The newsletter for insurance brokers and MGAs

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PKF

Broking Business

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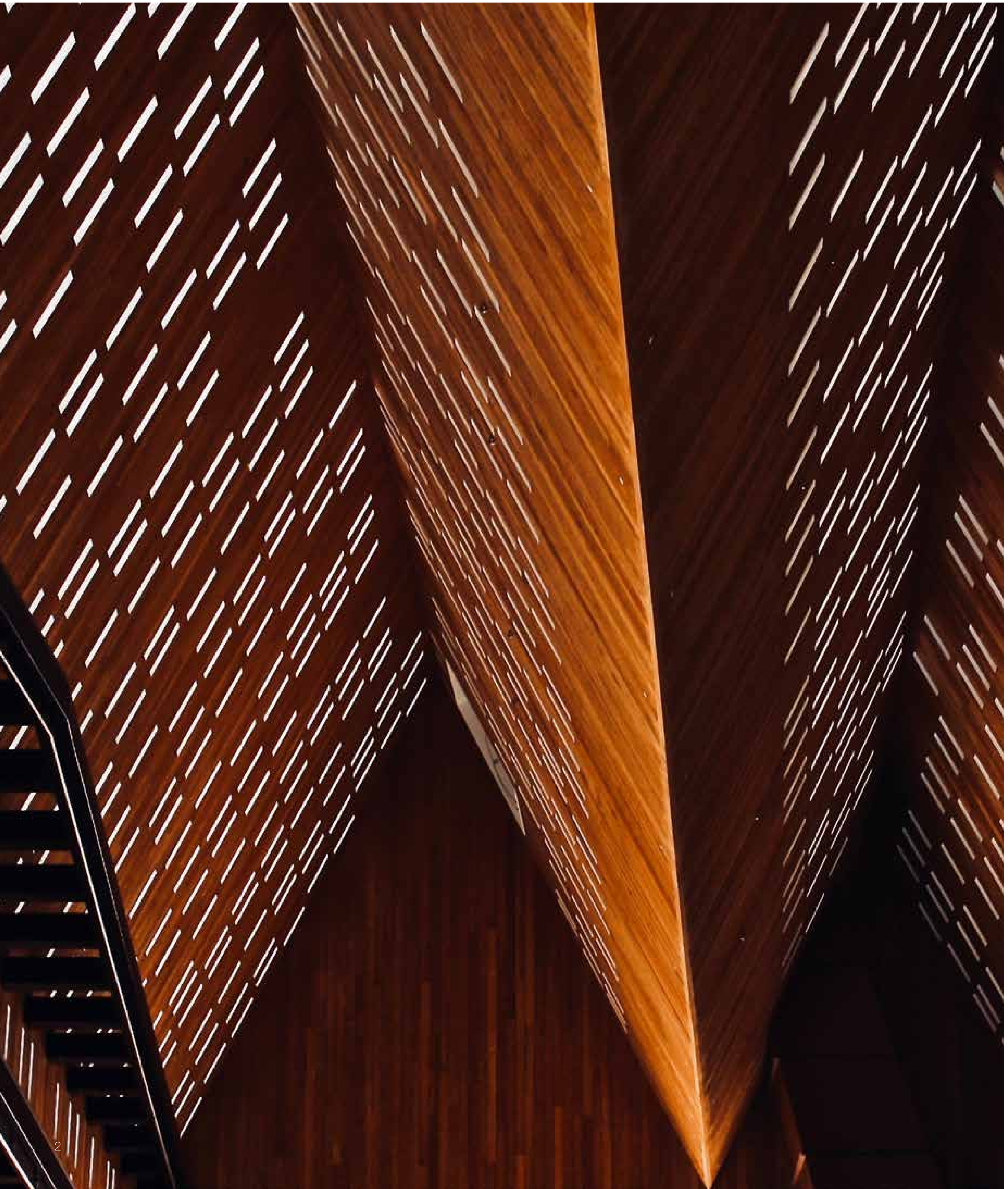

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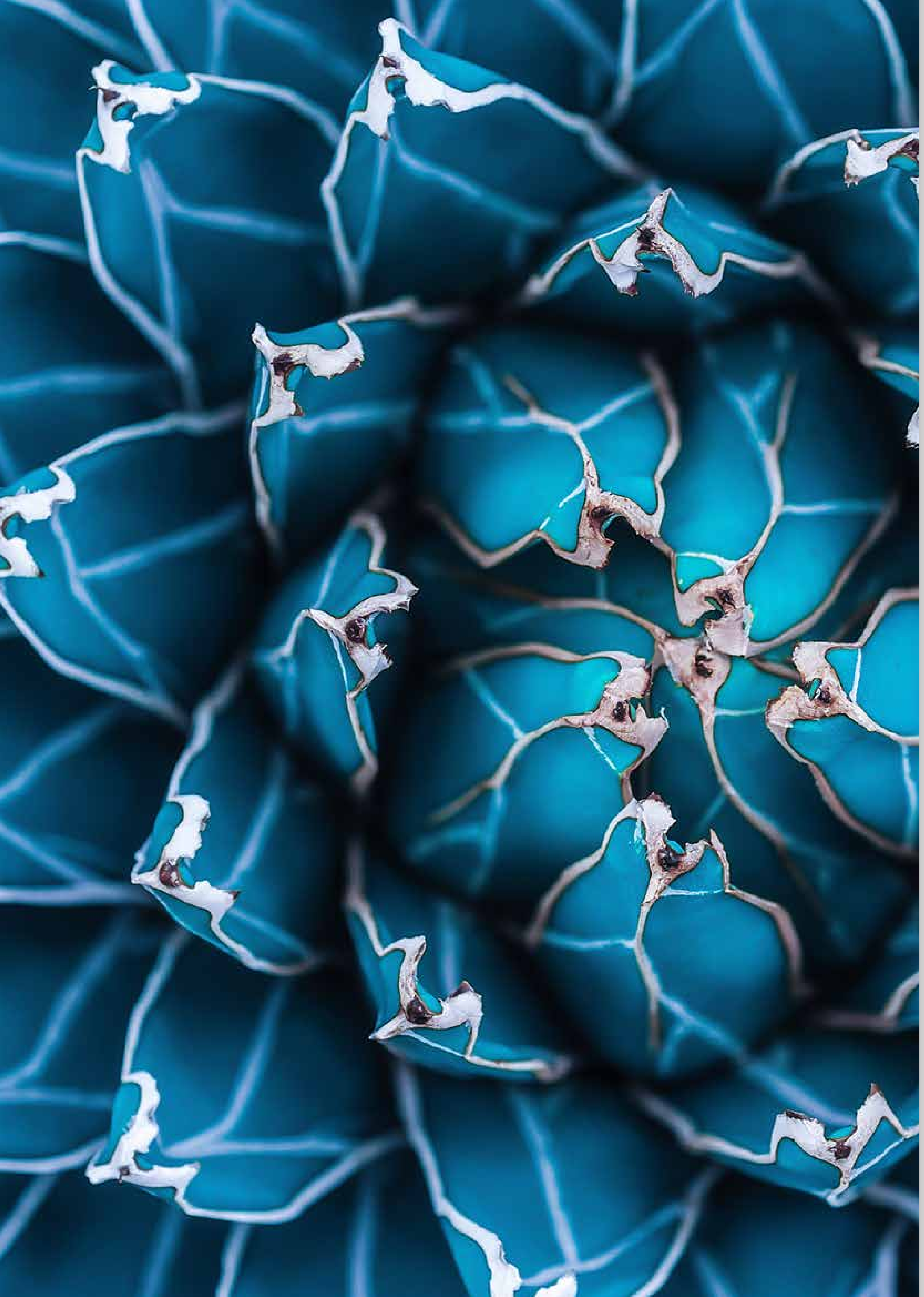

