets and a "bold top-down approach" including pan-European supervision by ESMA of systemic firms.

Sustainability

Government builds momentum on UK SDR rollout

On 16 May 2024, the UK Government published an Implementation Update on its Sustainability Disclosure Requirements (SDR) regime. The publication outlines what businesses can expect from UK SDR and next steps on implementation. Alongside the Implementation Update, the Government also published its framework for developing and adopting UK-adopted versions of the ISSB Standards as part of UK SDR. These UK-adopted versions of the ISSB Standards will be called the UK Sustainability Reporting Standards (SRS).

As part of UK SDR, the Government intends to consult on transition plan disclosures for UK companies in Q2 2024 and draft UK SRS in Q1 2025. Once finalised, the FCA will consult on introducing disclosure requirements for UK listed companies based on the UK SRS, whilst the Government will decide on disclosure requirements for other companies. The Policy and Implementation Committee, established by the Government, will coordinate implementation by Government and the FCA.

The Implementation Update also confirms that the Government intends to consult on the UK Green Taxonomy in due course, and that disclosure against the Taxonomy will be voluntary for at least two years before the Government explores mandatory disclosures as part of UK SDR.

For more information, please see our At a glance publication.

Technology

FPC member discusses impact of AI

Jonathan Hall, external member of the Bank of England's Financial Policy Committee (FPC), discussed the potential impact of artificial intelligence (AI) on market and financial instability in a speech on 7 May 2024. His observations, while not representing the official view of the FPC, provide insights that could inform upcoming discussions.

Hall focused on the evolving capabilities of AI, particularly the potential deployment of sophisticated AI trading agents capable of selecting and executing trading strategies. He highlighted two main risks: increased market brittleness and correlation, and misalignment of incentives.

To mitigate these risks, Hall proposed several strategies and mitigants for further exploration:

- adversarial training and sandboxes
- continuous learning
- controls including human oversight and considering adding a 'kill switch'
- testing including system-wide stress tests.

Hall also emphasised the need for AI trading agents to align with existing regulatory frameworks to ensure compliance and prevent market abuses. While regulators may consider mandating that AI systems incorporate their rule books, this may not be necessary as trading managers are already subject to conduct requirements.

Hall noted that a one-size-fits-all solution is unlikely and that individual firms will need to tailor the integration of regulatory rules into their models. He called for increased collaboration between regulators, market participants and safety experts to ensure that AI systems adhere to regulatory compliance and do not avoid/escape human oversight.

Wholesale markets

Planned changes to MiFID II ancillary activities exemption postponed

A statutory instrument was laid before Parliament on 29 May 2024 revoking upcoming legislative changes to the MiFID II ancillary activities exemption. HM Treasury (HMT) had previously consulted on amending the exemption from authorisation for firms that deal in commodity derivatives and emissions allowances as an ancillary part of their main commercial business.

The proposed changes to the criteria that must be met for a firm to benefit from the exemption were due to come into force at the start of 2025. The revised approach would have moved away from the current threshold-based test to a qualitative principles-based approach.

Responses to a subsequent FCA consultation paper on the framework for commodity derivatives, CP 23/27, raised significant concerns with this approach. HMT has therefore revoked the relevant legislative provisions in FSMA 2023 and committed to working with the FCA and engaging further with market participants on an alternative approach, to be implemented by 1 January 2027.

The FCA has also confirmed that while the UK version of delegated regulation (EU) 2017/592 (RTS 20) will remain in place while a permanent solution is considered, the annual notification requirement on firms who use the exemption will be abolished as planned.

Banking and capital markets

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Financial crime

PSR consults on APP scams data publication updates

The Payment Systems Regulator (PSR) issued a consultation on the proposed changes to its Authorised Push Payment (APP) scam data guidance on 7 May 2024. The guidance, originally published in October 2023, sets the requirements for the 14 largest payment service providers (PSPs) on how to publish APP scam performance data on the homepage of their website.

The proposed changes include a new scale to the performance charts to indicate who the best and poorest performing firms are, as well as a figure indicating the change in the PSP’s performance from last year. This is to make it easier for consumers to understand and interpret the data.

The consultation closed on 30 May 2024. The PSR will issue the updated guidance by the end of June 2024. The regulator will also consult on the more substantive issues raised during its consumer testing in autumn 2024 and will address these in the next cycle of performance data collection (cycle three).

PSR consults on CHAPS APP scam requirements

The Payment Systems Regulator (PSR) consulted on 8 May 2024 on CHAPS APP scam reimbursement requirements. The PSR proposes to direct banks and other payment firms participating in CHAPS to reimburse their customers who have been victims of authorised push payment (APP) scams. The direction will underpin the Bank of England’s (BoE) new CHAPS reimbursement rules.

Payment firms will already be required to reimburse APP scam victims who lose money through transactions over the Faster Payment System (FPS) from 7 October 2024. The PSR will now also support the BoE as it introduces similar requirements for CHAPS. The PSR's proposed approach to CHAPS aims to be as similar as possible to its approach to FPS, to reduce unnecessary duplication of work for directed payment firms, while ensuring a high level of protection in both systems.

The consultation closed on 31 May 2024. The PSR expects to finalise and publish the specific direction in September 2024, and to implement it on 7 October 2024.

Recovery and resolution

PRA identifies improvement areas for non-systemic firms' recovery planning

The PRA detailed the findings of a recent review on recovery planning in a Dear CEO letter on 15 May 2024. The review, conducted over the past 18 months, assessed the recovery planning capabilities of approximately 70 non-systemic UK banks and building societies.

The letter highlights the crucial role of recovery planning in ensuring financial resilience for banks and building societies under stress, aiding in understanding vulnerabilities and preparing mitigation actions to support businesses, households, executives, and boards.

