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WELCOME TO OUR INSURANCE REGULATORY EBULLETIN

Welcome to this edition of our Insurance Regulatory eBulletin, which aims to keep you updated with significant regulatory developments and their implications across the insurance sector.

A bumper month – particularly if you enjoy regulatory reading. EIOPA has issued an 878 page tome on its proposals for modifying the current Solvency II Directive and related regulations in 2020. The proposals include changes to the long-term guarantee measures, new regulatory tools for macro-prudential issues, recovery and resolution, and insurance guarantee schemes. There also proposed revisions to elements of freedom of services provisions, reporting and disclosure, and the solvency capital requirement. The PRA was busy updating various supervisory Statements relating to Solvency II whilst the FCA has been considering the effects of climate change, the changing nature of regulation and what machine learning might mean for consumers. The FCA also issued an interim report on general insurance pricing practices and its next steps in this area.

I hope you enjoy reading this latest update. Please do not hesitate to contact myself or your normal BDO contact if you have any concerns over any matter highlighted in this update.

ALEX BARNES
PARTNER

+44 (0)20 7651 1213
alex.barnes@bdo.co.uk

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EIOPA

EIOPA ISSUES OPINION ON SUSTAINABILITY WITHIN SOLVENCY II

In August 2018, EIOPA received a request from the EC for an Opinion on Sustainability within Solvency II, with a particular focus on aspects relating to climate change mitigation. The call for an opinion requested EIOPA's views on the integration of sustainability, in particular climate-related developments, into the Solvency II framework for the valuation of assets and liabilities, investment and underwriting practices, the calibration of market and natural catastrophe risks and the use of internal models.

On 30 September, EIOPA published the requested Opinion on Sustainability and Solvency II addressing the integration of climate-related risks in the Solvency II Pillar I requirements. The opinion notes that whilst Solvency II - as a risk-based, forward-looking and market-consistent framework - is well equipped to accommodate sustainability risks and factors, climate change brings considerable challenges to the valuation of assets and liabilities, underwriting and investment decisions and risk measurement.

At a high level, the Opinion stresses the importance of scenario analysis in the (re)insurance undertakings' risk management in view of the potentially substantial impact to their business strategy from climate change-related risks. (Re)insurers should consider the impact of their underwriting practices in a manner consistent with sound actuarial practice, where risk mitigation and loss prevention can make a significant difference. The development of new insurance products, adjustments in the design and pricing of the products and the engagement with public authorities, should be part of the industry's overall activity in relation to climate change-related risks.

2020 WORK PROGRAMME OF THE EUROPEAN SUPERVISORY AUTHORITIES

On 2 October, the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA) together known as the Joint Committee of the European Supervisory Authorities (ESAs) published their Work Programme for 2020.

The Joint Committee's activities will continue work in the areas of cross-sectoral risk analysis, consumer protection, financial conglomerates, securitisation as well as accounting and auditing. There will be a particular focus on areas such as packaged retail investment and insurance-based products (PRIIPs), financial innovation, the European Commission's FinTech Action plan and the work of the European Forum for Innovation Facilitators (EFIF) as well as sustainable finance and securitisation.

JOINT OPINION ON THE RISKS OF MONEY LAUNDERING AND TERRORIST FINANCE AFFECTING THE EU'S FINANCIAL SECTOR

On 4 October, the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) issued a Joint Opinion identifying and analysing the current and emerging money laundering and terrorist financing (ML/TF) risks potentially affecting the EU's financial sector.

The ESA's identified risks into two categories of cross-sectoral risks and sector-specific risks. The Opinion identifies, amongst other things, challenges such as uncertainty resulting from the withdrawal of the UK from the EU, and risks associated with new technologies; and concerns regarding divergent national legal frameworks. Terrorist financing risks also continue to be a concern due to weaknesses in transaction monitoring and limited information flows between law enforcement, firms and competent authorities (CAs). A number of potential actions for CAs are proposed within the Opinion in order to mitigate identified cross-cutting ML/TF risks.

EIOPA TESTS THE REVISED & NEW TEMPLATES FOR SOLVENCY II REPORTING AND DISCLOSURE REVIEW

On 9 October, EIOPA launched Wave 1 - a field test of the revised and newly proposed Solvency II reporting templates. The field test is open for all solo undertakings and service providers. The aim of the field test is to provide undertakings a chance to implement the new and revised reporting requirements, to identify issues and to report back to EIOPA.

