

Being better informed

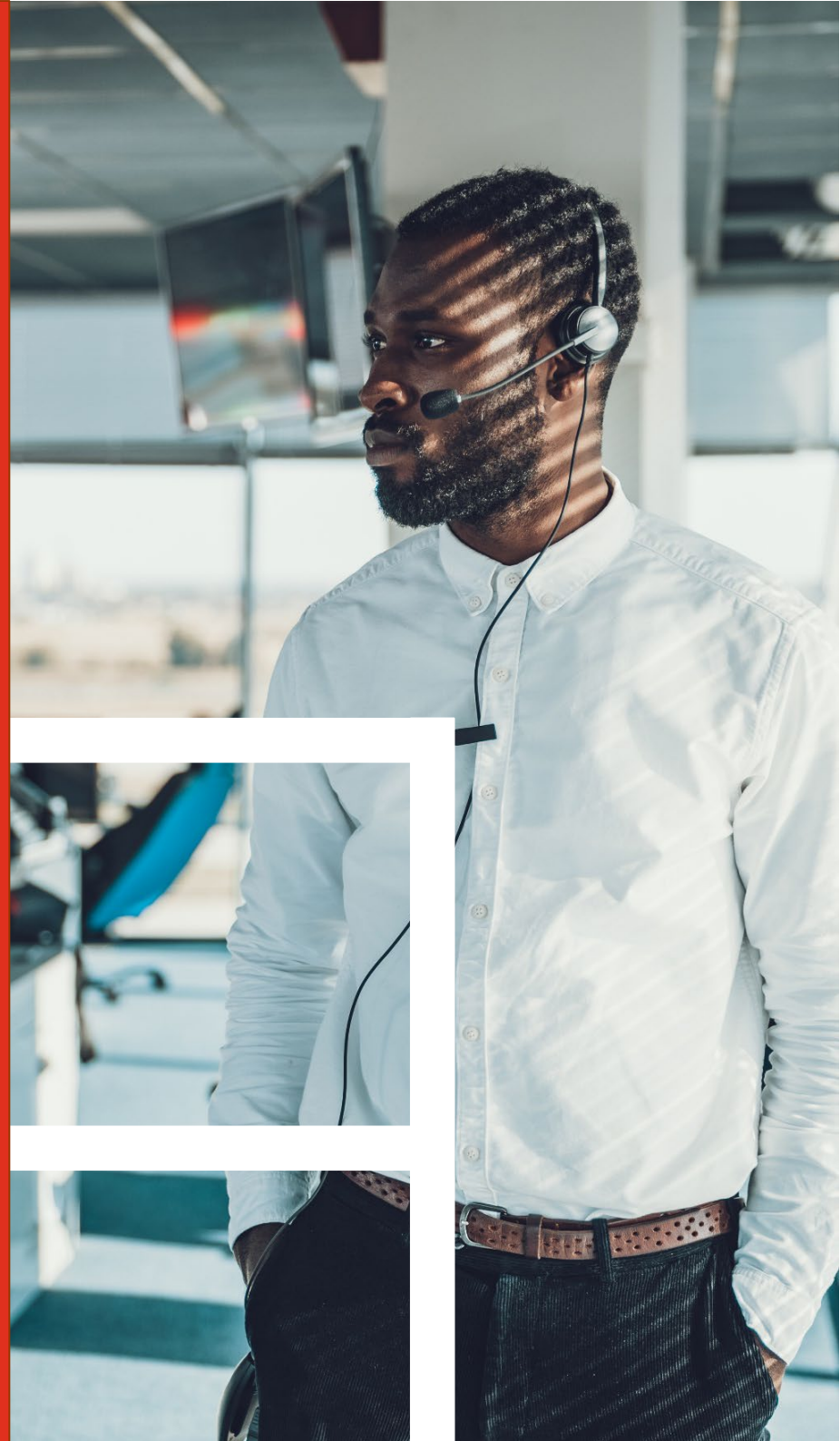
FS regulatory bulletin

FS regulatory insights

November 2023

In this month's edition:

- HMT confirms regulatory framework for digital assets
- PRA reiterates concerns over counterparty management
- Regulators assess AI discussion paper feedback
- TPT launches final disclosure framework



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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Policymakers continued their focus on digital assets and emerging technologies last month, with HM Treasury (HMT) publishing three long-awaited papers on regulated cryptoassets and stablecoins, reconfirming its intention to bring a number of cryptoasset and stablecoin activities into the regulatory perimeter for financial services. HMT will bring forward a new regulatory regime for wider cryptoassets, largely as consulted on earlier in the year, with secondary legislation expected to be laid in 2024, followed by regulatory consultations. Please see our [Hot Topic](#) for a detailed analysis.

