AFB

COMPLIANCE PLATFORM

COMPLIANCE EXPERT PANEL – OUTPUT PAPER

**AFB Expert Panels meet regularly and produce Output Papers on behalf of the whole membership (see Note).*

PRA AND FCA BUSINESS PLANS FOR 2020/21

A. PRA BUSINESS PLAN

The PRA published its Business Plan in April 2020. It identifies eight strategic goals and sets out the PRA's workplan for each of these.

In light of Covid-19, the PRA had to reassess plans and reprioritise work and resources. As a result, it took various measures, including the cancellation of the 2020 annual cyclical scenario stress tests and delaying the publication of the 2019 biennial exploratory scenario ("BES") results.

The PRA has also looked at supervisory work with individual firms and postponed less critical elements, including certain skilled person reviews, so that firms can focus on their contingency arrangements, and the PRA can target key areas to support financial stability.

The PRA has extended consultation periods and implementation timescales for new policies, including changes to internal ratings-based models, which will be delayed until the start of 2022.

The PRA will continue to assess the effects of Covid-19 and actively revise elements of the Business Plan if necessary. Current plans for each of its strategic goals for 2020/21 are summarised below.

1. Robust prudential standards and supervision

The PRA has a strategic goal of having in place robust prudential standards, and holding regulated firms, and those who run them, accountable for meeting these standards. Work related to this goal includes:

- Ensuring that the new ring-fencing governance structures and risk management arrangements are working effectively.
- Processing high numbers of third country branch applications in relation to Brexit. A number of EEA bank branches will require authorisation as third country branches when passporting rights fall away.
- Assisting in firms' transition away from LIBOR. The Financial Policy Committee ("FPC") has considered further potential supervisory tools that authorities could use to encourage the reduction on the stock

of legacy LIBOR contracts to an absolute minimum before the end of 2021, and will keep the use of such tools under review in light of progress made by firms on the transition. The PRA will step up engagement with firms through regular supervisory relationships, reviewing MI and collecting data from firms to assess progress.

- Ensuring the PRA's supervisory approach can continue to be applied, including through adaptations to information-sharing arrangements with other European regulators.
- Providing support for the FPC review and assessment of the capital framework, housing tools and the financial stability implications of Brexit.

2. Adapting to market changes and horizon scanning

The PRA has a strategic goal of continuing to adapt to changes in the markets in which it is involved and pre-empting and mitigating risks to its objectives. Work related to this goal includes:

- Climate change. Working with industry through the Climate Financial Risk Forum ("CFRF") to build intellectual capacity and establish best practice in how to manage the financial risks from climate change and preparing for the next climate BES testing the resilience of business models of the largest banks and the financial system as a whole to physical and transition risks from climate change.
- FinTech. The PRA is key to BoE's work on FinTech, including digital currencies and RegTech. The BoE has launched a review which seeks ways to decrease the burden on industry and to increase the timeliness and effectiveness of data in supporting supervisory judgements. It will also investigate how the application of AI and machine learning in financial services is evolving, and how it affects firms' safety and soundness.
- New risks. The PRA intends to identify and mitigate new risks, such as those posed by climate change, technological innovations, and cross-sector issues by engaging in thematic reviews and specialist cross-firm reviews as well as ongoing engagement with industry and external bodies.

3. Financial resilience

The PRA has a strategic goal to ensure firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take. Work relating to this goal includes:

- Finalising proposals on how firms manage the risks associated with asset encumbrance, and the quality of their risk management practices, reflecting the recommendations of the Zelmer review and CP24/19.
- Paying particular attention to newer firms, in particular where business models have not yet been seasoned, and to areas where risks may be crystallising.
- Preparing for the implementation of international banking reforms, particularly Basel III for which the implementation date has now been deferred to 1 January 2023.
- Consulting on enhancing the process of reviewing the ICAAP for mid-sized UK banks and building societies.
- Reviewing firms' asset quality and management of investment risk. The PRA will continue to review firms' risk management and governance of illiquid and other assets, including their internal ratings. If the PRA has concerns about particular internal ratings, it may commission an opinion from an External Credit Assessment Institution under section 166 FSMA. The PRA will target their reviews at firms with large and/or complex exposures.