The field test covers the following templates:

- S.04.03 - Basic Information - list of underwriting entities
- S.04.04 - Activity by country - location of underwriting
- S.04.05 - Activity by country - location of risk
- S.14.01 - Life obligations analysis
- S.14.02 - Non-life business - policy and customer information
- S.25.01 - Solvency Capital Requirement - for undertakings on Standard Formula
- S.25.02 - Solvency Capital Requirement - for undertakings using the standard formula and partial internal model or full internal model
- SR.25.02 - Solvency Capital Requirement - for undertakings using the standard formula and partial internal model or full internal model - RFF/MAP
- S.29.05 - Detailed analysis per period for life insurance and reinsurance undertakings - Technical flows and Technical provisions
- S.29.06 - Detailed analysis per period for non-life insurance and reinsurance undertakings - Technical flows and Technical provisions
- S.42.01 - Cyber risk
- S.43.01 - Internal model - Additional information on IM
- S.43.02 - Internal model - Market & credit risk and sensitivities
- S.43.03 - Internal model - Credit event risk for financial instruments
- S.43.04 - Internal model - Credit risk Non-Financial Instruments
- S.43.05 - Internal model - Non-life & Health non-slt

- S.43.06 - Internal model - Output correlations between undertaking's internal lines of business
- S.43.07 - Internal model - Life & health risk
- S.43.08 - Internal model - Operational risk
- S.43.09 - Internal model - Model Changes

Stakeholders are invited to participate in the field test, testing one, some or all of the templates. Feedback is welcome until the 31 January 2020.

EIOPA IDENTIFIES CONSUMER PROTECTION ISSUES IN TRAVEL INSURANCE

On 9 October, EIOPA published a report on its thematic review which sought to better understand travel insurance products in order to identify any potential sources of conduct risk and consumer detriment so that supervisory action can be taken if necessary.

The report sets out the key findings of the review including that, while the travel insurance market does not seem at risk of a general market failure, certain business models face increased conduct risks primarily from remuneration structures based on very high commissions and low average claims ratios (sometimes below 20% of gross written premium. It was also noted that new players (such as airline and ferry companies, price comparison websites, aggregators, banks and supermarkets) are entering the market, typically selling travel insurance products online as an ancillary activity.

Following on from this report, EIOPA will work on measures to improve consumer outcomes and will examine all the available tools for driving improvements. These include:

- a warning to the industry about high commissions and business models that rely on such remuneration structures;
- dialogue with the industry including new market players, national competent authorities and consumer representatives on ways to tackle consumer behaviour in the context of such markets from a practical standpoint;
- setting out regulatory expectations on the practical implementation of the Insurance Distribution Directive (IDD) in this market; and
- dialogue on the use of commission caps as a stronger intervention.

EIOPA CONSULTS ON TECHNICAL ADVICE FOR THE 2020 REVIEW OF SOLVENCY II

On 15 October, EIOPA launched a public consultation on an Opinion that sets its technical advice for the 2020 review of Solvency II. The Opinion responds to the call for advice of the European Commission of 11 February 2019 on the 2020 review of Solvency II.

The call for advice comprises 19 separate topics which can be summarised in three parts.

- Firstly, the review of the long term guarantee measures. These measures were always foreseen as being reviewed in 2020, as specified in the Omnibus II Directive. A number of different options are being consulted on, notably on extrapolation and on the volatility adjustment.
- Secondly, the potential introduction of new regulatory tools in the Solvency II Directive, notably on macro-prudential issues, recovery and resolution, and insurance guarantee schemes.
- Thirdly, revisions to the existing Solvency II framework including in relation to freedom of services and establishment; reporting and disclosure; and the solvency capital requirement.

EIOPA believes that overall the Solvency II framework is working well and their approach to the call for advice has in general been one of evolution rather than revolution, except where it results either from supervisory experience (e.g. in relation to cross-border business), or the wider economic context (e.g. in relation to interest rate risk). The consultation covers all areas of the call for advice except for insurance guarantee schemes and most topics on reporting and disclosure which have already been consulted on.