Elsewhere, the FCA, Bank of England and PRA published a feedback statement to their October 2022 artificial intelligence (AI) discussion paper. The responses (from stakeholders including industry bodies, banks and technology providers), focus on the definition of AI, domestic and international alignment, the implementation of existing frameworks such as the Senior Managers & Certification Regime and the Consumer Duty, and third-party risk management. Although the feedback statement doesn't include new policy proposals or indications for future intervention, it will inform the regulators' next steps on AI regulation and guidelines. See our [At a glance](#) publication for further analysis.

In the banking sector, there were notable updates on risk management and remuneration. The PRA published a Dear CRO letter, sharing insights from its thematic review of banks' fixed income financing (termed 'matched book' repo). The review focused on the financing of market sovereigns liquid credit fixed income instruments, and identified a number of shortcomings in firms' counterparty risk managements and margining arrangements.

The PRA notes that while firms have improved their counterparty risk management controls for hedge fund clients as part of their prime brokerage businesses, firms still need to implement enhanced credit due diligence principles, client disclosure standards and counterparty risk management controls (beyond equity financing business lines). The letter is an important reminder of the PRA's strengthening focus on firms' approach to risk management and controls, paralleled by the FCA's recent wholesale banks supervisory letter. Please see our [At a glance](#) publication for more details.

The FCA wrote to the Chairs of Remuneration committees (RemCos) at the largest banks and building societies and PRA-designated investment firms, setting out its supervisory focus areas for remuneration. The regulator intends to focus on: the removal of the bonus cap, the Consumer Duty, culture and accountability, diversity and inclusion, and sustainability in finance. The letter asks RemCo Chairs to respond to the FCA on the actions they are taking on the issues raised.

Finally, in sustainability reporting, the UK Transition Plan Taskforce (TPT) published its final sector-neutral Disclosure Framework, which provides recommendations on developing and disclosing gold-standard transition plans. Alongside the Framework, the TPT published technical mapping of its recommendations to major corporate reporting standards internationally, and a consultation on its draft Sector Summary. The final framework has not changed substantially from the draft version, but there were some notable additions, including recommendations on how transition plans should seek to safeguard the natural environment. Our [At a glance](#) publication provides further details.

Read on to find out more about these and other developments. You can also visit our PwC webpage for further regulatory insights, including our latest Risk & Regulation Rundown [podcast episode](#), which looks at the changing financial crime landscape and how firms should respond to growing regulatory pressures in this space; and our blog on the vital role for technology and innovation in addressing financial inclusion challenges. You may also be interested to read PwC's Global Central Bank Digital Currency (CBDC) Index and Stablecoin Overview report, which ranks the CBDC maturity for [global](#) retail and wholesale projects, and provides details on CBDC developments around the world.

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Contents

How to read this bulletin?

Review the Table of Contents and the relevant Sector sections to identify the news of interest. We recommend you go directly to the topic/article of interest by clicking in the [active links](#) within the table of contents.

| | |
|------------------------------------|-----------|
| Executive summary | 2 |
| Cross sector announcements | 4 |
| Banking and capital markets | 8 |
| Asset management | 11 |
| Insurance | 12 |
| Contacts | 14 |

Cross sector announcements

In this section:

| | |
|-------------------------|---|
| Artificial intelligence | 4 |
| Benchmarks | 5 |
| Digital assets | 5 |
| Sustainability | 6 |
| UK Competitiveness | 7 |



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Artificial intelligence

FCA sets out approach to AI

The FCA published a [speech](#) by Jessica Rusu, Chief Data, Information, and Intelligence Officer on 5 October 2023, reaffirming the regulators' commitment to a principles-based, outcome-driven regulatory approach for the governance of artificial intelligence (AI).

Rusu acknowledged AI's potential to streamline operations and drive innovation across financial services, but highlighted the importance of identifying and mitigating the inherent risks and challenges AI presents. According to the regulator, there is a need for a robust digital infrastructure and resilience, particularly against systemic risks which may arise from dependencies on third-party technological providers. Additionally, Rusu stressed the crucial role of high-quality data, in ensuring AI's responsible adoption and effectiveness.

Addressing the issue of AI scams and consumer safety, Rusu called for stringent vigilance and protective measures, pointing to the increasing sophistication of AI-powered cyber threats.

Rusu also discussed the importance of existing regulatory frameworks, such as the Senior Managers & Certification Regime and the Consumer Duty, in upholding standards and fostering responsible AI adoption. Looking ahead, the FCA advocates a collaborative effort among industry leaders, innovators, and regulators to navigate the complex landscape of AI in financial services.

Regulators assess AI discussion paper feedback

The Bank of England, PRA and FCA issued a [feedback statement](#) in response to their [discussion paper](#) (DP5/22) on the use of artificial intelligence, on 26 October 2023. This initiative is part of a broader effort to better understand how to address and mitigate emerging risks related to AI.