Welcome to our latest issue of Broking Business...

With the 31 March 2022 deadline for implementing operational resilience frameworks fast approaching, Jessica Wills, Head of our Governance, Risk and Control Assurance (GRC) team offers our tips on what firms should be focusing on in the coming weeks.

Richard Willshire, Director in our GRC team, shares an update on the FCA's Consumer Duty consultations and its anticipated new rules. Alongside the FCA's Consumer Duty update, the regulator has also published its consultation paper (CP21/34) on improving the Appointed Representatives (AR) regime, which identifies an increased risk of harm to consumers and markets, as a result of the expansion and complexity of AR models in financial service markets. Richard explores what you should expect.

Regardless of their ownership or prevailing jurisdictional requirements, ESG and associated reporting should be a key focus of intermediaries. Partner, Martin Watson explores why this is and identifies some of the opportunities for businesses investing in this area.

Although firms' compliance with the CASS 5 client money rules is improving, the FCA has started to look at specific areas of the CASS rules in more detail. So what should you look out for? Read our article on page 16.

And finally, with delays to some tax refunds and the impact of group companies on 'profit thresholds' both affecting cash flow, it's worth another look at the corporation tax payment on account process. See Tax Partner, Howard Jones' article for more information.

We hope you find this edition useful and thought provoking. As always, please contact any of the team to discuss how we can support your business and, as always, do let us know your thoughts on future topics.

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Operational resilience: The final countdown

The 31 March 2022 deadline for implementing operational resilience frameworks is drawing closer. We share our observations on activity so far, and offer our tips on what firms should focus on in the coming weeks.

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Following much consultation and development, the regulatory requirements for operational resilience are rapidly approaching. For insurance intermediaries, this applies to enhanced scope SM&CR firms. By the end of March these firms should have:

- identified their important business services
- set impact tolerances
- performed mapping and scenario testing to a sufficient level to identify vulnerabilities.

Firms must also have conducted 'lessons learned' exercises, developed communication plans and documented their self-assessment, providing a snapshot of the firm's operational resilience at a specific point in time.

Although the regulator has allowed for proportionality in its rules, and a transition period to 31 March 2025 for full implementation, there is still a lot for firms to do ahead of the 31 March 2022 deadline. In a recent FCA webinar, the key message was to "make sure you comply with the first policy milestone by 31 March this year", showing the FCA will not accept any delays or non-compliance at that date.

How are you doing?

Through our regular interactions with firms and assurance work in this area, here's what we've observed:

Important business services

- Most firms have identified their important business services and, in many cases, concluded they only have a few.
- Some firms have mistakenly identified processes or systems, rather than services. The rules require identification of services, with the supporting processes and systems captured in the mapping.
- In identifying important business services, many firm have focused more on potential harm to their customers rather than risks to the financial system or market. Firms should demonstrate that they have adequately considered both customers and the market.
- Sometimes the rationale for important business services is lacking or too high-level. The FCA has also highlighted this. In particular, it expects rationale to be well thought out and distinct for each important business service - and supported by metrics (e.g. market share, number and type of customers, transaction volumes).

Impact tolerances

- Most firms have set impact tolerances, the majority using metrics of duration/time (e.g. x hours/days) as mandated in the rules.
- Firms have faced some challenges identifying the point at which intolerable harm to customers and the market is reached. This has led to some good discussion and debate. But the rationale and conclusions are not always well articulated and documented.
- Some firms are failing to adopt the external view of operational resilience the FCA requires. These firms are focusing on the impact of disruption on the firm itself rather than on customers and the market.
- The recent FCA webinar stressed firms must have a clear process for setting impact tolerances and be able to explain their thinking.

Mapping (processes, people, technology, facilities and information)

- Mapping exercises are at different levels of completion across firms. Levels of detail and granularity vary. For the 31 March 2022 deadline, the regulator requires the mapping to be at a level of sophistication to identify important business services, set impact tolerances and identify any vulnerabilities in operational resilience.
- In some cases, the mapping is simply too high level. For example, for 'technology', citing 'IT infrastructure' rather than the individual underlying systems which support the provision of the service. Similarly, for 'people', failing to specify any key persons necessary for service delivery. Although the mapping process will likely be iterative during the transition period, firms won't be able to identify specific vulnerabilities nor design suitable scenario tests without sufficient detail at the start.

Other requirements

We've seen very little scenario testing, and few 'lessons learned' exercises, communication plans or self-assessment documents. While it seems some work is happening on these behind the scenes, the output isn't yet ready and we envisage firms will continue to focus on these areas right up to the March deadline.

On the whole, though, we are seeing firms taking the topic of operational resilience seriously with good levels of board and senior management engagement. So this is positive.

What should firms focus on in the time remaining?

1. Reflect on our feedback in this article and from the recent FCA webinar, and review the outputs you have completed so far in light of this. In particular, we encourage firms to assess the level and quality of documentation and rationale for decisions taken to date on important business services, impact tolerances and mapping.