The main proposals are as follows:

- Consideration to choosing a later starting point for the extrapolation of risk-free interest rates for the euro or to change the extrapolation method to take into account market information beyond the starting point.
- Consideration to changing the calculation of the volatility adjustment to risk-free interest rates, in particular to address any overshooting effects and to reflect the illiquidity of insurance liabilities.
- A proposal to increase the calibration of the interest rate risk sub-module in line with empirical evidence, in particular the existence of negative interest rates. The proposal is consistent with the technical advice EIOPA provided on the Solvency Capital Requirement standard formula in 2018.
- A proposal to include macro-prudential tools in the Solvency II Directive.
- A proposal to establish a minimum harmonised and comprehensive recovery and resolution framework for insurance across the EU.
- Proposals around proportionality where EIOPA has reviewed the rules for exempting insurance undertakings from the Solvency II Directive, in particular the thresholds on the size of the (re)insurer's business. As a result, EIOPA proposes to double the thresholds related to technical provisions and to allow Member States to increase the current threshold for premium income from the current amount of EUR 5m to up to EUR 25m. Further, proposals are being made to improve the proportionality of the governance requirements for (re)insurance undertakings, in particular on the Solvency II key functions, the Own Risk and Solvency Assessment, the required policies and on administrative, management and supervisory bodies.

In a number of areas, further work is ongoing and stakeholders are invited to contribute to it, in particular on the risk margin, equity risk and property risk. This consultation will be accompanied by information requests to national supervisory authorities and to industry to collect data on the impact of the individual proposals included in the consultation and the combined impact of the proposals.

EIOPA will finalise its view on the advice on the basis of the consultation feedback and the impact data collected and will issue the Opinion on the 2020 review in June 2020.

The deadline for submission of feedback is Wednesday, 15 January 2020.

ESA'S CONSULT ON CHANGES TO THE KEY INFORMATION DOCUMENT FOR PRIIPS

On 16 October, the ESAs issued a Consultation Paper (CP) on amendments to existing rules on the Key Information Document (KID) for Packaged Retail and Insurance-based Investment Products (PRIIPs).

The aims of the review are to:

- address issues that have been identified by stakeholders and supervisors since the implementation of the KID in 2018;
- make specific changes to allow the rules to be applied to investment funds that are expected to have to prepare a KID from 1 January 2022 onwards.

The CP proposes changes in the following areas:

- illustrations of what a retail investor might receive in return from their investment (performance scenarios);
- information on the costs of the investment;
- specific issues for different types of investment funds;
- specific issues for PRIIPs offering a range of options for investment ("Multi-Option Products").

As part of this review, the EC, in cooperation with the ESAs, is undertaking a consumer testing exercise to assess the effectiveness of different presentations of performance scenarios. The results are expected in the first quarter of 2020.

When deciding on their final proposals, the ESAs will take into account the feedback from respondents to this consultation, as well as the results of the consumer testing exercise.

The deadline for feedback is 13 January 2020.

PRUDENTIAL REGULATION

SOLVENCY II: EQUITY RELEASE MORTGAGES – PART 2 - PS19/19

On 27 September, the PRA issued a Policy Statement (PS19/9) containing feedback to the responses to Consultation Paper 7/19 'Solvency II: Equity release mortgages - Part 2'. The PS also contains the PRA's final Supervisory Statement 3/17 'Solvency II: Matching adjustment' - illiquid unrated assets and equity release mortgages". As a result of the consultation and following further analysis, the PRA has made a number of clarifying changes to the draft supervisory statement in particular some additional transparency about the PRA's approach to reviewing the EVT parameters.

The expectations set out in the updated SS3/17 will come into effect on Tuesday 31 December 2019, and will supersede the version of SS3/17 published in December 2018 that was due to come into effect on the same date.

BANK OF ENGLAND SECTOR RESILIENCE EXERCISE

On 27 September, the Bank of England published the high level findings of the financial sector ("sector") cyber simulation exercise that took place on 9 November 2018. This exercise, commissioned by the Cross Market Operational Resilience Group jointly chaired by the Bank and UK Finance, explored the sector's resilience to a major cyber incident impacting the UK.