The statement summarises the key points made by respondents, which include:

- Defining AI: respondents argue emphasis should be placed on understanding the characteristics and associated risks of AI through a principles-based approach, rather than settling on a specific definition.
- Regulatory alignment: there is a call for enhanced coordination among regulators as well as further international collaboration.
- Data regulation: respondents state that existing fragmentation should be addressed as well as data-related risks, including issues related to bias and fairness.
- Consumer outcomes: regulation and supervision should prioritise consumer outcomes, respondents argue.
- Third-party models: the increasing reliance on third-party models is raising concerns, highlighting the need for additional guidance.
- Governance structures: while existing firm governance structures and regulatory frameworks, such as the Senior Managers and Certification Regime (SM&CR), are seen as sufficient for managing AI risks, respondents say some practical guidance could provide helpful regulatory certainty.

Whilst the feedback statement does not include policy proposals, it provides insight into areas the regulators may prioritise in future work such as data regulation, guidance on the implementation of SM&CR, addressing bias and fairness.

Our [At a glance](#) publication provides further analysis.

Benchmarks

European Commission proposes Benchmark Regulation reforms

On 17 October 2023 the European Commission published a [proposal](#) to amend the EU's Benchmark Regulation (BMR) that would significantly reduce the scope of benchmark administrators subject to its requirements. The Commission's proposal follows a [review](#) of the scope and third country regime of the BMR that recognised the heavy reliance of EU benchmark users on non-EU benchmarks, whose future availability has been uncertain. While the proposals do not affect the scope of the UK BMR, the UK Government has previously said it will also consider potential changes to ensure the UK has an appropriate third country regime for benchmarks.

The Commission's proposal reduces the scope of the BMR to those benchmarks that are significant or critical to the EU's financial markets. The quantitative thresholds, at €50bn and €500bn respectively, will be kept the same. EU Climate Transition Benchmarks and EU Paris-Aligned Benchmarks will also be in scope. Non-EU benchmarks are currently available for use in the EU until 31 December 2025, under the BMR's transitional provisions. As it stands, after that date EU benchmark users can only use non-EU benchmarks that have been endorsed by an EU benchmark administrator, recognised in the EU, or if the third country has a framework that has been deemed equivalent to that of the EU.

The proposal needs to go through the European legislative process. Subject to that, the date for the new rules to apply is 1 January 2026.

Our [At a glance](#) publication provides further analysis.

Digital assets

FCA updates crypto firm registration statistics

The FCA [published](#) updated statistics on crypto firm applications on 6 October 2023. Since becoming the AML/CTF supervisor of UK cryptoasset businesses in January 2020, the FCA has registered 43 firms, or 14% of the applications. The FCA has rejected or refused 14% of applications, as the applications did not include key components necessary for the FCA to carry out an assessment, or the poor quality of key components meant the submission was invalid. All other applications since 2020 were withdrawn by firms.

FCA issues warning on crypto marketing

The FCA [published](#) another warning on cryptoasset marketing on 25 October 2023. The new regime for cryptoasset promotions came into effect on 8 October 2023. Since then, the FCA has identified three common issues with crypto marketing:

- Promotions making claims about the 'safety', 'security' or ease of using cryptoasset services without highlighting the risk involved
- Risk warnings not being sufficiently visible due to small fonts, hard-to-read colouring or non-prominent positioning
- Firms failing to provide customers with adequate information on the risks associated with specific products being promoted.

The FCA expects authorised firms approving the financial promotions of cryptoasset firms to take their regulatory obligations seriously. The regulator continues to work with businesses, including social media platforms, app stores, search engines and domain name registrars to remove or block illegal promotions. It is also working with payments firms to limit UK consumer exposure to firms issuing illegal promotions.

The FCA encourages consumers to check its [warning list](#) before making any crypto investments. Since the regime going live, the FCA has issued over 200 alerts on crypto firms.

FCA updates information on crypto applications

The FCA [issued](#) a new page to support new crypto firms on making AML/CTF regime registration on 26 October 2023. The page outlines the requirements and expectations under the FCA's supervision and how firms should prepare before, during and after the application.

HMT sets out next steps for systemically important stablecoins

HM Treasury (HMT) issued a consultation response on managing the failure of systemic 'digital settlement asset' (DSA) firms, including stablecoins, on 30 October 2023. The policy intent is to establish a legal framework for managing the financial stability risks posed by the failure of a systemic DSA firm, and for ensuring the return or transfer of customer funds and custody assets.

HMT confirms four policy proposal steps to deliver these objectives:

- Use the Financial Market Infrastructure Special Administration Regime (FMI SAR), with amendments, as the primary regime for systemic DSA firms that are not banks
- Introduce an additional objective for the FMI SAR, applicable to systemic DSA firms only, focused on the return or transfer of customer funds and custody assets, and make new rules to ensure this new objective can be applied effectively
- Give the Bank of England (BoE) the power to direct administrators
- Require the BoE, as the lead prudential supervisor of systemic DSA firms, to consult with the FCA prior to seeking an administration order or directing administrators in respect of firms subject to regulatory requirements imposed by both the BoE and FCA.