2. Consider the remaining actions you need to take before the 31 March 2022 deadline and develop a clear plan. In particular, allow enough time for the final steps which you may not have focused on so far – scenario testing, 'lessons learned' exercises, communication plans and the self-assessment document.

3. Allow for board or committee review and approval (where needed) of key outputs, and sufficient time to implement any feedback. The FCA requires boards to show they are satisfied the firm is meeting its operational resilience responsibilities. So they must demonstrate suitable oversight and hold senior management to account.

4. Allocate sufficient resources to complete the remaining actions and don't delay – the FCA has said that firms must "act now to ensure you are ready for the 31 March deadline". Although there is a transition period, the FCA has been clear on the actions firms need to take ahead of the 31 March 2022 deadline and this may require some additional effort and resource in these final weeks.

Finally, we encourage firms to consider their ongoing assurance needs in relation to operational resilience. Some firms have already approached PKF for assurance work on their operational resilience frameworks in Q2/3 this year. The focus is on whether firms have met the key requirements of the FCA and whether the documentation and outputs satisfactorily demonstrate compliance and the level of detail and rationale the FCA is expecting to see.

Our assurance work will also provide insights and help firms to identify priorities and next steps for the transition period to 31 March 2025. If you would like to discuss your assurance needs, please contact our Governance, Risk & Control Assurance team.

Why intermediaries need to work on ESG

Regardless of their ownership or prevailing jurisdictional requirements, ESG and associated reporting should be a key focus of intermediaries. We explore why this is and identify some of the opportunities for businesses investing in this area.

The concept of sustainability is evolving and expectations on all businesses are increasing. For company directors to act in the long-term interests of all their stakeholders has long been a requirement of UK company law. But it is only relatively recently that government and regulatory bodies in the UK have been asking companies to think about more than just short-term, bottom line profit.

There's a great deal of information (not to mention a confusingly large number of acronyms) out there in relation to 'sustainability' in the corporate world. But the broader factors that companies are increasingly being asked to consider are most commonly referred to as 'ESG': the environmental, social and governance issues that might impact upon the financial performance of their business.

It's important to emphasise that ESG reporting is not just about climate change, even though it is the most advanced area of ESG. That's because there are already regulatory requirements for certain types of business in the UK to disclose information about the impact of the changing climate on their business, as well as their business' impact on the changing climate. But formal reporting standards in relation to broader sustainability factors are also coming down the road.

Only the very largest insurance intermediaries in the UK will currently be caught by the climate change reporting requirements. But ESG reporting, in particular for the broader insurance market, is a topic which all intermediaries need to be considering. Here's why.

Your business' impact on the outside world

When tendering for new contracts as a provider of professional services, PKF is now being asked for more holistic information in relation to our firm compared to 12 months ago. The focus used to be solely on demonstrating technical capabilities, relevant experience and scale. But this is starting to change.

It's clear to us that companies are now placing greater demands on their supply chains and business partners in order to demonstrate their own commitment to ESG. They are seeking demonstrable evidence that those they partner with have an ethos similar to their own and see discernment in this area as a key part of their own ESG obligations.

Several large insurers have already come out and said that they want their operations and supply chains to be 'net zero', and we expect this and similar targets to be more widely adopted.

Intermediaries will need to be ready to disclose their own ESG strategies and commitments (and before too long, their own ESG performance metrics) to their risk carrier partners.

Having this information in a reportable format, and having a positive story to tell, is going to be key in maintaining strong insurer relationships. It may even become a prerequisite for entering into new ones.

The number of intermediaries publicly talking about their commitment to, and progress with, ESG is still relatively small. Although the format and content of public disclosure is evolving, there are bodies (such as the Sustainability Accounting Standards Board) that have developed frameworks for companies to use. These principles have been adopted by many blue chip organisations, including Marsh and Willis. But beyond the global industry players, few companies have yet developed comprehensive ESG public disclosures.

The focus on intermediaries' stance on ESG is only going in one direction. So we recommend that all brokers give thought to what relevant information they wish to communicate to the outside world, and identify any obstacle to being able to do so.

The outside world's impact on your business

For insurance companies in the UK, there are already regulatory requirements (most notably the PRA's Supervisory Statement SS3/19) that govern their management of financial risks stemming from climate change. All insurers have been required to take steps to embed climate change considerations into their governance and risk management processes, as well as to undertake scenario analysis. They are also expected to set targets for climate change commitments, and metrics to begin measuring their progress towards them. But the level of progress across the industry is mixed, with many insurers still trying to understand what a proportionate and meaningful set of metrics and targets for their business looks like (see Aviva's 2020 Climate-Related Financial Disclosure as a comprehensive insurer example).