4. Operational resilience

- The PRA has a strategic goal to develop its supervision of operational resilience to mitigate the risk of disruption to provision of key services. Work relating to this goal includes:
- Policy Statement on impact tolerances for important business services in 2020/21, following CP 29/19.
- International engagement including participation in the Basel Operational Resilience Group, the G7 Cyber Experts Group and European Systemic Cyber Group.

5. Recovery and resolution

The PRA has a strategic goal to ensure firms have credible plans to recover from stress events, and that firms work to remove barriers to resolvability to ensure any orderliness of any failure. Work relating to this goal includes:

- Monitoring implementation of the Resolvability Assessment Framework by the largest UK banks and building societies.
- Continuing work to ensure firms can wind down trading and derivatives businesses in an orderly manner, as part of their recovery and post-resolution restructuring frameworks. In the coming year the PRA will progress this work, with a view to consulting on their approach.
- A Consultation Paper on revised approach to operational continuity in resolution is planned.

6. Competition

The PRA has a strategic goal to facilitate effective competition by actively considering the proportionality of its approach as it contributes to the safety and soundness of the UK financial system. Work relating to this goal includes:

- Analysing barriers to growth for smaller firms, including assessing the extent to which the overall regulatory burden affects them as they grow.
- Developing a tailored approach to supervising small and fast-growing firms, including work on a regime for small, non-systemic banks and building societies. This includes pursuing proportionate outcomes from the implementation of Basel III, CRR II Regulation and CRD V.
- Developing approach to mortgage risk weight floors and Pillar 2 liquidity and reviewing the leverage ratio.
- Continuing to implement policies to facilitate internal ratings-based model applications from smaller banks and refining the Pillar 2A capital framework.

7. EU withdrawal

The PRA has a strategic goal of delivering a smooth transition to a sustainable and resilient UK financial regulatory framework following the UK's exit from the EU. Work relating to this goal includes:

- During the transition period, a key priority will be establishing new regulatory relationships with the EU. The PRA will work on equivalence assessments of the UK to the EU, and of third countries.
- In the banking sector, the PRA will continue to monitor any risks presented by firms' business models and governance as a result of restructuring their activities to accommodate the UK's withdrawal from the EU.

8. Efficiency and effectiveness

The PRA has a strategic goal of operating more efficiently and effectively by ensuring that resources are allocated to work that best advances its strategy and reduces the greatest risks to the delivery of its statutory objectives, and by providing an inclusive working environment. Work relating to this goal includes:

- Investigating making the PRA Rulebook machine-readable and identifying opportunities for simplification and removing redundancies.
- Discussing with firms how to transform data collection to decrease the burden on industry and to increase the timeliness and effectiveness of data in supporting supervisory judgements. This work will follow on from the BoE's January 2020 discussion paper on this issue.

B. FCA BUSINESS PLAN

In April 2020, the FCA published its Business Plan and has identified five key priorities over the next 1-3 years, six pieces of "cross-cutting" work as well as sector specific work.

Covid-19 has fundamentally reshaped the FCA's key priorities, the planned focus areas have now largely been overshadowed by the response to the Covid-19 emergency which will dominate the work that the FCA does for consumers, markets and firms. Routine supervisory work has been replaced by detailed Covid-19 specific information requests and enforcement activities which were originally limited to desk-based work have been adapted to include interviews by video-link. It may be months before the FCA is able to focus fully on planned activities. It will publish an update to this plan later this year if necessary.

Five key priorities

1. Transforming how the FCA works and regulates

Key intended outcomes include:

- Making faster and more effective decisions to work in a more integrated way as 'One FCA'.
- Prioritising end outcomes for consumers, markets and firms by being clearer with firms about expected outcomes.
- Prioritising intelligence and information sharing and acting on it to ensure a more focused and co-ordinated approach.
- Influencing international issues that affect UK markets and consumers to strengthen the UK financial system and the UK's reputation as an international marketplace.