The Government plans to issue a secondary legislation in 2024, followed by the BoE's regulatory consultation.

Please read our [Hot Topic](#) for more information.

HMT confirms regulatory framework for digital assets

HM Treasury (HMT) published Future financial services regulatory regime for cryptoassets on 30 October 2023. HMT confirms it will bring forward a new regulatory regime for wider cryptoassets, largely as consulted on earlier in the year.

The Government will apply a phased approach. The regulation of fiat-backed stablecoins will take priority in phase 1, including issuance, payments and custody. The regulation of other activities in relation to cryptoassets, including algorithmic stablecoins, commodity-backed tokens and certain asset-referenced tokens, will be in scope for phase 2. It will cover activities including issuance, exchange, dealing, lending and custody of unbacked cryptoassets.

Once the cryptoasset regime is in place, firms undertaking regulated activities must adhere to the same financial crime standards and rules under FSMA which apply to equivalent or similar traditional financial services activities. Crypto firms already registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) will also need to seek authorisation from the FCA, under the wider FSMA-based regime.

For fiat-backed stablecoins, the Government commits to bringing forward secondary legislation as soon as possible, by early 2024, to enable the FCA to regulate fiat-backed stablecoins. This forms phase 1 of the plan to regulate cryptoassets. For wider cryptoassets (phase 2), the Government's aim is for the secondary legislation to be laid in 2024, followed by regulatory consultations.

Please read our [Hot Topic](#) for further information.

FCA joins global regulators to foster digital innovation

The FCA [issued](#) a statement on 31 October 2023, confirming a global partnership on a collaborative initiative exploring fund and asset tokenisation use cases, and decentralised finance. The FCA joins Singapore's Central Bank, the Financial Services Agency of Japan, and the Swiss Financial Market Supervisory Authority as part of the project.

HMT updates plans on fiat-backed stablecoins

HM Treasury (HMT) [published](#) an update on its planned approach to regulate fiat-backed stablecoins. The Government intends to prioritise the creation of FCA-regulated activities under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) for the issuance and custody of fiat-backed stablecoins issued in the UK. It will also regulate the payment services relating to certain fiat-backed stablecoins when used in UK payment chains, under the Payment Services Regulations 2017.

HMT commits to bringing forward secondary legislation as soon as possible, and by early 2024, to enable the FCA to consult and implement the regulatory regime.

Sustainability

ESMA to assess industry progress on MiFID II sustainability requirements

The European Securities and Markets Authority (ESMA) announced on 3 October 2023 that it will [launch a Common Supervisory Action](#) (CSA) with National Competent Authorities on the progress made by firms regarding the MiFID II sustainability requirements, which became applicable in 2022. In particular, the CSA will look at how firms are integrating sustainability into their suitability assessment and products governance processes and procedures. The CSA will be carried out in 2024.

European Parliament adopts European Green Bond Standard

The European Parliament on 5 October 2023 [adopted the European Green Bond Standard \(EuGBS\)](#), which will be a voluntary standard for issuers of bonds that want to use the EuGBS designation for their environmentally sustainable bonds. The EuGBS was [provisionally agreed](#) in February 2023.

The EuGBS introduces a registration system and supervisory framework for external reviewers of EU Green Bonds. There are also clarified requirements for issuers of green bonds around the use of proceeds, and there will be template formats for disclosure requirements. Issuers will need to show how investments feed into the company's transition plans. EuGBS aligns with the EU Taxonomy legislation, with a degree of flexibility until all technical screening criteria have been developed and are in place for all economic objectives. This means that up to 15% of all proceeds of EuGBS can be invested in economic activities in sectors that are not yet covered by the EU Taxonomy, though the issuer will need to explain clearly where this investment will go.

The EuGBS will come into effect 12 months after it is published in the Official Journal.

TPT launches final framework

The UK Transition Plan Taskforce (TPT) published its final sector-neutral [Disclosure Framework](#), providing recommendations on developing and disclosing gold-standard transition plans, on 9 October 2023.

Due to the positive feedback received on the draft Framework, the final version has not changed substantially. There have, however, been some additions, including recommendations on how transition plans should seek to safeguard the natural environment.

Alongside the Framework, the TPT published [technical mapping](#) of its recommendations to major corporate reporting standards internationally, and a [consultation](#) on its draft Sector Summary that will be open for comment until 24 November 2023. The proposed Sector Summary supplements the Framework by outlining decarbonisation levers, metrics and targets for 40 sectors, leveraging existing third-party guidance.