The exercise demonstrated that recommendations from the last sector exercise have been implemented and identified further opportunities for improvement. It also successfully rehearsed the Cross Market Business Continuity Group, an executive level group chaired by the Bank to enable financial authorities (Bank of England, PRA, FCA and HMT) to interact with the sector during times of major operational disruption. Alongside the financial authorities, participants included 29 of the most systemically important firms and Financial Market Infrastructures. Participants responded to a severe but plausible cyber-attack scenario targeting the sector.

As the report sets out, the exercising found:

- Opportunities to improve the way firms coordinate at an operational level during incidents that impact the sector
- Disparity in risk tolerance for suspending services could impact the functioning of the financial sector
- Recovery of services is impacted by differences in the way data is stored across the financial sector
- Effective and consistent communications are key to maintaining customer and market confidence.

RESPONSES TO CP13/19 'OCCASIONAL CONSULTATION PAPER' – PS21/19

On 30 September, PRA released Policy Statement 21/19 (PS21/19) which provides feedback to responses on Consultation Paper (CP) 13/19 'Occasional Consultation Paper' and includes the final rules, updated supervisory statements (SS), and relevant templates and LOG files.

The PS attaches the revised rules and relevant Supervisory Statements on:

- SS23/15 'Solvency II: The quality of capital instruments'
- Minor updates to SS8/14 'Subordinated guarantees and the quality of capital for insurers' and SS2/15 'Solvency II: Own funds'
- SS25/15 'Solvency II: Regulatory reporting internal model outputs'.

SOLVENCY II: THE QUALITY OF CAPITAL INSTRUMENTS – SS3/15

On 30 September, the PRA published an update to Supervisory Statement 3/15 (SS3/15), following the publication of Policy Statement 21/19 'Responses to CP13/19 Occasional Consultation Paper'.

SS3/15 covers the following topics:

- prohibition on redemption of instruments within five years of the date of issue;
- liability management and capital reduction;
- principal loss-absorbency mechanism for Tier 1 instruments subject to limitation ('restricted Tier 1'); and
- additional considerations for instruments intended to contribute to group own funds.

This version of SS3/15 is effective from 30 September 2019.

SUBORDINATED GUARANTEES AND THE QUALITY OF CAPITAL FOR INSURERS - SS8/14

On 30 September, the PRA released an update to Supervisory Statement (SS8/14), following PS21/19 'Responses to CP13/19 Occasional Consultation Paper', which applies to all insurers (firms) authorised by the PRA and may also be relevant to insurance holding companies and other entities in the same group.

It sets out the PRA's expectations of firms relating to:

- the use of subordinated guarantees in connection with capital instruments issued by a company;
- how subordinated guarantees should not undermine the quality of capital held by firms to meet capital requirements; and
- how, if the liability created by the guarantee serves to undermine the guarantor's quality of capital, the guarantor's regulatory capital position should be reported.

The key changes were to delete extraneous and historical material from SS8/14 to align them with the current format and bring it up to date.

The new policy came into effect for all instruments issued on or after 30 September 2019.

SOLVENCY II: OWN FUNDS - SS2/15

On 30 September, the PRA released an updated Supervisory Statement (SS2/15) addressed to UK Solvency II firms and to Lloyd's, setting out the PRA's expectations of firms in relation to:

- ancillary own funds and Article 96 of the Solvency II Directive;
- the right to cancel (or defer) dividends or other distributions;
- transitional measures for own funds; and
- pre-issuance notification.

The key changes made to delete extraneous and historical material from SS2/15 (such as the transitional measures) to align them with the current format and bring it up to date.

The new policy came into effect for all instruments issued on or after 30 September 2019.

SOLVENCY II: REGULATORY REPORTING INTERNAL MODEL OUTPUTS - SS25/15

On 30 September, the PRA updated its Supervisory Statement 25/15 (SS25/15) which is applicable to UK insurance firms within the scope of Solvency II and to the Society of Lloyd's regarding their Syndicates and in respect of outputs of the Lloyd's internal model.

SS25/15 outlines the PRA's expectations of firms while providing clarity on the information to be reported by firms that use an internal model to calculate the solvency capital requirement (SCR). In addition, it also contains templates and LOG files that the PRA expects firms to use when submitting regulatory reports. The templates and LOG files are available here: Regulatory reporting - insurance sector.

This version is effective from 30 November 2019.

