

The Uplink: Financial services regulatory news, 23 September 2022

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2022 Autumn Statement (Growth Plan): key financial services announcements

The [Growth Plan 2022](#) makes growth the government's central economic mission, setting a target of reaching a 2.5% trend rate. The financial services sector will be at the heart of the government's programme for driving growth across the whole economy. Later this autumn the government will bring forward an ambitious deregulatory package to unleash the potential of the UK financial services sector. This will include the government plan for repealing EU law for financial services and replacing it with rules tailor made for the UK, and scrapping EU rules from Solvency II to free up billions of pounds for investment.

PRA speech on addressing concentration risk in UK life insurance sector

The PRA has identified [two particular trends within the UK life insurance sector](#):

- In life reinsurance; "(a) the continued high level of longevity reinsurance; and (b) the emergence of more complex so-called 'funded reinsurance'".
- In life insurance: "The second trend concerns the continued growth of untraded or illiquid assets [eg loans to "infrastructure, social housing and sustainable energy" businesses] in life insurers' portfolios."

The PRA estimates "that over 80% of new business since 2016 has been reinsured at industry-level. This has partially been driven by the introduction of the risk margin under Solvency II but also by an increasingly competitive marketplace."

Funded reinsurance “involves the insurer paying a single, upfront premium which will be invested by the reinsurer to make the annuity payments ... Substantial collateral from day 1 is required from the reinsurer ...” There are material risks to the protection of customers in the event of insurer ‘recapture’ (ie the cessation of the reinsurance involving the transfer of assets to the insurer).

PRA consults on changes to regulatory regime for credit unions: new rules for new lending practices

The PRA considers that the existing Credit Unions part of the PRA rulebook is simple, reflective of the fact that when the regulatory framework was introduced, credit unions were viewed as simple savings and loans facilities run predominantly by volunteers.

The PRA has considered whether a simply-calibrated regime continues to be appropriate for all credit unions given its consideration that a small, but growing, number of credit unions have moved away from the traditional model both in terms of size and complexity of products offered to members (eg mortgages, corporate loans).

Among other things, the PRA consultation paper wants to set or clarify expectations as to:

- the amount and quality of capital held by a credit union;
- liquidity stress testing for credit unions with more than £10 million in assets, with a further expectation for credit unions with more than £50 million in assets and/or credit unions that wish to undertake more sophisticated investment business;
- credit unions that provide credit cards and/or loans to corporate members;
- risk management for credit unions with more than £10 million in assets,
- governance, business plans, and forecasts; and
- internal audit.

FCA multi-firm review assessing liquidity for orderly wind-down by general insurance brokers

The FCA says it: “worked with firms across the general insurance broking sector as part of our response to the Covid-19 pandemic... [and] found inconsistencies in their approaches to assessing adequate liquidity for orderly wind-down. So in the first half of 2022, we reviewed a sample of [10] general insurance brokers, predominantly London market and commercial general insurance brokers. Our purpose was to understand which of these approaches and practices either increased or weakened the credibility of these firms’ wind-down arrangements. We have provided direct, specific feedback to the firms assessed in this review.”

The FCA reviewed brokers’ “risk management frameworks, stress testing and reverse stress testing and their underlying modelling assumptions ... [and] undertook interviews with key members of staff from the senior management, risk and compliance functions.

Brexit: EU Law (Revocation and Reform) Bill 2022-23 published and introduced to Parliament: financial services aspects

The purpose of the Retained EU Law (Revocation and Reform) Bill is to provide the Government with all the required provisions that allow for the amendment of retained EU law (REUL) and remove the special features it has in the UK legal system. These reforms were announced in the Queen’s speech in May 2022.