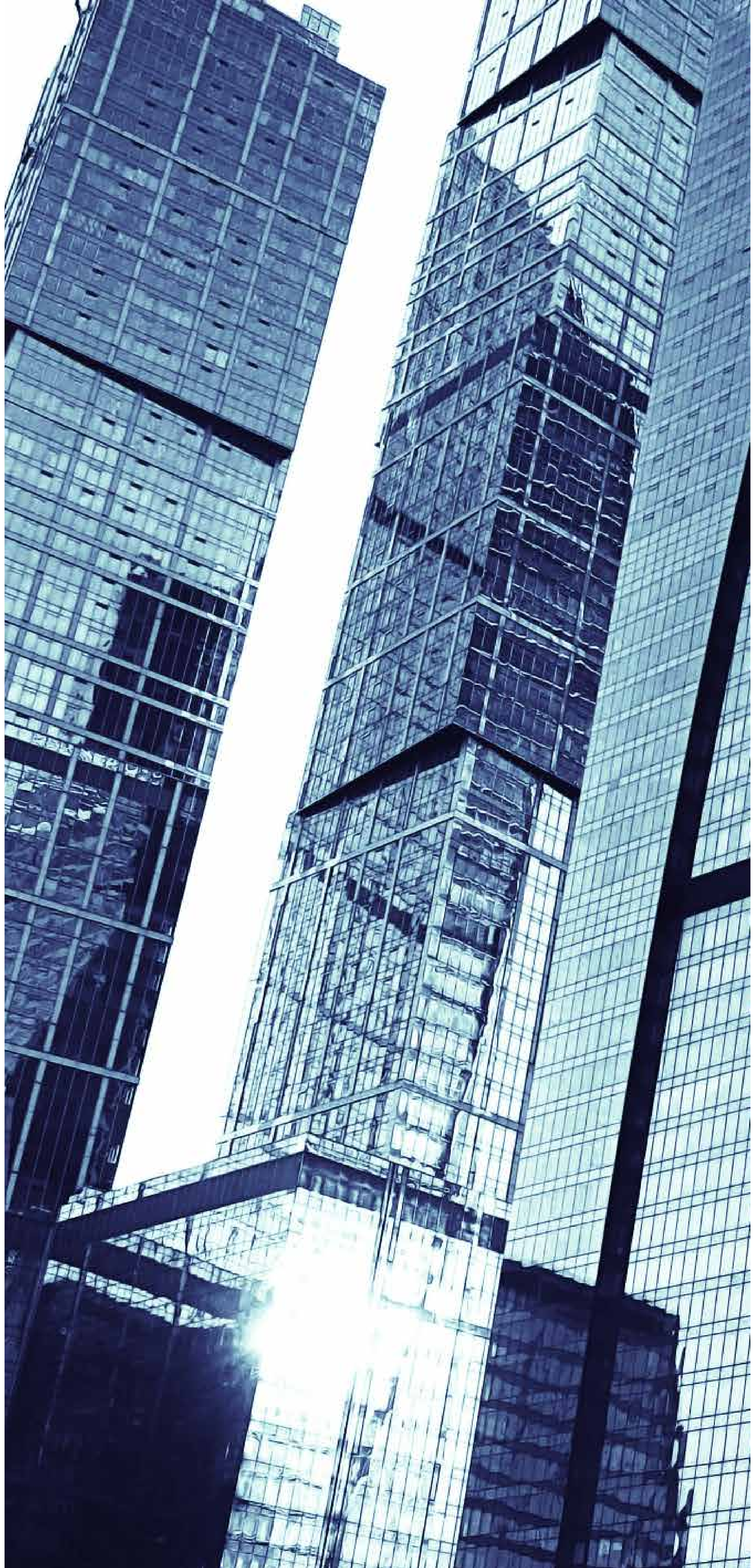
Intermediaries are not immune to the risks posed by climate change. The risks being identified by insurers are going to flow through the supply chain somehow - and are already doing so. Here are examples:

- Changes to underwriting methodology. Be it the increased frequency and severity of extreme weather events or the changes in mortality rates caused by rising global temperatures, many insurers are updating their underwriting processes and assumptions to take account of the increased physical, transition and liability risks from climate change. Intermediaries, in particular MGAs, need to understand the impact of these changes on their own business lines.
- Development of climate conscious products. To meet their own climate related targets, insurers are developing new products. These may be to meet societal needs relating to new risk exposures from climate change, or from an increased demand for green/ethical policies. Intermediaries must understand the changing needs of their client base, as well as the changing suite of products available for distribution.
- Potential changes in capacity provided by markets. Lloyd's set a market-wide policy to stop new insurance cover for coal, oil sands and Arctic energy projects by January 2022, and to pull out of the business altogether by 2030. This is likely to be the start of a growing trend of risk appetite changes driven by ESG policies, which will impact heavily on intermediaries operating in certain sectors.

Although these examples are focused on the impact of climate change, the principles will likely extend into the other areas of ESG as and when regulatory requirements or reporting standards begin to expand.

Many insurance intermediaries may take the view that none of this is going to happen for several years, so it needn't be a focus for management. But never before has our firm seen such a broad range of voices across regulators, standard setters and society, talking so much about a risk management and financial reporting topic. And all are saying the time to act is right now.

It's also worth noting that many investors and private equity backers are asking ESG-related questions today as part of their valuation and investment decisions. This is adding weight to the need to pull ESG thinking and reporting forward - for many businesses who are seeking (or wishing to maintain) external funding.



How will ESG-focused companies benefit?

This may sound like a lot of work to add to management's already long list of things to do. But, rather than just being a compliance exercise, we see some clear opportunities for intermediaries who are early movers in this space.

Investors continue to demonstrate a significant appetite for assets in the insurance sector. With many of them looking to support a green economy, demonstrating that your business has ESG considerations at the heart of your strategy is only going to make you more attractive and push multiples up. We encourage companies to see this as more than a 'tick-box' exercise and think about how it can be integrated into the wider business strategy.

Nor should the opportunities presented by new business lines be under-estimated. As our world begins to transition to a low carbon economy, what new kinds of technology will spring up to help us achieve this? As the diversity of our workforces begins to shift, what impact will this have on ways of working? All these transition risks present opportunities for new and innovative products - and intermediaries have a key role to play in this evolution.

Keeping Generation Z happy

What is very clear across all sectors is that ESG factors will also play a big role in attracting and retaining talent in the future. Numerous surveys looking at what Generation Z want in a job show that whilst pay and benefits continue to be the most important, these are closely followed by how aligned the employer is to their own values. Articulating a well presented set of ESG objectives, clearly linked to the firm's purpose and strategy is key. Demonstrable evidence of positive progress towards these objectives will go a long way towards helping the talent of tomorrow decide whether your business is something they want to be part of.

For more information about the issues raised in this article, please contact Martin Watson.