THE PRA'S APPROACH TO ENFORCEMENT - PS23/19

On 4 October, the PRA published a Policy Statement (PS23/19) providing the final Statement of Policy (SoP) 'The PRA's approach to enforcement: Statutory statements of policy and procedure. This was consulted on in Consultation Paper (CP) 10/19 'Enforcement: Changes to the PRA's settlement policy'.

The PS is relevant to all PRA-authorised persons, qualifying parent undertakings, persons who are or have been auditors or actuaries of a PRA-authorised person, senior managers and certified employees at firms, and all individuals involved in providing financial services to PRA-authorised persons.

In the CP the PRA proposed amendments to the SoP to:

- simplify the PRA's settlement discount scheme (by retaining a 30% penalty discount for early settlement and removing the 20% and 10% discounts available for settlement in later stages of an enforcement action); and
- clarify and make more transparent the PRA's procedures for settlement.

The PRA received no responses to the CP and has decided to make the changes to the SoP as consulted.

The SoP takes effect from Friday 4 October 2019, with one exception: in relation to a case where the PRA has already concluded 'Stage 1' settlement discussions with the subject, without reaching a settlement.

OCCASIONAL CONSULTATION PAPER - CP25/19

On 7 October, the PRA issued an Occasional Consultation Paper (CP25/19) proposing minor amendments to PRA Rulebook parts, supervisory statements (SSs), statements of policy (SoPs) and the relevant templates.

The majority of the CP relates to banks and building societies but the CP proposes minor corrections and updates to SS34/15 'Strengthening individual accountability in insurance'.

Responses to the proposals are required 9 December 2019.

SOLVENCY II: ADJUSTING FOR THE REDUCTION OF LOSS ABSORBENCY WHERE OWN FUND INSTRUMENTS ARE TAXED ON CONVERSION - CP26/19

On 11 October, the PRA issued a Consultation Paper (CP26/19) which proposes to amend the PRA's expectations on the treatment of restricted Tier 1 own funds (rT1) instruments in the light of recent information from HMRC. The proposals would make amendments to Supervisory Statement SS3/15 'Solvency II: the quality of capital instruments.'

The SS currently sets out the PRA's expectation that insurers will deduct the maximum tax charge generated on write down, when including externally issued rT1 instruments in their own funds. The consultation proposes expanding this expectation to reflect the maximum tax charge that could be generated on conversion of such items into ordinary shares. To reflect any changes to SS3/15 following this consultation the PRA would also update the reporting clarification published as Appendix 2 to Policy Statement (PS) 4/19 'Solvency II: Adjusting for the reduction of loss absorbency where own fund instruments are taxed on write down'.

The consultation closes on Monday 13 January 2020

NEW MEMORANDUM OF UNDERSTANDING ON EQUIVALENCE AND EXEMPTIONS POST BREXIT

On 17 October, the PRA, HM Treasury, and the FCA published a Memorandum of Understanding (MoU) between HM Treasury, the Bank of England (Bank), Prudential Regulation Authority (PRA) and FCA. The MoU sets out how the parties expect to coordinate their respective functions in relation to equivalence and exemption determinations. These are new functions that will be transferred to UK authorities in the context of the UK's withdrawal from the European Union and will come into effect from exit day.

INSURANCE ACCOUNTING

FRC RESPONSE TO AMENDMENTS TO IFRS 17

On 8 October, the Financial Reporting Council (FRC) published its response to the International Accounting Standards Board's (IASB) Exposure Draft (ED/2019/4) on the proposed amendments to the IFRS 17 – Insurance Contracts.

The FRC supports most of the proposed amendments and appreciates the efforts of the IASB to address issues related to the implementation of IFRS 17. However, the FRC recommends that the IASB ensure that an alternative proposal on matters associated with annual cohort requirements is in place. It also notes that even if the IASB agrees to move the date of entry into force of IFRS 17 beyond 2022, all amendments must be finalised by mid-2020 in order to eliminate uncertainties regarding the timely approval of the standard in Europe.

CONDUCT REGULATION

REGULATION ROUND UP

On 16 October, the FCA published its monthly Regulation round-up. The Hot Topics included the General insurance pricing practices (GIPP) interim report*, the Motor Finance Discretionary Commission Models consultation, and Gabriel users sharing suggestions for the new FCA data collection platform.