2. Enabling effective consumer investment decisions

Where pensions and retail investments sectors work poorly, consumer losses from unsuitable investment decisions, or fraud, can be catastrophic. The FCA sees significant risk of harm in these markets. Key outcomes to be achieved include:

- Investment products are appropriate for consumer needs. Some consumers are exposed to a higher investment risk than they can absorb and so the FCA aims to ensure products are designed to meet consumers' needs, deliver good value and are marketed fairly and clearly.
- Consumers make effective decisions about their investments. The aim is for consumers to have access to high quality advice and support and understand how to avoid scams/fraud.

- Firms and individuals operate under high regulatory standards and act in consumers' interests. A higher standard of governance and accountability is needed to avoid misconduct.

3. Ensuring consumer credit markets work well

Consumers who borrow to meet essential living expenses typically pay more for credit. The impact of Covid-19 and will influence shape and influence the approach the FCA takes. Key outcomes to be achieved include:

- Consumers can find products that meet their needs. Information should be clear and simple.
- Consumers do not become over-indebted through credit they cannot afford. There is concern that firms benefit from exploitative fees and charges.
- Affordable credit is available to smooth consumption. Access to fair and affordable credit is important and the FCA will continue to work with the government to ensure this.
- Consumers can take control of debt at an early stage when they fall into financial difficulty. Firms should identify consumers at risk early and offer suitable forbearance.

4. Making payments safe and accessible

There has been an increase in firms and products entering the payments services sector recently. The FCA wants to ensure SMEs can safely access the variety of payments services on offer. Key outcomes to be achieved include:

- Consumers transact safely with payment firms. Increased focus on evaluating firms' systems and controls while monitoring emerging risks. Focus will turn to ensuring payments firms have appropriate systems and controls to minimise financial crime.
- Payment firms meet their regulatory responsibilities while competing on quality and value. Where firms fail to meet safeguarding and other regulatory requirements, the FCA will act swiftly to rectify this.
- Consumers and SMEs have access to a variety of payments services. The FCA is concerned that, as firms’ business models change, they may stop providing some services to some groups. A priority is helping to ensure customers have continued access to cash.
- When measuring progress, the FCA has made it clear that it will (amongst other things) assess if firms have adequate systems and controls to prevent financial crime including fraud.

5. Delivering fair value in a digital age.

Fair value for consumers is key to healthy competition. The FCA highlights the so called "loyalty penalty" as an example of where markets fail to achieve fair value for consumers. The development of digital markets is also noted with a warning of a potential disproportionate impact on vulnerable consumers, some of whom may be among the ‘digitally disenfranchised’. Key outcomes to be achieved include:

- Consumers can choose from products that meet their needs, at a suitable quality and price. Consumers should be able to make informed buying decisions.
- Digital innovation and competition supporting greater value. Firms should use data and algorithms to price products ethically as markets become increasingly digital. They should implement adequate controls to prevent unfair bias or discrimination.
- Vulnerable consumers are not exploited or targeted with poor value products and services and access to key products and services is fair. Firms should have robust policies on fair value and not target consumers with poor value products and services.

Cross-cutting work

The FCA will work across sectors on the above five key priorities. In addition, it has identified further "cross-cutting work" in the 2020/21 plan. This focusses on similar issues to the "cross-sector priorities" section of the 2019/20 plan except for climate change which is new for 2020/21.

1. The UK's withdrawal from the EU and changes to the regulatory framework

- In 2019/20, EU withdrawal was an immediate issue the FCA had to tackle. The UK has now left the EU and the FCA is committed to supporting a smooth transition in its 2020/21 plan.The FCA will work closely with European and global stakeholders on developing robust global financial standards.
- The FCA will provide the Government with technical support in negotiations with the EU and ensure the UK financial services industry is ready for the end of the transition period.
- The FCA will work with the Government and other stakeholders to shape the future regulatory framework, not only to reflect a future outside the EU, but also to address the FCA's view that the current framework is too focused on rules and process, and not enough on principles and outcomes. The FCA sees far too many resources devoted to redress and remediation, and not enough to empowering consumers to take good decisions and regulatory action to prevent harm and safeguarding consumers’ financial wellbeing.

2. Climate Change – new for 2020/21

- The FCA will assess the feedback on its recent consultation on climate-related disclosure rules for certain issuers.
- There are also plans for the FCA to better understand how retail investment products are designed, the accuracy of disclosure and whether this enables consumers to make effective decisions on "green products".