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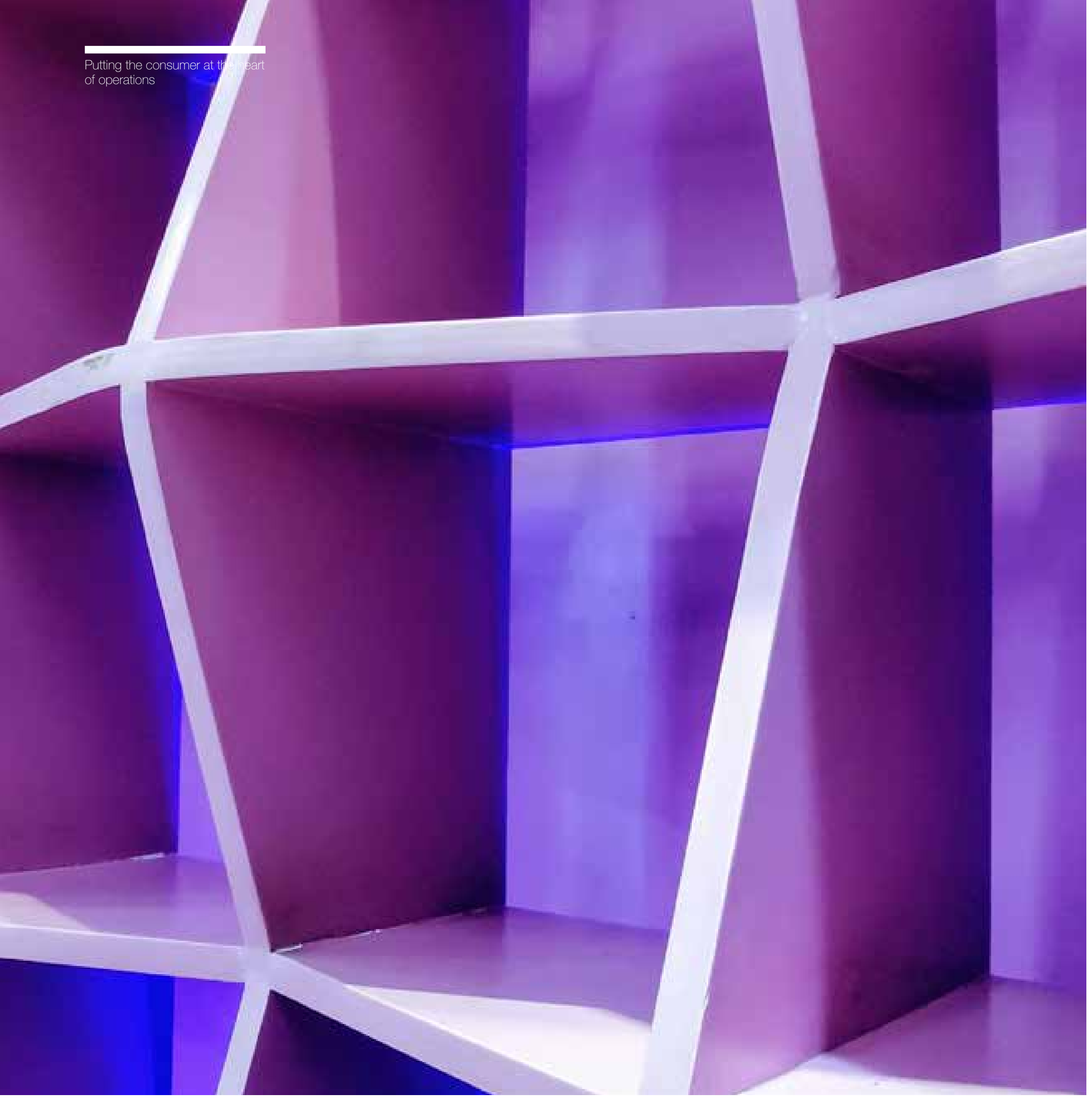

Putting the consumer at the heart of operations

We update you on the FCA's Consumer Duty consultations and anticipated new rules.

The FCA's second consultation (CP21/36) on the Consumer Duty closed on 15 February. The regulator will publish the policy statement summarising responses, and confirm the new rules, by 31 July this year.

The underlying principles of, and feedback on, both consultation papers focus on the FCA's desire to see a higher level of consumer protection in retail financial markets, and to promote vigorous competition in the interest of consumers. It wants to drive a healthy and successful financial services system in which consumers can make informed choices about financial products and services.

Whilst the FCA has observed a range of good practice by some firms, it also notes that firms are not prioritising good consumer outcomes consistently or sufficiently. Poor outcomes drive consumer harm and erode trust in firms and in the market as a whole.

What does the FCA want to do?

The FCA aims to develop a more consumer focused market that provides customers with a more level playing field. It should be a market that truly places consumers at the heart of the operation and designs products, services and interactions around their interests. The regulator believes this will, in turn, enhance the whole market and promote effective competition. It expects the initiative to drive up standards and customer satisfaction, in the pursuit of good consumer outcomes.

What will the Consumer Duty achieve?

The new Consumer Duty will build on previous market interventions and set a high standard of care. It will extend the rules on product governance and fair value, and highlight elements of persistent poor market practice.

It will require firms to focus on good customer outcomes by considering the needs of them all – including those with characteristics of vulnerability – and how these have been met at every stage of the product or service lifecycle.

What are the specific changes likely to be?

The FCA has identified three core elements:

1. A new Consumer Principle (which replaces current Principles 6 and 7) requiring firms to deliver good outcomes for retail customers.

2. Cross-cutting Rules setting out how firms should act to deliver these outcomes. It requires them to:
a. act in good faith
b. avoid foreseeable harm
c. enable and support retail customers to pursue their financial objectives.

3. Rules and guidance relating to the Four Outcomes set to drive better firm-consumer relationships:
a. Products and services
b. Price and value
c. Consumer understanding
d. Consumer support.

It's important to note that the new Consumer Duty extends to firms that are involved in the manufacture or supply of products and services to retail clients, even if they don't have a direct relationship with the end customer. The new proposals will therefore have a wider impact on firms and the market than we have previously seen.

What happens next?

The FCA expects to publish the policy statement summarising responses and to make new rules by 31 July this year. Firms will have until 30 April 2023 to implement the new requirements.

In the next issue of Broking Business, we will explore the governance and operational control changes insurance intermediaries will need to make to meet the expectations of the new Consumer Duty. In the meantime, please contact us if you have any questions.

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CASS 5: What are the burning issues?

Although firms' compliance with the CASS 5 client money rules is improving, the FCA has started to look at specific areas of the CASS rules in more detail. So what should you look out for? Paul Goldwin explains.

PKF's Insurance Intermediary team recently held their bi-annual meeting with the FCA to share experiences and issues identified during the CASS 5 client money audit season. They discussed several important topics that are clearly on the FCA's mind.

Appointed Representatives (ARs)

ARs are back in focus following the FCA's December issuing of CP 21/34 'Improving the Appointed Representative regime' (which followed on from the Thematic Review of 2016). The FCA is seeing a wide range of harm caused by poor due diligence procedures before appointing an AR, and inadequate oversight and control post appointment. The FCA says firms acting as principals to ARs generate 50 to 400% more complaints and supervisory cases than directly authorised firms.

The FCA is concerned this could extend to client money practices and were keen to hear our views on how our firms protect client money arising from the AR relationship.