This edition included the following articles that are relevant to insurers or insurance intermediaries:

- **Registering for Connect** – firms will need to use the Connect online platform, to submit a firm's details such as the mandatory annual details update (even if there is no change) - which becomes a requirement from January 2020;
- **Directory data** - collection is underway for insurance companies (and their appointed representatives) who must send the FCA their data by 9 March 2020. All solo regulated firms must send their data between 9 December 2019 and 9 December 2020.
- **The fourth General insurance (GI) value measures pilot** – participating insurers will start to report their value measures data from 3 areas: claims frequencies, claims acceptance rates and average claims pay-outs. The FCA aim to publish this data in Q1 2020.
- **Next steps for general insurance value measures** – the FCA consulted earlier in 2019 on its plans to make reporting value measures data a requirement. The General insurance pricing practices (GIPP) market study interim report contains an update on next steps. The FCA have postponed the publication of a Policy Statement on the proposed rules, so that they can consider this work alongside other relevant regulatory developments including remedies from the GIPP market study interim report.
- **Helping shape the pensions dashboard** - The Money and Pensions Service recently appointed an Industry Delivery Group (IDG) to lead the delivery of the pensions dashboards programme (a digital interface that will enable people to see all their lifetime pension savings in one place). The IDG is currently looking for individuals to join its working groups.

* covered below

GENERAL INSURANCE PRICING PRACTICES (GIPP) INTERIM REPORT

On 4 October, the FCA published its interim report on the general insurance pricing practices market study - part of a package of work to make general insurance markets work well for consumers. The market study in October 2018 following a thematic review to understand whether pricing practices in home and motor insurance support effective competition and lead to good consumer outcomes. The FCA were concerned about the potential harm to consumers from pricing practices. In addition, stakeholders had also raised concerns about outcomes from general insurance pricing practices. In September 2018, Citizens Advice made a super-complaint about loyalty pricing to the Competition and Markets Authority (CMA). Home insurance was 1 of 5 markets included in the super-complaint. The CMA published its response in December 2018. It recommended that the FCA look at ways to tackle 'price walking' and other harmful business practices in home insurance.

The FCA has found that the home and motor insurance markets are not working well for all consumers. While a large number of people shop around, many loyal customers (around 6 million consumers) are not getting a good deal. Other key findings are:

- Insurers often sell policies at a discount to new customers and increase premiums when customers renew, targeting increases at those less likely to switch.
- 6 million policy holders paid high or very high prices in 2018, if they paid the average for their risk they would have saved £1.2 billion.
- Longstanding customers pay more on average but loyalty is not the only issue – high prices were paid by some consumers who had been with their provider for less than 4 years.
- 1 in 3 consumers in the consumer research who paid high prices showed at least one characteristic of vulnerability, such as having lower financial capability. For consumers who bought combined contents and building insurance, lower income consumers (below £30,000) pay higher margins than those with higher incomes.
- People who pay high premiums are less likely to understand insurance or the impact that renewing has on their premium.
- Firms engage in a range of practices that could make it more difficult for consumers to make informed decisions and could raise barriers to switching.
- Many consumers who switch or negotiate their premium can get a good deal.

The insurance industry has acknowledged the need to address concerns about pricing practices and has been taking some steps to do this. However, the FCA think that further intervention is also required. In the immediate term, the FCA will continue working to address the problems uncovered including:

- ensuring firms improve the governance, control and oversight of pricing practices
- delivering the changes required from firms following implementation of the Insurance Distribution Directive and other policy work.
- Continuing to improve transparency and engagement at insurance renewal.

The FCA are also considering a range of industry wide measures to reform these markets so they work well for consumers in the future and the interim market study report sets out these remedies.

FCA BOARD MINUTES: 24 AND 25 JULY AND 4 SEPTEMBER

On 10 October, the FCA published the minutes of the FCA Board meeting of 24 and 25 July 2019. The minutes cover the Annual Enterprise-wide Risk Management (EWRM) Report, Communications Strategy, Report from the Chief Executive, Pensions Master Trust, BTS Strategy and Commercial Position, and the FCA Panel Survey 2019, amongst other matters.

FCA SETS OUT LATEST EXPECTATIONS FOR FIRMS ON BREXIT

On 11 October, the FCA issued an update on steps certain firms need to take in the event that the UK leaves the EU on 31 October 2019 without a deal.