To achieve this, the Bill will:

1. Repeal or assimilate REUL, within a defined scope, by the end of 2023
2. Repeal the principle of supremacy of EU law from UK law by the end of 2023;
3. Facilitate domestic courts departing from retained case law;
4. Provide a mechanism for UK government and devolved administration law officers to intervene in cases regarding retained case law, or refer them to an appeal court, where relevant;
5. Repeal directly effective EU law rights and obligations in UK law by the end of 2023;
6. Abolish general principles of EU law in UK law by the end of 2023;
7. Establish a new priority rule requiring retained direct EU legislation (RDEUL) to be interpreted and applied consistently with domestic

legislation;

8. Downgrade the status of RDEUL for the purpose of amending it more easily;

9. Create a suite of powers that allow REUL to be revoked or replaced, restated or updated and removed or amended to reduce burdens.

However, “certain financial services legislation” will not be subject to certain “sunset” clauses applicable in other areas

Insurance product governance: FCA update on application of PROD to products distributed through distributors based outside UK and intended for non-UK customers

The [FCA says](#) it has “noted manufacturers’ concerns about the challenges in obtaining information from overseas distributors” which are not subject to FCA regulation ... [and] is “currently considering longer-term ways to address the practical difficulties manufacturers are facing in meeting the [PROD 4.2](#) requirement to obtain information from non-UK distributors when undertaking the fair value assessment.”

At present, the FCA says its “expectations on manufacturers that sell products through overseas distributors that exclusively cover non-UK risks for overseas customers, are as follows:

Where manufacturers are required to obtain fair value related data/information from overseas distributors but have been unable to do so, we expect them to be taking reasonable steps to complete the fair value assessment required by the rules, including using data they may already hold or have been able to obtain for example on the total price paid by the customer.

However, where the requested information cannot be obtained from the overseas distributors, we do not expect manufacturers to report this to us as non-compliance with PROD 4.2.”

EIOPA supervisory statement on exclusions in insurance products arising from systemic events

Eiopa has observed that: “When systemic events materialize, insurers are often required to review their terms and conditions to limit disputes, promote certainty and avoid losses due to ambiguous contractual terms. Such reviews may often not to be carried out in accordance with product oversight and governance ... processes, which would ensure that the target market’s interests and needs are balanced vis-à-vis other business needs and considerations. ”

“... EIOPA recommends [members states’ regulators] to focus, where appropriate, their supervisory actions to insurance manufacturers’ assessment of the terms and conditions of their existing insurance products, to the extent such products have been impacted by the COVID-19 pandemic, the current invasion of Ukraine or other systemic events such as natural catastrophe. The aim of this assessment should be to determine whether the applicable exclusions from coverage are clear, and contract clarity is ensured for potential and existing customers, taking into account the target market’s characteristics and level of understanding of insurance products and their level of financial literacy.”

Financial crime: Economic Crime and Corporate Transparency Bill 2022 published

The Economic Crime (Transparency and Enforcement) Act (ECTE Act), the [Economic Crime and Corporate Transparency Bill](#) (ECCTB) sets out a number of measures through which the government aims to tackle economic crime and improve transparency over corporate entities.

The government states that the ECCTB will deliver the most significant reforms to Companies House in 170 years. Identity verification is proposed for all new and existing registered company directors, people with Significant Control, and those delivering documents to the Registrar. The Registrar of Companies House’s powers are broadened, including greater powers of investigation and new powers to check, remove or decline information submitted to, or already on, the companies register.

The ECCTB also seeks to tackle the misuse of limited partnerships by tightening registration requirements, requiring limited partnerships to maintain a connection to the UK and increasing transparency requirements. For the first time, it is proposed that the Registrar will be able to deregister limited partnerships which are dissolved, no longer carrying on business, or where a court orders that it is in the public interest to do so.

A number of proposals highlight the governments concern that digital coins are increasingly used to launder the proceeds of crime. It is proposed that cryptoassets are brought within the scope of civil forfeiture powers in Part 5 of the Proceeds of Crime Act 2002 (POCA), and a number of associated reforms include the removal of the requirement for an arrest before seizure powers can be exercised in relation to cryptoassets. Further reforms to POCA are proposed that would enable businesses in the regulated sector to directly share their concerns around economic crime.

In the wake of the recent criticism of the SFO, it is interesting to note that extensions to its powers are proposed under the new Bill. Currently, the SFO may only compel entities to provide information during pre-investigation stages for suspected cases of international corruption and bribery. It is now proposed that these powers are expanded to all cases, whether they relate to suspected fraud, bribery, or corruption.