And, in particular, if there was greater use of periodic rather than immediate segregation, and whether this had been applied correctly. It's clear the focus will remain on this, particularly for those firms with many ARs.

Credit write backs (CWBs)

The FCA was interested in whether we were seeing more credit write backs (CWBs) in the market, and whether firms were becoming more lax about the steps needed before effecting a credit write back. It is concerned some firms were unrealistically quick to release unclaimed credits - with instances not exceeding 24 months.

The regulator accepts there will be insurance balances in firm's ledgers which are historic, unclaimed and statute barred. But it still expects firms to have gone through due process, in accordance with its own rules, to identify the recipient of these funds. And firms must only release the funds after enough time has elapsed and the board of directors, having taken professional advice, are satisfied they have no option but to effect the CWB.

Buffers in client money calculations (CMCs)

It's clear the FCA believes firms should never hold 'buffers' in their client money calculations (CMCs), as this leads to a 'pollution of the trust'. It's a popular misconception that it's OK to leave a 'charges' buffer in the CMC to mop up bank or other administrative charges that firms may face. The regulator is clear that firms should instruct banks or other suppliers to make any charges to their office, rather than to their client money bank accounts. It expects client money auditors to breach in instances where charges or fees are debited to the client money bank account and absorbed via a buffer.

Commission/fee-only transactions

Similarly, the FCA clarified its position on the receipt of commission or fee-only transactions which are not received as part of a mixed remittance. The regulator expects firms to have procedures that monitor and identify the receipt of such transactions. They must then transfer these to the office account by close of play on the date of receipt and not, as popularly thought, within the next CMC withdrawal.

As for buffers, leaving the commission-only receipt in the client money bank accounts leads to 'pollution of the trust'. This could invalidate the status of the trust in an insolvency event, and leave client money unprotected.

Third party 'pay away' transactions

We discussed another area of controversy, the treatment of third party or introducer 'pay away' commission.

It's a common misconception among firms that a third party can effectively be treated as an 'insurer', and that any commission payments to third party introducers can be paid out of the client money bank account.
The FCA confirmed our longstanding view that this is incorrect and would result in a CASS breach. The regulator stressed that the gross commission, including the element belonging to the third party, should be withdrawn from the client money bank account as part of the CMC withdrawal into the office account. The third party is then paid from the office account.

Books of business transfers during M&As

The FCA welcomes the introduction of the private equity backed 'consolidator' in the insurance intermediary market.

The FCA believes consolidators are keen to have the right processes and procedures in place around client money. They are doing this by investing in systems, people and training and are happy to pay for professional advice to support this objective. This could mean the removal of many smaller firms from the market, who may have been less aware and concerned about client money rules. The result should be better client money protection.

The FCA is aware that, as consolidators acquire firms, there's often a move to transfer books of business from the acquired entity into the principal intermediary in the group. This is to take advantage of cost synergies, and so on. But, in doing so, there's a risk that client money may be moved around in a way that contravenes the rules and could potentially lead to bad consumer outcomes.

The FCA has stressed that firms must have the correct systems and governance framework to obtain consent from clients to move from one client money regime to another. This particularly applies where the new regime provides greater potential risk to clients, such as in the run-off of a statutory trust and transition to a non-statutory trust environment. In these cases, the FCA requires firms to obtain written consent from at least 85% of clients before applying for a waiver to effect the transfer.

Similarly, for the acquired firms, the FCA requires them to obtain the CASS auditor's 'negative assurance' sign off before transfer of all insurance business. The auditor must be satisfied that the client money bank accounts have been properly run-off, and that no client money remains, before they can approve the revocation of their client money permissions.

Even with these measures, the FCA will still be checking that transactions have been effected correctly and with no poor client money outcomes.

CASS mapping document

Many of our clients make good use of the CASS Risks and Controls matrix to document the client money rules and set out the controls that they have in place to ensure compliance with the relevant rules.
As the CASS 5 rules do not make the Risks and Controls matrix compulsory, we do see a number of firms choosing not to adopt it.

The FCA has clarified its position, saying that although the matrix is not part of the CASS rulebook, it considers that firms who do not use it fall foul of the 'client money organisational arrangements' under its Principles for Business. It therefore expects us as auditors to breach firms on this basis.

What to expect

All in all, client money compliance has certainly not dropped off the regulator's radar. We can now expect the FCA to adopt a more targeted approach in its supervision of firms' compliance with client money rules.

Please contact the PKF Insurance Intermediary team if you wish to discuss CASS 5 compliance generally, or any of the more specific topics outlined above.

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The challenge to corporation tax payments

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With delays to some tax refunds and the impact of group companies on 'profit thresholds' both affecting cash flow, it's worth another look at the corporation tax payment on account process.

Paying corporation tax used to be a relatively simple process. After the accounting year end, a company would calculate its corporation tax liability. On the normal due date, nine months and one day after the year end, it would pay what it owed to HMRC. Fortunately for many smaller companies, this is still the case.

The introduction of a payment on account system for 'large' and, more recently, 'very large' companies has increased the uncertainty over a company's settlement of its tax liability. These companies are required to estimate their profit for the year, determine their corporation tax liability and pay before the year end, depending on their classification as 'large' or 'very large'.

Which companies are affected?

A 'large' company is one with profits over £1,500,000. A 'very large' company has profits above £20,000,000. These thresholds are reduced by the number of related 51% group companies plus one (the company itself). This includes overseas companies, but excludes dormant and passive holding companies.

The total number of companies in a group means all companies that were part of the group at any point during the year. This adds complexity to groups making acquisitions or disposals in the year or where there has been a corporate restructuring. The threshold is further reduced for a short accounting period.

When are payments due?

The quarterly instalment regulations require a 'large' company to pay its corporation tax in four equal instalments: 6 months and 14 days, 9 months and 14 days, 12 months and 14 days, 15 months and 14 days from the start of the financial year. That means half the company's tax liability is paid by the year end.

A 'very large' company pays even earlier, with the instalments due 2 months and 14 days, 5 months and 14 days, 8 months and 14 days, 11 months and 14 days from the start of the financial year. That means it has paid all its estimated corporation tax liability before the year has ended.

Effect of the quarterly payments

So it's critical that each company's profit is accurately forecast and updated as the year progresses. Otherwise it cannot recalculate its tax liability and amend the quarterly payment plan. Fortunately, the first year that a company becomes 'large' is ignored for quarterly instalment payment purposes. But this does not apply to companies that become 'very large' in the year. For companies which are borderline 'very large', it's vital to keep an eye on the expected profits. This is because of the earlier quarterly payment's deadline and to minimise interest arising on any late payments.