As leaving the EU during the working week could create operational challenges for firms, firms should take reasonable steps to be prepared to comply with post-exit MiFID transaction reporting and EMIR trade reporting requirements. Alongside this, should the UK leave the EU without a deal, passporting will come to an end. Any EEA passporting firm wishing to continue operating in the UK will need to notify the FCA that they wish to enter the Temporary Permissions Regime (TPR) by 30 October 2019.

After exit, firms who notified the FCA of their intention to use the TPR will be contacted and provided with a landing slot when they will need to submit their application for full UK authorisation. Upon authorisation, the FCA will generally expect firms to have a physical presence in the UK to help ensure effective supervision. The FCA will be consulting on our approach and expectations shortly.

CONVERSION FROM THE APPROVED PERSONS REGIME TO THE SM&CR

On 11 October the FCA updated its web page on conversion to the SM&CR from the Approved Persons Regime. The FCA noted most firms will have their Approved Persons Regime (APR) functions automatically converted to the corresponding Senior Management Functions (SMFs). However, Enhanced firms and some Core firms (where they have a Non-Executive Chair) will need to complete a conversion notification form (Form K) on Connect to convert these individuals.

Firms are reminded to submit the Form K (Conversion Notification) by 23.59 on 24 November 2019 otherwise Controlled Functions will be withdrawn at commencement of the new regime and not mapped to Senior Management Functions. This means a firm would be in breach of regulatory requirements and, as a result, the FCA may take action

CLIMATE CHANGE AND GREEN FINANCE: SUMMARY OF RESPONSES AND NEXT STEPS – FS19/6

On 16 October, the FCA published a Feedback Statement (FS19/6) on its discussion paper on climate change and green finance. The document provides an overview of the responses received to Discussion Paper (18/8) on Climate Change and Green Finance issued in October 2018, as well as the FCA's actions and next steps.

The FCA received 73 submissions to DP18/8 concerning the following key themes: climate-related disclosures by securities issuers and regulated firms, common metrics and standards on sustainability, industry engagement, and stakeholders' concerns, commercial priorities and barriers to growth. Having considered the responses, the FCA has identified the key actions it will take, including:

- consulting on new rules to improve climate-related disclosures by certain issuers and clarifying existing obligations
- finalising rule changes requiring Independent Governance Committees (IGCs) to oversee and report on firms' environmental, social and governance (ESG) and stewardship policies, as well as separate rule changes to facilitate investment in patient capital opportunities
- publishing a feedback statement in response to a joint Discussion paper with the Financial Reporting Council (FRC) on Stewardship setting out actions to address the most significant barriers to effective stewardship
- challenging firms where we see potential greenwashing, clarifying our expectations and taking appropriate action to prevent consumers being misled
- contributing to several important collaborative initiatives, including the Climate Financial Risk Forum (CFRF), the Fair and Effective Markets Review (FEMR) working group, the Government-led cross-regulator taskforce on disclosures and the European Commission's Sustainable Finance Action Plan (SFAP)

MACHINE LEARNING IN UK FINANCIAL SERVICES

On 16 October the Bank of England (BoE) published a report on Machine Learning (ML) in UK Financial Services. Machine learning (ML) includes the development of models for prediction and pattern recognition from data, with limited human intervention. The application of ML methods has the potential to improve outcomes for both businesses and consumers within the financial services industry.

Both the BoE and the FCA have an interest in the way that ML is being utilised by financial institutions. Therefore, the BoE and the FCA conducted a joint survey in 2019 to better understand the current use of ML in UK financial services. The key findings of the survey are:

- ML is increasingly being used in UK financial services
- In many cases, ML development has passed the initial development phase and deployment is most advanced in the banking and insurance sectors
- From front-office to back-office, ML is now used across a range of business areas.
- Regulation is not seen as an unjustified barrier but some firms stress the need for additional guidance
- Firms thought that ML does not necessarily create new risks, but could be an amplifier of existing ones
- Firms validate ML applications before and after deployment
- Firms use a variety of safeguards to manage the risks associated with ML
- Firms mostly design and develop ML applications in-house
- The majority of users apply their existing model risk management framework to ML applications.

REGULATION IN A CHANGING WORLD

On 21 October, the FCA published a speech delivered by Christopher Woolard, Executive Director of Strategy and Competition at the FCA, at the City of London / Cicero event on Future of Regulation.