3. Innovation and technology

- The FCA will invest in new technologies and skills to better use data to regulate efficiently.
- The FCA will strengthen its anti-money laundering rules and support a joined-up approach to crypto assets.
- The FCA wants to use technology to reduce firms' regulatory reporting burdens by replacing Gabriel with a new platform for collecting firms' data.
- The FCA will also explore how to expand its services to encourage wider adoption of technologies, particularly for RegTech.

4. Operational resilience

- The FCA aims to set new requirements to strengthen operational resilience. Its joint papers with the PRA and Bank of England make it clear that it expects firms and Financial Market Infrastructure entities to take ownership of their own operational resilience.

- Firms and Financial Market Infrastructures are expected to:
    - Identify their important business services by considering how their customers or market integrity could be harmed by any service disruptions.
    - Map out the people, processes and technology at the firm that are necessary to deliver these services.
    - Set impact tolerances for each important business service (i.e. the thresholds for maximum tolerable disruption).
    - Test their ability to remain within their impact tolerances during severe but plausible scenarios.
    - Conduct 'lessons learned' exercises to identify, prioritise and invest in their ability to recover from disruptions as effectively as possible.
    - Develop internal and external communications plans for when important business services are disrupted.
    - Create a self-assessment document.

5. Financial Crime

- In line with the commitments in the UK National Economic Crime Plan 2019, the FCA will in 2020/21 start to implement changes to how it reduces financial crime, including greater use of data to identify firms or areas that are vulnerable.
- The FCA will continue to take enforcement action where it uncovers serious misconduct, particularly where there is a high risk of money laundering. In this regard, it has been widely publicised that the FCA will undertake dual track investigations and will consider prosecuting firms who fail to have in place adequate systems and controls to combat money laundering.
- Fraud falls within the FCAs priority of reducing financial crime and the FCA will focus on ensuring firms meet the requirements to have effective systems and controls to detect, disrupt and reduce the risk of financial crime.

6. Culture in financial services

- The FCA expects the requirements of the SMCR to be adhered to.
- The FCA will continue to focus on the four key culture drivers in firms – purpose, leadership, approach to rewarding and managing people, and governance. Weak governance and oversight in smaller banks is a driver of harm.

Sector-focussed work

1. Wholesale financial markets

Key aims:

- Orderly transition from LIBOR.
- Clean markets that make it difficult to commit market abuse and financial crime.
- Wholesale markets that deliver a range of good value, high-quality products and services to market participants.
- Markets remain orderly in a range of market conditions.
- Markets meet users' needs.

2. Investment management

Key aims:

- Investors get high-quality, fair value, products and services.
- Effective governance continues to be a priority.

3. Retail banking

Key aims:

- The sector is operationally resilient with minimal disruption to consumers and markets.
- Firms build resilience to serious and organised crime through improved systems and controls.
- Consumers and SMEs can access services that meet their needs, including cash.
- Customers get high quality products and services from retail banks.

NOTE

Meetings of AFB Expert Panels are held in compliance with AFB's Competition Law Guidance. All issues discussed are included in the relevant Output Paper. AFB holds a central record of all attendees at Expert Panel Meetings. AFB Expert Panel Output Papers are intended as general guidance and no action should be taken in reliance on them without specific legal advice.

QUERIES AND FOLLOW-UP

If you wish to speak to one of the AFB team, please feel free to contact

Ilza Javed, Associate, Practice and Events

Email: ilza.javed@foreignbanks.org.uk

Tel: +44 (0) 020 7283 8300

Alternatively, if you would like any further information about any of these matters, please feel free to contact the following individuals from the team at Dentons below:

Daren Allen, Partner, London
Email: daren.allen@dentons.com
Tel: +44 20 7246 7651 / +44 7515 919812

Celyn Armstrong, Partner, London
Email: Celyn.Armstrong@dentons.com

Tel: +44 20 7246 7174 / +44 7917 751622

Katharine Harle, Partner, London
Email: katharine.harle@dentons.com
Tel: +44 20 7320 6573 / +44 7795 618213

Craig Neilson, Partner, London
Email: craig.neilson@dentons.com
Tel: +44 20 7634 8804 / +44 776 9671077

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