HMRC will pay interest on overpaid corporation tax and charge interest on underpaid or late paid tax. There are penalties for deliberate underpayment of instalments.

But HMRC also acknowledges the uncertainty about the quarterly payments. It therefore treats any interest paid or received as a normal trading expense or income of the company, which is therefore taxed accordingly.

Benefits for groups of companies

Generally, every company is responsible for its own tax filings and payments. But there's some relief where companies can enter into a group payment arrangement (GPA) with HMRC. This is a much easier and more flexible way of dealing with tax payments for a group. The GPA is a legal agreement with HMRC and must be filed with them at least one month before the first quarterly instalment period.

Under the GPA, payment is made by a nominated company in the group. After the year end this amount will be allocated to the various group companies to settle their tax liabilities. It's important to keep this agreement up to date, as only companies that are party to it can benefit from the simplified tax treatment.

HMRC refund delays

Recently, HMRC's slowness in refunding overpaid corporation tax has created cash flow problems for some companies and it's crucial that care is taken over the estimation of a company's corporation tax liability. We hope HMRC will resolve this unfortunate practice as people return to a pre-pandemic reality. Theoretically, where a company has overpaid its tax, it may request a refund at any time. If this occurs before the corporation tax liability is finalised, any tax paid before the normal due date can be repaid without a formal claim being submitted.

In cases where the normal due date has passed and the company is seeking a repayment before its tax liability has been finalised, it must make a formal claim for a repayment. There are similar rules for companies within the quarterly instalment regime.

If you would like further information about the issues raised in this article, please Howard Jones.

Appointed Representatives: What the FCA is looking for

The FCA has published its consultation paper (CP21/34) on improving the Appointed Representatives (ARs) regime. It has identified an increased risk of harm to consumers and markets, as a result of the expansion and complexity of AR models in financial service markets. These include insurance distribution. What should you expect?

In 2021, the FCA recorded 40,000 ARs (including Introducer ARs) operating under roughly 3,600 principal firms in financial services markets. The general insurance and protection sector includes around 13,500 of these ARs, with just over half of all principals having a single AR.

The AR regime allows a firm or person to conduct defined regulated activities and act as an agent on behalf of an authorised firm (the 'principal'). This means insurers and intermediaries can distribute products and services through their ARs. But, more recently, principals have increasingly used the regime in different ways. For example, they have established business models that rely solely on the appointment of a material AR that outsizes the principal firm. And they have developed broad distribution networks, with a large number of ARs operating on behalf of a principal and aligned to a common objective, market or product range.

Recent FCA and HM Treasury reviews and enforcement actions have highlighted that consumer harm often occurs where principals don't conduct sufficient due diligence before appointing an AR. It can also result from inadequate oversight, monitoring or control once an AR is appointed. PKF referred to the consequences of these weaknesses in our Lessons from Alsford Page and Gems' article.

CP21/34 outlines the FCA's key proposals to enhance the AR regime across relevant sectors. The initial proposals require principals to provide additional and more timely information on their ARs and how they are overseen. They would also need to provide clarity and increase the responsibilities of, and expectations from, principal firms engaging and overseeing the regulatory operations of ARs.

The consultation closes on 3 March 2022, with finalised guidance and requirements set to be released later this year.

Pros and cons of the existing regime

So the FCA is concerned that the current AR regime is not operating well in all cases. But it does acknowledge the potential benefits of the regime and its business models for all parties. These are:

- cost effectiveness – the regime provides a cost-effective way for both principals and ARs to comply with regulation
- FCA engagement – it supports an amplified distribution of key FCA messages, focus and requirements through the principal / AR relationships
- effective competition – it allows more participants in financial markets and different types of firms
- innovation – it encourages regulatory incubation to support firms by helping them understand the regulatory environment and demands before direct authorisation, in turn allowing the trialling of new services or propositions through established AR networks
- robust monitoring – the FCA notes that some principals provide high quality oversight and robust monitoring of ARs, ensuring good consumer and market outcomes.

The realisation and demonstration of these benefits depend on the effectiveness and robustness of the oversight, monitoring and controls at each principal. The FCA has found that these benefits can be eroded, and the risk of harm increased, if principals are unclear about their regulatory responsibilities for their ARs or if there is insufficient oversight and inadequate controls over the regulated activities undertaken by the ARs - for which the principal has accepted responsibility.

The FCA's thematic reviews of the general insurance sector in 2016 noted a lack of clarity in roles and principal oversight. The regulator took steps to address issues at individual firms, including enforcement actions. It also produced a number of Dear CEO letters.

Working with the intermediary sector, PKF has observed these common pitfalls:

- Lack of understanding by principals of the AR relationship and the regulated activities they perform on their behalf
- Lack of understanding by principals of the AR relationship and the regulated activities they perform on their behalf
- Details of ARs on FCA register are not up to date. Failure to maintain internal registers of AR relationships and related information
- Poor record keeping for contracts with ARsAR contracts do not specify arrangements for handling client money
- AR monitoring relies on completion of annual monitoring questionnaires. These are too high level and lack questions on financial stability and competence
- AR monitoring questionnaires are not supplemented by any other independent checks by the principal i.e. they are too reliant on what the AR tells them

Although there are examples of good oversight and proactive management and monitoring of ARs, many principals have not considered the management and oversight of ARs using established control frameworks or activities at the principal. There has been a tendency to rely on informal relationships between ARs and principals.

The FCA proposals

Considering the benefits and potential to cause harm with the existing AR regime, the FCA has proposed two main areas of policy change. These aim to improve consumer outcomes and align to its updated Consumer Duty, which is also under consultation:

1. Additional information on ARs and notification requirements for principals. These would allow the FCA to identify potential risks linked to principals and ARs more easily, and provide a better understanding of the expertise, systems and controls the principals use to oversee their ARs effectively.

2. Clarification and strengthening of principals' responsibilities and the FCA's expectations of them – with clearer existing rules and additional guidance to principals on how to oversee their ARs.

The FCA is also seeking the market's views on the risks from regulatory hosting arrangements (where FCA principals support multiple ARs in conducting regulated activities as their prime operating model), and business models where ARs are large in size relative to the principal. It also asks for views on whether prudential standards should be strengthened to reflect the risk of harm posed to consumers and markets.