The TPT will consult on additional deep-dive guidance for seven priority sectors (including banking, asset owners, asset managers) on 13 November 2023, and to finalise its implementation guidance in Q1 2024.

In a [statement](#), the FCA said it intends to consult on guidance aligned with the TPT Framework, strengthening its expectations for listed companies around transition plan disclosure, when it consults on rules implementing UK-adapted ISSB Standards as part of UK SDR in H1 2024. Meanwhile, for UK-registered companies, the Government has committed to consulting on transition plan disclosure requirements in Q4 2023.

Please see our [At a glance](#) publication for more information.

EC proposes delay to CSRD reporting standards

On 17 October 2023, the European Commission [formally published proposals](#) to delay the deadline for the development of sector specific and third country undertaking European Sustainability Reporting Standards (ESRS). The standards set out the specific reporting standards for companies in the scope of the Corporate Sustainability Reporting Directive (CSRD). The first wave of standards have now been adopted, and will formally take effect on 1 January 2024. The second wave was due to be adopted by June 2024. However, the proposal would delay that by a further two years. The Commission believes this will give companies more time to embed the existing standards.

The proposal will be formally adopted once published in the Official Journal. The first companies fall into the scope of the CSRD from 1 January 2024.

EFRAG launches ESRS Q&A platform

On 24 October 2023, the European Financial Reporting Advisory Group (EFRAG) launched [a new Q&A platform](#) for the European Sustainability Reporting Standards (ESRS).

EFRAG was tasked with developing the standards to underpin the Corporate Sustainability Reporting Directive (CSRD) by the European Commission. The first set of standards were published in the summer of 2023, and have since been formally adopted by the European Commission, and three more sets will be published in the coming years.

The platform will allow stakeholders to submit technical implementation questions and receive non-authoritative responses from EFRAG. Questions previously answered by EFRAG will be publicly available on the platform.

FRC Lab issues ESG data recommendations

On 30 October 2023, the Financial Reporting Council (FRC) Lab [published two reports](#) looking at ESG data, and how companies can improve their data reporting practices. The Lab does not set out formal expectations of the FRC, but instead works with investors to develop good practice.

The reports cover recommendations relating to ESG data production, and ESG data distribution and consumption, including:

- Identifying what data is needed
- Collecting and processing data effectively
- Using data strategically
- Understanding your audience
- Focusing on what is relevant to an individual company.

UK Competitiveness

FCA Chief sets out approach to boosting competitiveness

FCA Chief Executive, Nikhil Rath, delivered a [speech](#) on 16 October 2023, outlining the FCA's approach to boosting the UK's competitiveness.

Rath reaffirmed the need for the FCA to maintain its operational efficiency, pointing to the progress it has made on processing authorisations applications and recent interventions in the cryptoasset promotions market. Rath also emphasised the importance of the FCA leading global standard setting discussions, in particular on crypto, sustainability and non-bank finance, and the need for global focus on the risks and opportunities presented by artificial intelligence.

Rath also confirmed that the FCA's consultation paper on [listings regime](#) reform will be published shortly, noting that these changes should support a bolder risk appetite to underpin long-term investment. To further advance the UK's competitiveness, Rath also highlighted investment in data and data infrastructure as critical and noted some of the FCA's ongoing initiatives to progress this. Finally, Rath noted that access to - and nurturing of - skills and talent is a key part of the competitiveness equation.

Banking and capital markets

In this section:

| | |
|---------------------|---|
| Account closure | 8 |
| Financial stability | 8 |
| Payments | 9 |
| Prudential | 9 |
| Remuneration | 9 |
| Risk management | 9 |



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Account closures

HMT updates on approach to bank account closures

HM Treasury provided an [update](#) on 2 October 2023 on its response to concerns regarding the closure of bank accounts. The statement noted the Government's intention to amend Threshold Conditions to ensure that firms are upholding their legal duties to protect freedom of speech. A consultation will be launched shortly to consider how these changes will be made, with the intention of legislating in 2024 to bring the changes into force.

The statement was accompanied by a [policy statement](#) providing an update on the Government's plans to reform rules relating to payment service contract terminations. This follows an announcement in July 2023 that account termination notice periods will be extended from 60 days to 90 days, and that firms must provide a clear and tailored reason for termination. The policy statement provides clarity on the implementation of the changes, including confirming the scope of the account termination rules will continue to apply, and reaffirming the limited exceptions that apply. The Government will publish a draft statutory instrument including the changes by the end of 2023.

Financial stability

FSB highlights resolution lessons from 2023 bank failures

On 10 October 2023 the Financial Stability Board (FSB) [published](#) the findings of its review into lessons arising from the failures of Credit Suisse, Silicon Valley Bank, Signature Bank and First Republic Bank for the international resolution framework. The FSB found that while the framework remains appropriate, several areas for further improvement were identified.