The PRA highlights two main areas of improvement: recovery scenarios and recovery capacity. It says firms need to use scenarios of sufficient severity, bringing them close to their point of non-viability (PONV). On recovery capacity, the PRA states that firms must improve their calculations and presentations of recovery capacity under various stress scenarios, using methodologies outlined in supervisory statement 9/17.

The PRA also outlines ‘effective practice examples’ such as:

- creating a dedicated recovery capacity section with comprehensive tables and cumulative benefit charts
- using a variety of recovery indicators beyond the European Banking Authority minimums
- ensuring stress scenarios are closely linked to reverse stress testing and Internal Capital Adequacy Assessment Process/Internal Liquidity Adequacy Assessment Process with increased severity to approach the PONV.

The PRA will engage with firms and trade associations to discuss the thematic review findings in the second half of 2024 and at the June CEOs conference. By October 2025, non-systemic firms should comply with new rules and expectations in policy statement 5/24 and supervisory statement 2/24 related to solvent exit planning.

Asset and wealth management

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Supervision

FCA and HMT confirm Overseas Funds Regime roadmap

HM Treasury and the FCA set out an updated roadmap for the Overseas Funds Regime (OFR) on 1 May 2024. The Government has already deemed the EU-UCITS regime (excluding MMFs) to be equivalent to UK fund rules. Existing UCITS are marketed into the UK under the Temporary Marketing Permissions Regime (TMPR).

The TMPR, subject to legislation, is being extended until the end of 2026. Existing funds will be allocated a three-month 'landing slot' (based on alphabetical order) to apply to be recognised under the OFR. Any operator missing their slot will lose permission to market in the UK.

The FCA will confirm final rules in July 2024, with the OFR open for new funds (not already taking advantage of the TMPR) from September 2024, with the 20 slots for existing funds starting in October 2024, and the final slot commencing in July 2026. The Government is also planning to consult on SDR labelling for OFR funds in Q3 2024.

FCA Chair outlines asset management agenda

FCA Chair, Ashley Alder, delivered a speech on 22 May 2024 outlining the FCA's policy agenda for the asset management sector.

Alder provided a summary of the key focus areas for the FCA across the asset management sector, including its ongoing regulatory reform programme, the regulator's focus on private markets, retail investments, and tokenisation.

Alder recognised the industry's feedback that UK alignment with EU rules on UCITS is preferable, but highlighted the potential benefits to be achieved from making the regime for alternative managers more proportionate. Alder also cited the ongoing regulatory focus on non-bank financial intermediation at a global and domestic level, and noted the potential for harms arising in the private finance sector, for example in valuations and conflicts of interest.

Alder also highlighted the regulator's continued work to improve outcomes for retail investors, in particular through its reform of PRIIPs regulation and review into the advice/guidance boundary. Alder finally noted the industry's ongoing work to explore commercial uses for fund tokenisation and explained that the FCA plans to keep its Handbook under review if changes are needed to keep pace with this innovation.

Insurance

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Conduct

FCA speech at the British Insurance Brokers' Association

Emily Shepperd, FCA Chief Operating Officer, delivered a speech on 16 May 2024 at the British Insurance Brokers' Association (BIBA) conference. Shepperd reflects on the FCA's recent interventions on multi-occupancy building insurance and Guaranteed Asset Protection insurance. Shepperd also discusses some of the risks and challenges facing the insurance sector, which include cyber harm, climate change, artifical intellgence (AI) and non-financial misconduct.

On AI, Shepperd confirms that the FCA is working with other regulators to produce a coordinated response. At this stage, the FCA does not envisage any stand-alone new regulations on AI in financial services. With regards to non-financial misconduct, Shepperd refers to the FCA's September 2023 portfolio letter to the wholesale insurance market. In this letter the FCA identified that the market had a long way to go in developing an inclusive culture. Shepperd confirms the FCA continues its work in this area to understand the scale of non-financial misconduct and the controls firms have in place for identifying and dealing with these cases.

Shepperd spoke about the opportunity to simplify the application of the existing insurance regulatory regime for commercial insurance, so that it is more tailored to the operation and the customer base of the commercial insurance market. Shepperd confirms the FCA will say more on this topic in due course.

Finally, Shepperd discusses the FCA's accountability to Parliament. In this context, Shepperd mentions the FCA's recent proposals to announce enforcement investigations earlier in the process. Shepperd confirms that the FCA recognises that this is a sensitive issue, and that the FCA will listen to feedback.

Supervision

PRA finalises authorisation and supervision approach to insurance branches

The PRA published its final policy on its approach to the authorisation and supervision of insurance branches on 23 May 2024. The final policy follows CP21/23, where the PRA proposed to transfer most of the expectations in SS2/18 to a new Statement of Policy (SoP). Additionally, the PRA updates SS44/15, which concerns third country insurance and pure reinsurance branches.

The purpose of the new SoP is to consolidate and clarify the PRA's policy on overseas insurers that write business in the UK through a third country branch, providing further clarity on the expectations of these branches. The PRA's changes are made considering its experience of authorising and supervising branches following the UK's withdrawal from the EU. The PRA also makes consequential changes to reflect Solvency UK reform.

The SoP clarifies the PRA's approach in several areas, including the ability to meet the Threshold Conditions, the 'broad equivalence' of the home jurisdiction's supervision regime and the home supervisor's ability to supervise. The SoP also covers new areas, which include the significance of the branch's UK operations and the relative sizes of the branch and the insurer.

The implementation date of the changes is the same as the date of publication, 23 May 2024.

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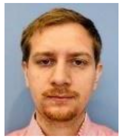

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