The following table summarises the FCA proposals, the intended outcomes and implications for firms, and the potential assurance needs.

Appointed Representative regime proposals		
Proposal	**Outcomes**	**Assurance needs**
Enhancements to monitoring, oversight and management of ARs		
The FCA is proposing to clarify principals' responsibilities for their ARs and to raise oversight expectations	• Clear expectations, roles and responsibilities are set and communicated by the principal. • Principals understand the risk profile across their AR model and undertake timely and effective monitoring to oversee the activities of ARs. • Principals establish and maintain governance, risk and control frameworks that support the effective oversight of their ARs.	• Confirm roles and responsibilities for ARs are clearly defined, documented, reviewed and agreed upon appointment, and reflect any changes to relationships as these occur. • Principals carry out timely and effective risk assessments and maintain risk profiles for their AR estate. • Review governance arrangements, risk frameworks, internal controls and adequacy of resources in overseeing and monitoring their ARs.
Principals to provide information on the AR's business	• Principals provide additional information to the FCA when an AR is appointed and on an ongoing basis. • Proposed information includes: • primary reason for AR's appointment • nature of regulated activities permitted by principal • non-regulated business of AR • whether AR provides services to retail clients • change of principal for AR • individual or group alignment of AR • employment relationships of individuals from AR • financial arrangements between AR and principal • expected revenue from regulated and non-regulated activities during first year.	• Confirm templates, frameworks and processes exist to define and support AR appointment, including accurate and timely completion of FCA information / documentation requirements. • Ensure information on ARs is available, accessible and up to date.
AR appointment / change notification reporting	• Principals notify the FCA of a proposed AR appointment at least 60 days before the appointment takes effect. • AR information change notification requirements exist (SUP12.7.7R). • Under the new proposals, firms will be required to notify the FCA on any planned changes to an AR's names or regulated activities at least 10 calendar days before the change takes effect. • Extending the current requirement on FCA-authorised firms to check their information annually to cover the details of their ARs, including the activities permitted by the principal. Principals to be required to check the accuracy of their AR details within 60 business days of their accounting reference date.	• Review the oversight and AR engagement programmes to ensure appropriate and time notification of changes. • Review the reporting and verification processes aligned to annual and ad hoc submission of details to the FCA.

Appointed Representative regime proposals		
Proposal	**Outcomes**	**Assurance needs**
Enhancements to information collection and reporting on ARs		
Enhancements to information collection and reporting on ARs	• Extending the current requirement on complaints data to require principals to provide more granular complaints data attributed to individual ARs. • Require the submission of complaints data on an annual basis using a new reporting form.	• Assess complaints policies and practices to identify and record complaints data at individual ARs. • Assess quality of guidance or training provided by principals to ARs on identifying and reporting complaints. • Ensure alignment and consistency of complaints policies and procedures across multiple or varied ARs / products and services.
Revenue information	• Proposal for principal firms to submit revenue data for each of their ARs – covering both regulated and non-regulated activities. • Propose that principal firms provide this data annually, within 30 days of their accounting reference date. • A transitional period for existing ARs to allow principals to provide this information for the first full year of data following implementation of the rules.	• Confirm governance, oversight and arrangements for engaging with ARs to obtain and record revenue data. • Assess data quality and available MI to report in accordance with FCA requirements. • Establish adequate processes and controls to ensure timely and accurate completion of documents and submission to FCA. • Provide project or programmes assurance for implementation of any new reporting systems and adoption of FCA reporting requirements under transitional arrangements.

We expect some challenges for firms in implementing these proposals, particularly those to enhance complaints and revenue information currently provided by ARs. Principals are reliant on the systems and processes in situ at ARs to capture, encode and collate this information consistently, robustly and in a timely manner. It is likely the systems vary significantly between ARs, reflecting their size and maturity. This means inconsistent recording or categorisation of revenue types. Similarly, there may be operational and system challenges in categorising or analysing data that enables principals and ARs to agree accurate complaints information. The proposals may require greater levels of communication and interaction between principals and ARs, clearer roles and responsibilities, and more time commitment to achieve this.

The challenges ahead

The proposals remain under consultation until 3 March. But the concerns raised by the FCA echo those made through previous thematic reviews and Dear CEO letters, as well as PKF's own observations. The emphasis on data collection and submission in the consultation paper is consistent with the FCA's drive to be a more data-focussed regulator. It also chimes with approaches outlined in other consultations launched through 2021 and 2022. We expect most of proposals to be finalised with no, or minor, changes in their wording. Firms will need to identify and assess the risks posed by their ARs and their approach to control, monitoring and oversight.

Completion of the consultation and subsequent finalisation of guidance may make some principals and ARs reconsider their business models and relationships in light of any increased regulatory burden. It may also encourage greater investment in systems and processes to collect and report on data at ARs.

PKF's GRC team can provide independent assurance of governance and oversight frameworks, monitoring and reporting activities and control processes to help principals demonstrate effective and robust oversight of ARs.

For more information, please contact Richard Willshire.

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About PKF
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to see how we can help...

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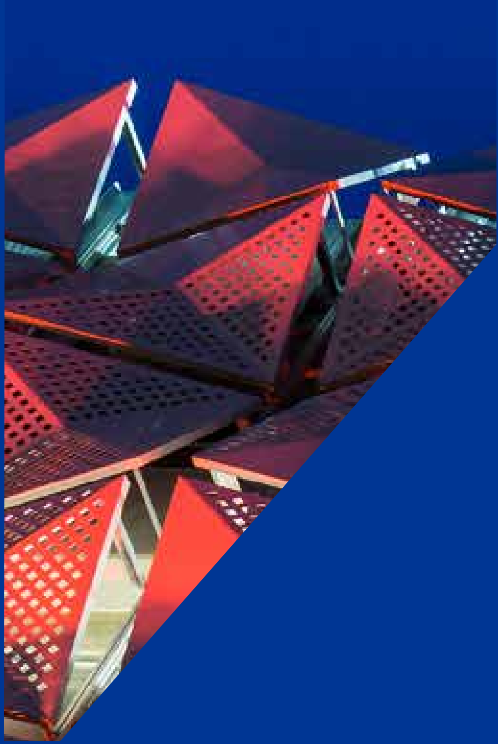

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