FCA statement on potential enforcement action against Link Fund Solutions

Link Fund Solutions Ltd (LFS), a subsidiary of Link Group, managed the LF Woodford Equity Income Fund (WEIF). Following an investigation into the circumstances leading to the suspension of the WEIF, the [FCA has issued LFS with a draft Warning Notice](#). The draft Notice includes a proposed penalty of £50 million (before prompt settlement discounts). The draft Notice also sets out the basis for the payment of redress, which could be up to £306 million.

This potential redress figure reflects the FCA's current view of LFS's failings in managing the liquidity of the WEIF but does not reflect amounts that could owed to anyone else, including members of the fund, as a result of potential wrongdoing by other parties. The FCA has approved the potential takeover of Link Group by Dye and Durham (D&D) on the condition that D&D makes funds available to meet any shortfall within LFS in the amount available to cover any redress payments, up to the £306 million estimate.

LFS has 14 days to respond to the Warning Notice. Unless it chooses to resolve the case by agreement within that period, LFS will have the opportunity to challenge the FCA's findings and the proposed enforcement action at the Regulatory Decisions Committee (RDC) and through the Upper Tribunal.

FOS business complaints data for H1 2022 and further data on proactively settled complaints under temporary change to reporting outcomes

On 22 September, [FOS published its complaints data for January to June 2022](#) where it is broken down by business name. In recent days it has also published its Quarterly Complaints data (analysed by reference to products and services complained about).

A review of the business complaints data is largely unsurprising and in line with previous key markers. For example, the uphold rate (37%) is the same as the July to December 2021 uphold rate and a similar number of businesses feature in the complaints data. This is unsurprising given an individual business will only feature where it has been subject to 30 new complaints and 30 resolved complaints within the relevant period.

This data also features the temporary new category of "proactively resolved cases" following the FOS outcome codes initiative. A total of 4,242 complaints were resolved in this way within the relevant period. The total number of complaints resolved through this initiative is reported as being 5,460.

FCA report on insurance for multi-occupancy buildings following Grenfell

Following the Grenfell tragedy, the cost of insuring multi-occupancy buildings exponentially increased. The FCA was asked to review this area of the insurance market and report on the underlying causes of year-on-year price increases.

The [FCA 'Report on insurance for multi-occupancy buildings'](#) makes a number of recommendations that industry, Government and regulators can take to increase the availability and affordability of cover for leaseholders of multi-occupancy buildings. The report focuses on understanding the factors affecting premiums for mid-rise and high-rise multi-occupancy buildings (i.e. those exceeding 3 floors or 11

metres in height) and takes into account matters such as insurers' risk appetites, underwriting and pricing approaches, the role of parties within/outside the scope of FCA regulation and relevant changes to the regulatory environment for buildings and fire safety.

The review concludes that, whilst premium rates have doubled since 2016, the market has contracted significantly. There are concerns around the level of commission paid to brokers, particularly where that commission is shared with the freeholder or the property managing agent in circumstances where, in the FCA's view, the third party has not delivered a commensurate service. The FCA also expresses concern about the quality of service, renewals and frictional costs, noting that a lack of transparency and increased cost has led to significant distress.

The FCA recommends that the Association of British Insurers (ABI) works with it and the government to create a risk pooling solution, providing a plan for the implementation of this system within 2 months. The FCA also recommends that government considers imposing a legal requirement on freeholders and property managing agents to provide information on the insurance policy to leaseholders.

Recognising that, in most instances, leaseholders are not 'customers' under the FCA rules or in insurance contracts, the FCA recommends that government considers ways in which they could be joined as parties. Regarding remuneration, the FCA suggests that government may wish to consider legislation applying directly to unregulated property managers and freeholders regarding the levels of commission that they are paid. In a direct attack on commission sharing with property managing agents, the FCA is considering further rules on remuneration, which could include preventing remuneration being paid to unauthorised parties and prohibiting remuneration calculations as a percentage.

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