Woolard discussed how the FCA has been considering whether its regulatory model is still relevant and capable of adapting to the changing economic landscape. The FCA believe that this is a good time to look at what has worked and what can be improved up in this matter because, further to the first wave of post-crisis regulation, firms are better capitalised and the personal responsibility of their leaders is more embedded.

The FCA is also taking into consideration that consumer requirements have changed due to long-term low interest rates leading to an increased search for higher investment return, and as consumers are aging, they have both less saved and inherit assets later in life. He also noted that we are now in an era of digitisation that draws on artificial intelligence (AI) and machine learning. This digital transformation is reflected in the new products finding their way direct to consumers over the internet, some of which are fraudulent.

The FCA will be looking at the desired outcomes that are wanted in the financial services markets, and will be inviting comments and ideas on the future of its regulation from other agencies to ensure that the FCA will be a regulator that is fit for the current and future age.

ENFORCEMENT ACTION

FCA REGULATORY FINES ROUND-UP

FCA regulatory fines for 2019 now total £389.9m. The following fines and related enforcement actions have been announced in the past month:

The Prudential Assurance Company Limited (Prudential)	The FCA imposed a fine of £23.9m for breaches of PRIN 3 and PRIN 6 relating to mis-selling and the unfair treatment of customers over non-advised sales of annuities. Between July 2008 and September 2017, Prudential's non-advised annuity business focused on selling annuities directly to existing Prudential pension holders. Prudential failed to ensure that customers were consistently informed that they may get a better deal if they shopped around and failed to take reasonable care to organise and control its affairs in breach of its obligation to ensure fair treatment of customers. Prudential also failed to ensure that documentation used by call handlers was appropriate and failed to monitor calls with customers properly. Prior to 2013, the risks created by a lack of appropriate systems and controls were increased by sales-linked incentives for call handlers and their managers which meant that call handlers might put their own financial interests ahead of ensuring fair customer outcomes. Call handlers were incentivised by the possibility of earning an additional 37% on top of their base salary and winning prizes such as spa breaks or weekend holidays. Prudential voluntarily agreed to conduct a past business review of non-advised annuity sales in order to identify any customers who may be entitled to redress as a result of the firm's failures. As of 19 September 2019, Prudential has offered approximately £110 million in redress to 17,240 customers (including ongoing annuity uplifts).
Tullet Prebon (Europe) Limited (Tullet Prebon)	The FCA imposed a financial penalty of £15.4m for breaches of PRIN 2, PRIN 3 and PRIN 11 related to wholesale conduct and failing to be open and co-operative. Tullett Prebon failed to conduct its business with due skill, care and diligence, failed to have adequate risk management systems and failed to be open and cooperative with the FCA. Tullett Prebon, now part of TP ICAP, is an electronic and voice inter-dealer broker, acting for institutional clients transacting in the wholesale financial markets, typically investment banks. The Rates Division of Tullett Prebon carried out 'name passing' broking which comprised a significant part of Tullett Prebon's overall business, employing many brokers and generating significant revenues for the firm. Following an investigation, the FCA found that, between 2008 and 2010, Tullett Prebon's Rates Division had ineffective controls around broker conduct. Lavish entertainment and a lack of effective controls allowing improper trading to take place, including 'wash' trades (a 'wash' trade involves no change in beneficial ownership and has no legitimate underlying commercial purpose) which generated unwarranted and unusually high amounts of brokerage for the firm. Senior management wrongly believed sufficient systems and controls were in place, when in fact, systems and controls were not used or directed effectively. Obvious red flags of broker misconduct and opportunities to probe were missed. Tullett Prebon also breached Principle 11 of the FCA's Principles for Businesses by failing to be open and cooperative with the FCA. This breach occurred between August 2011 and October 2014 and related to the FCA's request to Tullett Prebon in August 2011 for broker audio tapes. Although Tullett Prebon had the majority of the audio that the FCA required, they failed to produce the audio to the FCA until 2014. Tullett Prebon initially provided an incorrect account as to how the audio had been discovered.

FOR MORE INFORMATION:

ALEX BARNES

+44 (0)20 7651 1213
alex.barnes@bdo.co.uk

CHARLES PORTSMOUTH

+44 (0)20 7651 1428
charles.portsmouth@bdo.co.uk

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