The FSB underlines the need for an effective public sector liquidity backstop and for banks to be able to access such a facility as a last resort. The FSB also states that resolution authorities and firms need to address legal issues around cross-border bail-in procedures; ensure a range of resolution options are available; and develop better understanding of bail-in on financial markets. Specifically in relation to resolution authorities, the FSB states that they need to prioritise the testing of effective decision making and execution, alongside improving their communication and coordination efforts beyond core Crisis Management Groups.

On non-systemic banks, the FSB found that recent US bank failures call into question whether the scope of resolution planning and loss-absorbing capacity requirements should be expanded. The FSB will also review whether resolution authorities can be better prepared for bank runs in the context of technological developments, and the role of deposit insurance in resolution arrangements.

Payments

CPMI updates on cross-border stablecoin arrangements

The Committee on Payments and Market Infrastructures (CPMI) [published](#) a report on 31 October 2023, highlighting a range of considerations and challenges on the use of stablecoin arrangements in cross-border payments.

The report goes through key features of stablecoin arrangements which are relevant from the perspective of cross-border payments. It highlights a range of relevant considerations and challenges, analyses how stablecoin arrangements might interact and coexist with other payment methods and evaluates the potential impact of their use on the monetary policy, financial stability and payment functions of central banks.

Prudential

BCBS finds good progress on Basel III implementation

On 3 October 2023 the Basel Committee on Banking Standards (BCBS) published an [update](#) on the implementation of Basel III across member jurisdictions, as of end-September 2023. The update forms part of the Committee's Regulatory Consistency Assessment Programme (RCAP) which was established to monitor the consistent implementation of Basel standards into domestic legislation.

BCBS notes that member jurisdictions have made good progress on implementation, with a third of jurisdictions having implemented all or the majority of the Basel III standards. Two thirds are planning implementation of the remaining standards by end-2024, and the remainder by 2025 (including the UK, US and EU).

PRA CEO outlines lessons from recent bank failures

On 16 October 2023 Sam Woods, Deputy Governor for Prudential Regulation and CEO of the PRA, gave a [speech](#) reflecting on the lessons learned from recent bank failures. Woods noted that those failures did not lead to a wider systemic crisis and should therefore be seen as a success for the post-financial crisis regulatory regime. He underlined the importance of non-financial regulation and supervision, and noted that additional tools will be needed in relation to the resolution framework to ensure regulators had appropriate options.

PRA launches discussion on securitisation prudential treatment

The PRA issued a [discussion paper](#) on 31 October 2023 inviting industry feedback on policy options to reform the capital treatment of securitisation exposures.

As part of the UK's post-Brexit regulatory framework reform, HM Treasury intends to transfer the firm-facing requirements in the Securitisation Chapter of the Capital Requirements Regulation (CRR) into PRA rules. The discussion paper sets out policy options that the PRA will consider as it consults on the replacement rules.

In particular, the PRA notes that it is considering options relating to the calibration of the Pillar 1 securitisation capital requirements and their interaction with the Basel 3.1 output floor, as well as the possibility of better aligning the hierarchy of methods for determining securitisation capital requirements in CRR with Basel standards. The PRA is also inviting views on the scope of the UK framework for simple, transparent and standardised securitisations and the coverage of traditional and synthetic securitisations.

Feedback to the paper will inform the PRA's work on a consultation paper and draft rules expected to be published in H2 2024.

Remuneration

PRA and FCA confirm removal of bankers' bonus cap

The PRA and FCA [published](#) PS 9/23 on 24 October 2023, confirming the removal of the bonus cap for firms subject to CRR in the UK (known as the 'bankers' bonus cap'). The regulators previously [consulted](#) on their proposals in CP 15/22. The final rules confirm the changes will apply for the current 2023 performance year, as opposed to the original implementation date of 1 January 2024.

The regulators have confirmed that under the final rules, firms will be required to define their own appropriate ratio for fixed and variable pay. Guidelines on the factors to be considered by firms when setting this ratio have also been added. The PRA has clarified that guarantees (e.g. sign-on bonuses) should continue to be treated as variable pay for the purposes of calculating the variable-to-fixed ratio, and will continue to be subject to the usual rules on variable pay. The PRA has also confirmed that there will be no change to the expectation that firms should use an annualised rate when determining the fixed pay of a Material Risk Taker who joins a firm part way through a performance year.

FCA sets out banking remuneration priorities

The FCA issued a [letter](#) to the Chairs of Remuneration committees at the largest banks and building societies and PRA-designated investment firms on 30 October 2023. The topics in the letter reflect the key remuneration-related issues with which the FCA is concerned in its supervision of the banking sector: removal of the bonus cap, Consumer Duty, culture and accountability, diversity and inclusion (D&I), and sustainability in finance.

The FCA notes that the recent confirmation of the removal of the bonus cap aims to make the remuneration regime more effective and give firms greater flexibility to adjust variable pay where there is a downturn or material poor performance or misconduct. On Consumer Duty, the regulator encourages firms to consider how relevant risk, metrics and performance criteria can be used to inform remuneration decisions, including any adjustments if progress in embedding the Duty falls short.

The FCA sets out its expectations around culture, which include for firms to take prompt and robust action where standards are not met, including as a result of non-financial misconduct; and ensure a clear, strong and evidenced link between behaviours and remuneration outcomes.

Elsewhere, the FCA underlines that where a firm makes sustainability-related claims and commitments, for example on net zero, it expects the firm to link its strategy, governance and remuneration structures to them.

The letter asks RemCo Chairs to respond to the FCA on the actions they are taking on the issues raised. The regulator also flags that its next letter of this nature is not due for at least two years.

Risk management

PRA confirms outcome of fixed income financing review

The PRA published a [letter](#) to firms on 5 October 2023, sharing insights from its thematic review of firms' fixed income financing (termed 'matched book' repo). The PRA's review focused on the financing of market sovereigns liquid credit fixed income instruments, and was expanded to cover the volatility in UK gilt prices in September-October 2022.

The PRA's main observations relate to shortcomings around firms' counterparty risk management processes and margining arrangements, where the PRA concluded that firms need to strengthen their controls in relation to lending provided through secured or synthetic financing facilities. In particular, the PRA emphasised the need for firms to implement enhanced credit due diligence principles, client disclosure standards and counterparty risk management controls (beyond equity financing business lines). The PRA noted that firms have improved their counterparty risk management controls for hedge fund clients as part of their prime brokerage businesses. The PRA also focused on settlement and operational controls, stating that firms need to ensure that their operational processes and margining platforms were sufficiently robust in relation to potential market volatility. The PRA underlined that firms' controls should be able to mitigate counterparty risks relating to exceptional margin payment flows and securities settlements, and that firms should conduct appropriate liquidity risk analysis in these areas.

Our [At a glance](#) publication provides further analyse

Asset management

In this section:

Compensation schemes Error! Bookmark not defined.

Supervision 8



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Compensation schemes

FCA decides against excluding FSCS cover for LTAFs

The FCA issued a [feedback statement \(FS23/7\)](#) on 30 October 2023, confirming it has decided not to take forward a proposal to exclude Financial Services Compensation Scheme (FSCS) cover for regulated activities relating to Long-Term Asset Funds (LTAFs).

It comes after the regulator published a [policy statement \(PS23/7\)](#) in June 2023, which set out new rules regarding LTAFs, a type of open-ended authorised fund designed to invest efficiently into long-term, illiquid assets. The rules, which came into force on 3 July 2023, re-categorised LTAFs from a Non-Mass Market Investment to a Restricted Mass Market Investment. As part of PS23/7, the FCA asked for views on whether FSCS coverage for LTAFs should be removed, as a first step toward a broader consideration of FSCS coverage for non-standard assets.

In light of the feedback received, the FCA has decided not to exclude FSCS cover for regulated activities relating to LTAFs. It now proposes to consider any changes to the scope of FSCS protection for retail investments in the round, rather than for specific investment products. The regulator says it will consider this question as part of ongoing initiatives in the consumer investments sector.

Supervision

FCA sets out asset management priorities

In a [speech](#) to the Investment Association annual dinner on 11 October 2023, Ashley Alder, FCA Chairman, set out the future regulatory reform priorities for the asset and wealth management (AWM) sector.

Following its February 2023 discussion paper on 'Updating and improving the UK regime for asset management', the FCA is prioritising three areas of reform, against a backdrop of ensuring a proportionate regime for firms but also fair value for consumers. It is not proceeding with the creation of a single set of rules for all AWM firms, nor developing a new category of basic authorised funds.

The FCA will focus on reform to the rules for alternative investment fund managers (AIFMs), noting the current two different categories of manager, and associated rules. It will also review the limitations to activities carried out by full-scope AIFMs, and some reporting obligations. This is likely to be consulted on during 2024, with the reporting elements to be reviewed in 2025.

The regulator also wants to update the regime for retail funds, simplifying the rules for non-UCITS. Finally, it intends to support technological investment (such as Distributed Ledger Technology) more proactively. In addition the FCA sees the advice/guidance review with HM Treasury as an opportunity to use technology to design good customer journeys.

Alder acknowledges the breadth of change faced by firms as retained EU law is replaced, and the need for proportionate regulation. He also underlines previous comments made by the FCA on the challenge of regulatory reform versus societal tolerance of risk.

Insurance

In this section:

| | |
|-----------------------|------------------------------|
| Conduct | 12 |
| Stress testing | Error! Bookmark not defined. |
| Supervision | Error! Bookmark not defined. |



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Conduct

FCA recommends improvements to terminal illness benefits

The FCA [published](#) findings of its review into terminal illness (TI) benefits within life insurance protection products on 2 October 2023. Overall the FCA did not find routine poor customer outcomes for the TI benefit, but it did identify areas for improvement.

The FCA considers it is reasonable for insurers to require medical evidence of a 12-month prognosis of death to prove a valid claim. However, firms should proactively review whether this time period remains appropriate in relation to a customer's reasonable expectations, and the products and services outcome under the Consumer Duty.

With respect to the robust checking of the quality of claims handling, the FCA states it expects firms to assess a range of MI on claims and initial pre-claims enquires. Further, given TI customers are inherently vulnerable, delays in the claims process are likely to significantly impact such customers. Therefore, the FCA states it expects firms to consider whether its pre-claims and claims processes are sufficiently proactive, timely and flexible.

Additionally, the FCA expects firms to be transparent about the independence of their internal medical expert where the expert has an integral role to play in relation to claims decisions. The FCA also states firms should review the suitability of policy terms which prohibit TI claims in the last 12 months of the policy, as terms like this can cause potential foreseeable harm where a customer may have a qualifying TI but cannot access the benefit.

The FCA states that all life insurance protection insurers and intermediaries should consider its findings and take action to aid the delivery of good outcomes for customers.

Stress testing

PRA announces 2025 dynamic GI stress test

The PRA [issued](#) a short statement on 3 October 2023, announcing its intention to run a dynamic general insurance (GI) stress test exercise in 2025. The PRA states the aims of the exercise will be to: i) assess the industry's solvency and liquidity resilience to a specific adverse scenario; ii) assess the effectiveness of insurers' risk management and management actions following an adverse scenario; and iii) inform the PRA's response following a market-wide adverse scenario.

The PRA explains that this exercise will be different from previous exercises as it will involve simulating a sequential set of adverse events over a short period of time. The PRA will provide detail on the participation, design and timelines of this exercise in H1 2024. Unlike the enhanced stress test exercise for life insurers, the PRA plans to publish the results of this GI stress test exercise at an aggregate industry level.

Supervision

PRA outlines priorities and challenges in mutuals sector

Shoib Khan, Director of Insurance Supervision at the PRA, delivered a [speech](#) at the Association of Financial Mutuals Annual Conference on 2 October 2023. In his speech Khan discussed: why the PRA considers insurance mutuals are important to its objectives; some of the opportunities and challenges the PRA sees ahead; and how the PRA intends to take a proportionate approach when supervising mutuals.

Khan notes that while the PRA's 2022 Insurance Stress Tests found that in aggregate the solvency coverage of insurers remained above 120% in the adverse scenarios, there continues to be challenging market conditions which have implications for the financial resilience of insurers including mutuals. Khan also spoke of the importance of keeping risk management frameworks updated so that firms can effectively respond to changing market and credit risk conditions. Khan further discusses how upcoming Solvency II reforms in the UK will be supportive of mutuals, for example the size thresholds for the Solvency II regime will be increased. This is a change that will mostly impact the mutuals sector.

Khan uses the opportunity to remind mutuals of its expectations. This includes the expectation that boards should be carefully monitoring their firm's viability, and should ensure that plans are in place to allow an orderly exit from the market should this be needed.

PRA clarifies its approach to regulating third-country branches

The PRA published a consultation paper ([CP21/23](#)) on 4 October 2023, clarifying its authorisation and supervisory expectations for insurance third-country branches (TCBs).

The PRA proposes to issue a new statement of policy to replace SS2/18, which will clarify its approach to assessing the risks of a TCB. Through its proposals the PRA aims to maximise reliance on home supervisors, focus on the importance of the financial resources of the TCB's parent undertaking and ensure a proportionate approach to supervision. The PRA will review the financial resources information provided by the TCB's parent undertaking to assess that business is conducted in a prudent manner.

The PRA notes reinsurance can be an important risk management tool, but equally notes that overreliance on this tool can impact the incentives for prudent risk selection and management. As such, the PRA also sets out its approach to considering the implications of an undertaking's reinsurance arrangements when assessing the risks of a TCB.

The PRA additionally proposes to amend SS44/15 to set out the PRA's expectations in relation to notifications, ORSA reporting, governance and senior management functions, re-domiciliation, outsourcing and operational risk. On ORSA reporting for example, the PRA proposes to allow a TCB to submit its parent undertaking's ORSA instead of a separate TCB ORSA. The undertaking's ORSA must clearly identify and address any material risks to the TCB's operations.

The consultation period closes on 12 January 2024 and the proposed changes are expected to take effect by Q2 2024.

For more information, please read our [At a glance](#) on this publication.

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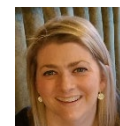
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